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Regulating for Efficiency in Health Care Through the Antitrust Laws*

*Thomas L. Greaney***

I. Introduction

From the inception of the Sherman Act, the need to evaluate the competitive consequences of cooperation among rivals has posed a central dilemma for antitrust enforcement. Such collaboration can reduce rivalry, alter market structures, or facilitate other, more pernicious forms of collusion. Yet often these same activities carry the promise of creating cost savings, effecting synergies, correcting market failures, or producing other benefits. Considerable uncertainty attends factfinders' assessments of which effect will occur and of its probability and magnitude. Further complicating the task is the prospect that both results may occur simultaneously: collaboration lessening marketwide competition can also produce cost savings or other benefits. In this circumstance, it is at least theoretically necessary to weigh costs and benefits before determining the legality of the activity.

One ambitious attempt to illuminate the shadowy line between beneficial and harmful cooperation is the Health Care Policy Statements ("Policy Statements" or "Statements"), recently issued jointly by the United States Department of Justice ("DOJ") and the Federal Trade Commission ("FTC").[1] These Statements, which cover a wide variety of combinations and joint activities involving physicians, hospitals, and third-party payors, seek to give guidance regarding the antitrust implications of the extensive vertical and horizontal integration that is occurring in the health care industry. Notably, the Policy Statements embody the view, prominent in the antitrust jurisprudence of the last twenty years, that decision makers can and should explicitly evaluate the procompetitive potential of even the most suspect agreements among rivals. In most instances, the

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1. U.S. Dep't of Justice & U.S. Fed. Trade Comm'n, Statements of Enforcement Policy and Analytical Principles Relating to Health Care and Antitrust, 4 Trade Reg. Rep. (CCH) ¶ 13,152 (Sept. 30, 1994) [hereinafter 1994 Health Care Policy Statements]. These Statements revise and expand the agencies' previous pronouncements. *See* U.S. Dep't Justice & U.S. Fed. Trade Comm'n, Statements of Antitrust Enforcement Policy in the Health Care Area, 4 Trade Reg. Rep. (CCH) ¶ 13,151 (Sept. 15, 1993).

heart of the undertaking involves appraising and quantifying the efficiencies associated with such behavior and, where appropriate, offsetting those gains against competitive losses.

This Article finds that the role efficiencies play under the Policy Statements when examining joint ventures and mergers in the health care industry is deeply flawed. Part II describes the startling absence of consensus in the antitrust community concerning the meaning of efficiency and the serious methodological problems associated with performing a trade-off analysis. Part III discusses the approach of the Policy Statements to identifying and weighing efficiencies and analyzes their application in agency advisory opinions and in litigation. Part IV reviews the implications of efficiencies analysis in the changing regulatory and economic context of the health care industry. Part V examines the increasingly regulatory posture of federal and state antitrust enforcement efforts and suggests that substantive and institutional problems defeat the purposes of the undertaking. Part VI sets forth the practical and theoretical problems associated with applying the efficiencies tradeoff in the health care industry. Finally, Part VII assesses some of the limitations that are necessary before a court or prosecuting authority can perform an efficiencies analysis.

II. THE EFFICIENCY QUANDARY

Regardless of which economic school colors they wear, virtually all observers of the antitrust scene today accept "efficiency" as a central goal of the law. Scholars and jurists associated with the Chicago school assert that conduct leading to lower costs and lower consumer prices should never be held unlawful.[2] However, strong support for the primacy of efficiency can also be found among those espousing antitrust's "noneconomic" objectives.[3] Finally, the growing "post-Chicago" economic literature, which relies heavily on strategic-behavior models and closely considers market imperfections,

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2. *See* E. THOMAS SULLIVAN & HERBERT HOVENKAMP, ANTITRUST LAW, POLICY AND PROCEDURE 72 (1994) ("Under the efficiency methodology better products at lower prices is the *sine qua non* of legality.").

3. Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1051 (1979) ("The issue among most serious people has never been whether non-economic considerations should outweigh significant long-term economies of scale, but rather whether they had any role to play at all, and if so, how they should be defined and measured."). *But see* Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 67, 68 (1982) (contending that although Congress passed the antitrust statutes to further economic objectives, those objectives addressed distributive rather than efficiency concerns).

likewise demands that careful attention be paid to the efficiency consequences of conduct, particularly when it affects innovation and the long-run incentives facing competitors.[4]

Moreover, antitrust tribunals and enforcement agencies purport to directly appraise the efficiency consequences of business conduct in a variety of circumstances. In areas once subject to strict per se treatment, courts today first assess the plausibility of efficiency justifications before characterizing specific conduct as subject to the per se rule or to a "rule of reason" analysis.[5] Indeed, an overall tendency to legitimize efficiencies has led the Supreme Court to insist that entire categories of behavior, like vertical nonprice restraints, be appraised under the rule of reason.[6] Once under the rule of reason, efficiencies play a central role in determining whether the balance tips in favor of countenancing the conduct. Although the Supreme Court has not done so as yet, the federal antitrust enforcement agencies and a number of lower courts have begun to recognize an efficiencies defense which in effect allows otherwise objectionable mergers—those likely to lessen price competition—to proceed because of their offsetting benefits in enhancing efficiency.[7] Efficiencies also come into play in other circumstances, albeit somewhat more indirectly. For example, under section 2 of the Sherman Act, the conduct of monopolists is appraised under a business justification standard; the two-product requirement of tying arrangements also implicitly entails efficiency factors.

All this might lead the casual observer to assume that antitrust law had pretty well-defined notions of (1) what "efficiency" means and (2) how to measure it. Not so and not so. As the ensuing sections discuss, many normative and methodological questions that underlie these issues remain unresolved.

A. Efficiency, Consumer Welfare, and the Goals of Antitrust

The content of the efficiency concept remains a source of uncertainty and, in some cases, obfuscation in antitrust doctrine. To most economists, efficiency denotes those activities that increase the value of all of society's assets or wealth. Importantly, the economic definition of efficiency is comprised of several distinct components.[8]

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4. Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209, 279–82 (1986).

5. Broadcast Music, Inc. v. CBS, 441 U.S. 1, 16–24 (1979). *See generally* 7 PHILLIP E. AREEDA, ANTITRUST LAW ¶ 1504, at 361 (1986) (discussing expansion of rule of reason analysis).

6. Continental T.V., Inc. v. GTE Sylvania, 433 U.S. 36, 49–59 (1977).

7. *See infra* note 24 (giving examples).

8. For authorities proposing similar typologies of efficiencies as outlined in the

"Allocative efficiency" refers to the state in which societal resources are allocated to the production of goods and services such that no reallocation could make some consumers better off without making others worse off. "Production (or operating) efficiency" refers to the production of goods and services through the most cost-effective means at current levels of technology. "Innovation efficiency" refers to the invention, development, and diffusion of new products and cost-saving or quality-enhancing production techniques.

Antitrust law tends to focus exclusively upon promoting allocative efficiency. This emphasis represents an important and controversial policy choice because, as Professor Brodley has argued, innovation efficiency and production efficiency probably play far greater roles in the enhancement of social wealth.[9] In addition, enforcement policy as interpreted by those advocating exclusive reliance on the allocative efficiency standard has been skewed to disfavor claims of exclusionary conduct despite the conduct's harmful consequences to all three forms of efficiencies.[10]

Moreover, the prevailing doctrine's myopic concern with allocative efficiency ignores another important, and arguably predominant, congressional concern in prohibiting restraints of trade, monopolization, and anticompetitive mergers: the transfer of wealth from consumers to producers. Besides reducing the total amount of wealth in society, monopoly pricing effects a transfer from buyers to the monopolist, depriving the consumer of his "consumer surplus."[11] Interestingly, Chicago school advocates adamantly insist that such wealth transfers are inconsequential from an efficiency standpoint.[12] Such assertions rest on a set of controversial assump-

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text, see 2A PHILLIP E. AREEDA ET AL., ANTITRUST LAW ¶ 402b (1995); Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020, 1025–27 (1987).

9. Brodley, *supra* note 8, at 1026–28.

10. *Id.* at 1032; Herbert Hovenkamp, *Antitrust's Protected Classes*, 88 MICH. L. REV. 1, 12–13, 21, 30–31 (1989).

11. Consumer surplus is the difference between the maximum amount the buyer was willing to pay and the price he actually pays. With monopoly overcharges, consumers purchasing the product are denied the lower, competitive price and lose some portion of their consumer surplus to the monopolist. ROGER D. BLAIR & DAVID L. KASERMAN, ANTITRUST ECONOMICS 35–40 (1985).

12. *See* ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 61, 90 (Free Press 1993) (1978) (explaining sole goal of antitrust policy is "consumer welfare" which does not include an ethical component) [hereinafter BORK, THE ANTITRUST PARADOX]; William F. Baxter, *Responding to the Reaction: The Draftsman's View*, 71 CAL. L. REV. 618, 621 (1983) (noting that balancing consumer against business welfare makes it "impossible to articulate well-defined operational rules" and advocating economic efficiency as only workable standard); Robert H. Bork, *The Role of the Courts in Applying Economics*, 54 ANTITRUST L.J. 21, 24 (1985) (not-

tions about interpersonal utility comparisons and a dubious application of Pareto welfare principles. Thus, recent economic examinations of whether a "pure consumer welfare" standard or an "aggregate economic welfare" (allocative efficiency) standard should be employed in antitrust analyses have insisted upon careful examination of the relative income distribution between consumers and stockholders and consideration of the effects of innovation and dynamic competition.[13]

Although antitrust enforcement usually improves both allocative efficiency and prohibits wealth transfers, such is not always the case. For example, cost-reducing mergers or joint ventures may simultaneously enhance market power and enable the combined firm(s) to raise prices. While output may increase or remain unchanged (hence satisfying allocative efficiency concerns), society may be worse off where the loss in consumer surplus exceeds any gains.[14]

Thus, antitrust's application of the concept of efficiency is inexorably linked to one's assessment of what conception of welfare the Clayton and Sherman Acts were designed to protect. If those laws give consumers an entitlement to enter into transactions they would have made but for the restraint of trade or merger conferring market power, then efficiencies should not save the day unless they are large enough to cause a fall in price despite the increase in monopoly power.[15] If, on the other hand, wealth transfers between consumers and producers are of no concern under the statutes, then net efficiencies should be compared only to the losses which are associated with lowered output and perhaps "rent-seeking" behavior.[16]

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ing that judicial balancing of consumer welfare against business welfare is "engaging in a task so unconfinedly legislative as to be unconstitutional").

13. Gary L. Roberts & Steven C. Salop, Efficiency Benefits in Dynamic Merger Analysis 4–14 (May 10, 1993) (unpublished manuscript, on file with author).

14. There are several additional circumstances in which consumer welfare and allocative efficiency may not coincide. Price discrimination may increase allocative efficiency while enabling monopolists to transfer wealth to themselves from consumers. In addition, antitrust rules that adversely affect producer incentives, such as certain rules governing standing and those penalizing monopolists that merely supplant other monopolists by improper means, may adversely affect producer incentives without affecting allocative efficiency, at least in the short run. *See* Brodley, *supra* note 8, at 1034.

15. Krattenmaker & Salop, *supra* note 4, at 280.

16. Oliver E. Williamson, *Economies as an Antitrust Defense Revisited*, 125 U. PA. L. REV. 699, 731–35 (1977).

B. *Trade-off Analysis in Antitrust*

The possibility of explicitly assessing the "trade-off" between allocative losses and efficiency gains resulting from mergers has been extensively debated in the literature. Oliver Williamson's seminal work in this area advocating adoption of an efficiencies defense in merger analysis contemplates a trade-off analysis that would measure the monopoly "deadweight loss" created by an increase in market power.[17] This loss is weighed against the economies associated with the merger as reflected in the merged firm's lowered costs. Figure 1 below depicts Professor Williamson's "naive trade-off model" for a merger that increases both market power and efficiency. Before the merger, the two firms have costs of MC1 and price is P1. The merged firm is able to raise price from P1 to P2, while lowering costs from MC1 to MC2. If efficiency gains generated by the merger (area C) exceed the "deadweight loss" (area D), a net efficiency gain is present.

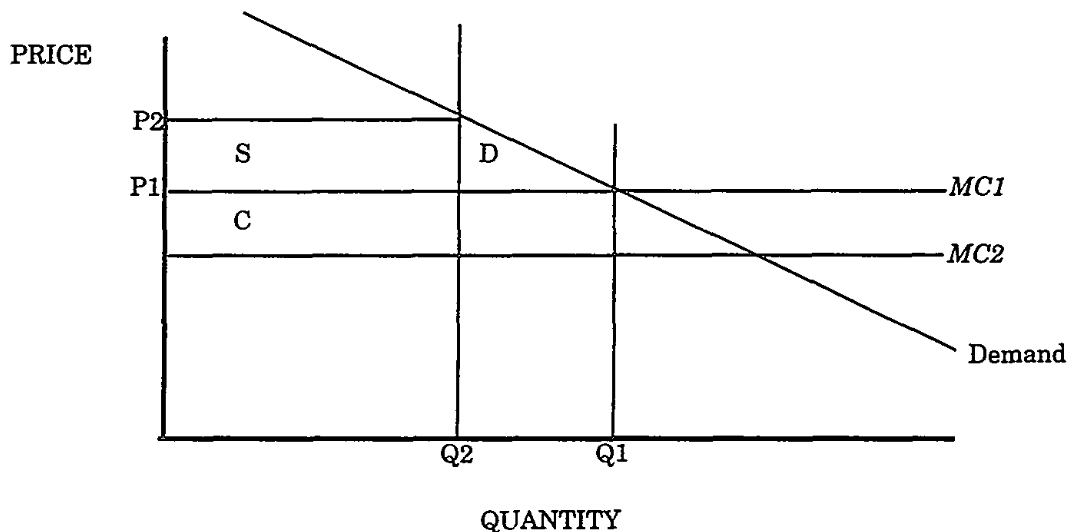

FIGURE 1

Under the efficiencies defense contemplated by this model, mergers would be legal when they create substantial efficiencies, even though they raise prices to consumers and the benefits of increased efficiency accrue to the merged firm in the form of higher profits.

17. Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Trade-offs*, 58 AM. ECON. REV. 18, 21–23 (1968); *see* Williamson, *supra* note 16, at 706–09.

Proponents of this defense emphasize that in markets with average elasticity of demand and supply, relatively modest gains in efficiencies will offset large price increases.[18] The welfare rationale for countenancing a merger that results in harm to consumers in the form of higher prices is that there is at least the possibility of a Pareto improvement in social welfare in that the merged firms may compensate consumers for such harms out of their increased profits. Notably, Williamsonian analysis ignores the wealth transfer from consumers to the merging firms (area S) because it is viewed as an inconsequential transfer from consumers to producers that does not cause any loss in aggregate social wealth.

Critics of Williamson's approach fall into two principal groups.[19] The first group interprets the legislative intent of the Clayton Act to require a pure consumer welfare approach and advocates a "price test" for mergers. This approach stresses that the Pareto welfare criterion requiring that transactions improving the welfare of some individuals but reducing the welfare of others cannot be said to improve social welfare. It views the harms from mergers as consisting not only of the "deadweight loss" (area D, figure 1) but also of the "wealth transfer" from consumers to sellers (area S). Only where the cost savings attributable to the merger are of such magnitude that they lead to a price reduction relative to pre-merger prices would an efficiencies defense apply. In performing the efficiency/market power trade-off, the fundamental question should be: "How much must marginal cost decrease to offset a given increase in market power and ensure that prices not increase?"[20] This ap-

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18. Williamson, *supra* note 17, at 22–23 (finding economies of only 1.2% will offset price increases of 10%). Relaxing overly restrictive assumptions of the Williamson model produces very different results. *See* Alan A. Fisher et al., *Price Effects of Horizontal Mergers*, 77 CAL. L. REV. 777, 804–08 (1989) (using oligopoly model and finding that cost savings needed to offset market power are far greater than those resulting from the Williamson model); *see also* Roberts & Salop, *supra* note 13, at 63–73 (analyzing efficiencies under alternative welfare standards).

19. Williamson's path-breaking work has generated a sizeable literature. Those skeptical of a workable efficiencies defense include BORK, THE ANTITRUST PARADOX, *supra* note 12, at 127–28; RICHARD A. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 112–13 (1976); Alan A. Fisher & Robert H. Lande, *Efficiency Considerations in Merger Enforcement*, 71 CAL. L. REV. 1580, 1582, 1650–57 (1983); Fisher et al., *supra* note 18, at 815–18. Among those supporting the use of an efficiencies defense in merger cases are Joseph Kattan, *Efficiencies and Merger Analysis*, 62 ANTITRUST L.J. 513, 521–27 (1994); Timothy J. Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 CASE W. RES. L. REV. 381, 416–31 (1980); Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 GEO. L.J. 195, 206–27 (1992); Steve Stockum, *The Efficiencies Defense for Horizontal Mergers: What Is the Government's Standard?*, 61 ANTITRUST L.J. 829, 847–50 (1993).

20. Fisher et al., *supra* note 18, at 791.

proach would allow efficiency gains to trump increased market power, but only where the gains would affect postmerger prices.

The second group rejects the Williamson model's implicit assumption that efficiencies associated with the merger will be attained by all other firms in the market.[21] This school would factor in efficiency gains only to the extent it can be reasonably anticipated that they will be imitated or emulated by others in the market. Where efficiencies diffuse throughout the market over time *and* such diffusion is attributable to the merger (that is, the efficiencies would not have otherwise diffused throughout the market), they should be measured and balanced against harms to the extent possible.[22]

C. The Muddled Case Law

The case law and the policies of the enforcement agencies mirror the quandary discussed above. Despite more than two decades of debate since Williamson framed the issue, there is no consensus in the cases over whether an "efficiencies defense" should apply to mergers. The Supreme Court last spoke over thirty years ago in terms that seemed to repudiate the defense.[23] However, lower

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21. Kattan, *supra* note 19, at 523–27; Roberts & Salop, *supra* note 13, at 61.

22. Roberts and Salop do not devise a formal mechanism for measuring diffusion and admit to the complexity of the task, suggesting that presumptive average values might be used to devise guidelines. Roberts & Salop, *supra* note 13, at 58–62 (discussing factors complicating their proposal such as establishing appropriate time horizon and assessing likelihood of imitation and emulation). The authors also point out that both the Williamsonian model and the pure consumer welfare model place a particular balance on consumer surplus and producer surplus (the Williamsonian model weighting them equally and the pure consumer welfare model placing all weight on consumer surplus). They point out that other welfare weights are possible and suggest that decision makers might explicitly choose those relative weights based on income distribution or other factors when performing the efficiencies trade-off. *Id.* at 24–33.

23. FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967) ("Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition."); *see also* United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 371 (1963) ("[A] merger the effect of which 'may be substantially to lessen competition' is not saved because, on some ultimate reckoning of social and economic debits and credits, it may be deemed beneficial."); Brown Shoe Co. v. United States, 370 U.S. 294, 323–34 (1962). *Procter & Gamble* and *Brown Shoe* go so far as to suggest that mergers might be condemned because of their propensity to improve efficiency, a position that has been implicitly repudiated by subsequent developments in other areas of antitrust law. *See* Broadcast Music, Inc. v. CBS, 441 U.S. 1, 19–21 (1979) (endorsing consideration of efficiencies); U.S. Dep't of Justice & U.S. Fed. Trade Comm'n, Horizontal Merger Guidelines, 4 Trade Reg. Rep (CCH) ¶ 13,104, § 4 (Apr. 2, 1992) [hereinafter Merger Guidelines]. *See generally* 4 PHILLIP E.

courts have increasingly incorporated an evaluation of efficiencies into their merger analysis, although none has explicitly exonerated a merger based on the Williamsonian trade-off alone.[24] A fair summary of the decided cases expressly considering the efficiencies defense is that they have tended to find proof of efficiencies wanting in circumstances where the courts have found the merger to be anticompetitive, but have credited efficiencies when sustaining the merger due to an absence of proof that likely anticompetitive effects exist.[25] An alternative to treating efficiencies as an affirmative defense to an anticompetitive merger is to factor procompetitive efficiencies into the court's competitive analysis under section 7 of the Clayton Act.[26]

The policies of the antitrust enforcement agencies have been less than a model of consistency on the issue. As explained in the Merger Guidelines, the FTC and DOJ accept an efficiencies defense for purposes of deciding whether or not to challenge a merger and claim to weigh efficiencies in the assessment of whether a merger will have an anticompetitive effect.[27] However, they continue to argue that the defense should not be recognized by the federal courts.[28] Moreover, the agencies have changed their formulation of

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AREEDA & DONALD F. TURNER, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 940 (1980) (endorsing efficiencies defense in horizontal mergers).

24. A number of courts have accepted the efficiencies defense in § 7 merger cases in principle but have found the evidence insufficient to outweigh proof of anticompetitive effects. *See* FTC v. University Health, Inc., 938 F.2d 1206, 1222 (11th Cir. 1991); United States v. Rockford Memorial Corp., 717 F. Supp. 1251, 1289–91 (N.D. Ill. 1989), *aff'd*, 898 F.2d 1278 (7th Cir.), *cert. denied*, 498 U.S. 920 (1990); *In re* American Medical Int'l, 104 F.T.C. 1, 213, 217 (commission opinion), *modified*, 104 F.T.C. 617 (1984); *see also* United States v. Carilion Health Sys., 707 F. Supp. 840, 849 (W.D. Va.) (finding merger enhanced competition), *aff'd*, 892 F.2d 1042 (4th Cir. 1989).

25. Kattan, *supra* note 19, at 517–18.

26. *See University Health*, 938 F.2d at 1222; Kattan, *supra* note 19, at 518–19. *But see* FTC v. Imo Indus., 1992-2 Trade Cas. (CCH) ¶ 69, at 943 (D.D.C. Nov. 22, 1989) (granting preliminary injunction to merger found likely to increase prices and reduce costs).

27. Merger Guidelines, *supra* note 23, § 4. Merger guidelines adopted by the state attorneys general have been even less receptive to claimed efficiencies defenses. *See* National Ass'n of Attorneys Gen., Horizontal Merger Guidelines, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,406, § 5.3 (Apr. 13, 1993) (expressing skepticism about frequency of merger-specific efficiencies outweighing competitive harms, requiring "clear and convincing evidence" and proof of benefits to consumers in order to recognize the defense). *But cf.* Attorney General, Commonwealth of Massachusetts, Antitrust Guidelines for Mergers and Similar Transactions Among Hospitals, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,450 (Sept. 14, 1993) ("The possibility of efficiencies is potentially an important factor in reviewing hospital mergers" provided there is "'clear and convincing evidence' of efficiencies which will . . . benefit consumers.").

28. The FTC contended in its appeal before the 11th Circuit in *University*

the defense with each successive iteration of the Merger Guidelines. Most recently, they have dropped, without explanation, provisos that efficiencies should prevail only "in extraordinary cases" and must be demonstrated by "clear and convincing evidence."[29]

There is more widespread acceptance of the role of efficiency analysis in evaluating joint ventures. As a doctrinal matter, the rule of reason requires an assessment and balancing of a venture's pro- and anticompetitive tendencies.[30] However, the methodology for undertaking this task remains shrouded in confusion. Courts are understandably inclined to shortcut the inquiry with "screens," such as market power, less restrictive alternatives, and so forth,[31] so that instances of courts actually undertaking the rule of reason balancing test are exceedingly rare. When "balancing" is actually demanded, courts frequently accept the justification that because *some* integration is present, substantial efficiencies are involved, and they neglect to meaningfully weigh those effects against potential harms.[32] This approach whittles the analytic process down to a

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Health that an efficiencies defense is not legally cognizable. 938 F.2d at 1222; *see* Stockum, *supra* note 19, at 836.

29. *Cf.* U.S. Dep't of Justice, Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,103, § 3.5 (June 14, 1984) [hereinafter 1984 Merger Guidelines] (merging parties must present "clear and convincing" evidence of efficiencies). The 1984 Guidelines deleted language contained in the 1982 Guidelines indicating that "[p]lausible efficiencies are far easier to allege than to prove" and that the Department will not consider claims of specific efficiencies "[e]xcept in extraordinary cases." *See* U.S. Dep't of Justice, Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,102, § 5 (June 14, 1982). The agencies indicate that the deletion of the "clear and convincing evidence" standard in the 1992 Guidelines does not necessarily indicate a change in the standard that they will apply, but only an unwillingness to address burden-of-proof issues that are to be established by the courts. *See* Merger Guidelines, *supra* note 23, § 0.1.; *cf.* ABA ANTITRUST SECTION, THE 1992 HORIZONTAL MERGER GUIDELINES: COMMENTARY AND TEXT 56 (1992) (dissenting statement of Commissioner Mary L. Azcuenaga noting that deletion of "clear and convincing" provision, though not intended to signal a change in policy, may create misleading perception).

30. *Broadcast Music*, 441 U.S. at 19–20; *see also* U.S. Dep't of Justice, Antitrust Guidelines for Int'l Operations, 53 Fed. Reg. 21,584 (June 8, 1988) (suggesting that lower requirements for efficiencies trade-off may apply to analysis of joint ventures than mergers).

31. *See* Rothery Storage & Van Co. v. Atlas Van Lines, 792 F.2d 210, 214–15 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1033 (1987); Ball Memorial Hosp. v. Mutual Hosp. Ins., 784 F.2d 1325, 1334–35 (7th Cir. 1986); *see also* Chicago Professional Sports Ltd. Partnership v. National Basketball Ass'n, 961 F.2d 667, 673–74 (7th Cir.) (restricting output without offsetting efficiency justification obviates need to define market), *cert. denied*, 113 S. Ct. 409 (1992). *See generally* Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 17–22 (1984) (contending courts should use screens before applying rule of reason).

32. Robert Pitofsky, *A Framework for Antitrust Analysis of Joint Ventures*, *in* COLLABORATIONS AMONG COMPETITORS: ANTITRUST POLICY AND ECONOMICS 839, 851, 855 (Eleanor M. Fox & James T. Halverson eds., 1991) (citing United States v. Co-

meaningless sliver. Efficiencies are equated with integration and are deemed to outweigh competitive harms regardless of their magnitude.

As discussed in Part III, several techniques for dealing with the problem of balancing have been proposed. For the most part, however, the enforcement agencies and courts have satisfied themselves with techniques that obviate the need for balancing in the more clear-cut factual circumstances. For example, the FTC has adopted an approach that attempts to distinguish valid efficiency claims from others and makes it clear that even valid justifications do not constitute an affirmative defense, but require close scrutiny to assure that they exceed any anticompetitive effects.[33] However, the FTC only attempts to limit the number of cases in which a full balancing analysis must be undertaken; it provides little guidance for performing the calculation once the alternatives are exhausted. Unfortunately, the federal agencies have, if anything, increased uncertainty about this process through their policy pronouncements and enforcement actions in the health care arena.

III. THE DOJ/FTC HEALTH CARE POLICY STATEMENTS AND THEIR APPLICATION

The day after the Clinton administration introduced its health care reform legislation, the Health Security Act, the federal antitrust enforcement agencies unveiled a set of policy statements regarding the application of antitrust to the health care industry.[34] Designed primarily to quell complaints that antitrust law might impede competitive reform, these statements might be charitably characterized as essentially a political communique because they go

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lumbia Pictures, 189 F. Supp. 153, 178–81 (S.D.N.Y. 1960) as an example in which no attempt was made to estimate magnitude of efficiencies associated with collaborative agreement or to balance them against harms).

33. The methodology employed by the FTC in its decision in *In re* Massachusetts Bd. of Registration in Optometry, 110 F.T.C. 549 (1988), reflects an attempt to obviate the need for a full-blown weighing of efficiencies against harms where possible. Under this approach, for those joint practices by competitors deemed "inherently suspect," the FTC first evaluates whether there exists plausible and credible efficiencies supporting the restraint. *Id.* at 586–88. This step does not require quantification of cost savings and enables the factfinder to condemn the restraint without detailed analysis or a quantification of market power where valid efficiencies are lacking. *See* Michael G. Vita et al., *Economic Analysis in Health Care Antitrust*, 7 J. CONTEMP. HEALTH L. & POL'Y 73, 111–14 (1991); *see also* Detroit Auto Dealers Ass'n, 108 F.T.C. 193, 237 (1986) (finding claimed efficiencies of lower overhead costs attracting higher quality sales personnel and preventing unionization as implausible or invalid), *aff'd*, 955 F.2d 457, 469–72 (6th Cir.), *cert. denied*, 113 S. Ct. 461 (1992).

34. *See* 1994 Health Care Policy Statements, *supra* note 1, at 20,755.

to considerable lengths to portray antitrust law as "user friendly" for providers undertaking collaborative joint ventures.[35] Though warding off legislative calls for antitrust exemptions is a worthy goal,[36] one may question the effectiveness of the enterprise[37] and its unfortunate side effects upon antitrust doctrine.

As amended and supplemented in September 1994, the Policy Statements now cover nine categories of collaborative activity among providers and insurers. Together, they span the gamut of potential antitrust causes of action, including horizontal and vertical restraints, mergers, and monopolization claims associated with the principal kinds of joint ventures and other collaborative activities that pervade the health care industry today. A dominant theme is the central role of efficiency analysis in evaluating possible antitrust prosecutions. This section discusses the treatment of efficiency claims under each policy statement.

The first policy statement deals with hospital mergers. It establishes a safety zone for cases in which one of the merging hospitals has fewer than 100 beds and an average daily census of fewer than forty patients over the preceding three years.[38] This provision serves as a proxy for efficiency concerns.[39] By setting a "safe harbor" that applies regardless of the degree of concentration or other factors suggesting that the merger may lessen competition, the statement creates a presumptive rule premised on the presumed inefficiency of hospitals operating below the threshold.[40] Statement One also invokes the efficiencies defense contained in the 1992

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35. *See* Thomas L. Greaney, *A Critique: The Department of Justice/FTC Policy Statements*, ANTITRUST, Spring 1994, at 20, 24. For a more favorable view of the 1993 Statements, see David Marx, Jr. & Christopher M. Murphy, *Antitrust Enforcement Encourages Health Care Providers to Cooperate Procompetitively*, 3 ANNALS HEALTH L. 1, 10, 27 (1994).

36. On the dubious economic and policy premises of legislation exempting providers from antitrust law, see James F. Blumstein, *Health Care Reform and Competing Visions of Medical Care: Antitrust and State Provider Cooperation Legislation*, 79 CORNELL L. REV. 1459, 1493–501 (1994); Thomas L. Greaney, *When Politics and Law Collide: Why Health Care Reform Does Not Require Antitrust "Reform,"* 39 ST. LOUIS U. L.J. 135, 139–46 (1994).

37. A large number of states have adopted antitrust exemption statutes and many federal health reform proposals continue to press for some form of relief from antitrust law for provider collaboration. *See infra* text accompanying notes 71–72.

38. 1994 Health Care Policy Statements, *supra* note 1, at 20,774.

39. *See* Fisher & Lande, *supra* note 19, at 1677 (proposing adjusting Merger Guidelines' thresholds as an alternative to incorporating explicit efficiencies defense).

40. The economic literature suggests that the minimum efficient scale for acute care hospitals is in the 100- to 200-bed range. *See* Vita et al., *supra* note 33, at 97–98 (summarizing literature on estimating hospital cost functions and concluding that hospitals exhibit constant returns to scale or constant unit costs with increasing output once a threshold of 200 beds is reached).

Merger Guidelines, which allow for an efficiencies defense for significant, merger-specific efficiencies supported by substantial evidence and not realizable through other means such as joint ventures or internal expansion.[41]

Five additional statements offer guidance on provider joint ventures. Statement Two discusses the agencies' methodology for analyzing hospital joint ventures that purchase, operate, or market high technology or other expensive equipment.[42] It establishes a safety zone for ventures that include only the number of hospitals necessary to support the equipment.[43] This effectively incorporates an economies of scale defense where purchase or delivery of such services mandates collaboration if the equipment is to be available at all. For ventures not falling within the safety zone, the statement sets forth a rule of reason analysis and provides that efficiencies will be balanced against potential anticompetitive effects.[44] Statement Two states that procompetitive efficiencies will be balanced against anticompetitive effects, but does not disclose the methodology that the agencies will employ for such balancing.[45] Nor does the statement discuss what efficiencies warrant attention, except to note that "efficiencies can be substantial because of the need to spread the cost of expensive equipment over a large number of patients and the potential for improvements in quality to occur as providers gain experience and skill from performing a larger num-

41. Merger Guidelines, *supra* note 23, § 4. The agencies have indicated on a number of occasions that they consider efficiencies in evaluating hospital mergers. *See* Mark J. Horoschak, *Antitrust Enforcement Policy for Health Care Markets, in* HEALTH CARE REFORM & ANTITRUST 133, 144 (Practising Law Inst. ed., 1994) (stating FTC is most likely to recognize efficiencies associated with better use of fixed assets such as those realized by consolidations of hospital departments or clinical services, especially where increased volume enables a hospital to bring new or better services to community); Charles F. Rule, Assistant Attorney General, Antitrust Div., U.S. Department of Justice, Antitrust Enforcement and Hospital Mergers: Safeguarding Emerging Price Competition, Remarks Before the National Health Lawyers Ass'n 15–18 (Jan. 21, 1988) (on file with DOJ, Office of Legal Procedure). The DOJ has on occasion declined to challenge mergers involving hospitals where it was convinced that there were genuine efficiencies that could be obtained only through merger. *See* Rule, *supra*, at 21–22 (discussing DOJ's decision not to challenge hospital merger in Danville, Illinois, involving hospitals with 235 and 219 beds, both operating below 50% capacity, and merger in Portsmouth, Ohio, involving hospitals with 225 and 210 beds, one of which was in financial difficulty).

42. 1994 Health Care Policy Statements, *supra* note 1, at 20,775.

43. *Id.* The Statement also allows for inclusion of additional hospitals if it can be established that the original venture could not support the equipment on its own or through the formation of competing joint ventures. *Id.*

44. *Id.* at 20,775–76.

45. *Id.* at 20,776.

ber of procedures."[46] An illustrative example suggests that some additional considerations may apply. The example suggests that a "sliding scale" might be used in the balancing process, because greater likely anticompetitive effects will require greater likely efficiencies.[47] In addition, without explicitly noting the requirement, the example observes that the efficiencies under discussion could not be achieved in a less restrictive manner.[48]

Statement Three applies to joint ventures involving specialized clinical or other expensive health services. Like Statement Two, it contemplates a balancing of efficiencies against anticompetitive effects; however, it explicitly incorporates a sliding scale for weighing efficiencies in the text of its analytic principles.[49] In addition, it notes that quality-related efficiencies associated with better medical practices resulting from performing an efficient number of procedures may be considered.[50]

Statement Seven creates a safety zone for provider joint-purchasing arrangements where the joint purchases amount to less than thirty-five percent of total sales of the product in the market and less than twenty percent of the revenues of each participant.[51] These structural thresholds presumably are premised in part on the efficiencies inherent in these arrangements, such as those resulting from volume discounts and reduced transaction costs associated with cooperative buying. For ventures not falling within the safety zone, Statement Seven curiously does not follow the other statements in mandating a balancing of efficiencies against anticompetitive effects; instead it suggests that "significant efficiencies" may save an arrangement absent substantial risk of anticompetitive effects.[52]

Statements Eight and Nine deal respectively with physician-network joint ventures such as preferred provider organizations ("PPOs") and multiprovider networks such as physician hospital organizations.[53] Both statements adopt structural benchmarks that are premised in part on recognizing the efficiencies achieved by

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46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.* at 20,780.

50. Statement Three notes that efficiencies may include "the potential for improvement in quality to occur as providers gain experience and skill from performing a larger number of procedures." *Id.*

51. *Id.* at 20,785.

52. *Id.* at 20,786 ("Where there appear to be significant efficiencies from a joint purchasing arrangement, the Agencies will not challenge the arrangement absent substantial risk of anticompetitive effects.").

53. *Id.* at 20,787–98.

such arrangements. The physician-network statement establishes a safety zone that rests on transactional and risk-spreading efficiencies, while the multiprovider-network statement additionally rests on efficiencies that may result from vertical integration.[54] Both statements go on to incorporate an explicit efficiencies defense, stressing the cost savings associated with assumption of risk and possibly recognizing other efficiencies such as reduced administrative costs, improved utilization review, improved case management, economies of scale, and quality assurance.[55] Both statements apply a sliding-scale balancing approach and state that they will not accept efficiencies reasonably achievable by other means.[56]

As the foregoing reveals, the approach of the Health Care Policy Statements to efficiencies is somewhat erratic—sometimes suggesting a sliding scale will be used in balancing efficiencies, sometimes not; sometimes suggesting that efficiencies must be passed on to consumers, but usually not; sometimes mentioning "net" efficiencies, usually not. No apparent rationale exists for differentiating in these ways among the several types of collaboration analyzed in the Policy Statements, although some commentators have interpreted certain statements as signalling recognition of an extremely broad efficiency defense.[57] It must therefore be assumed that they do not mean to specify with precision the analytic course to be followed in each instance. Even more problematic is the fact that no methodology is offered for identifying, quantifying, or weighing efficiencies.

Moreover, the advisory opinions issued by the FTC and the DOJ's Antitrust Division since the adoption of the Policy Statements fail to clarify the agencies' policies regarding the role of an efficiencies trade-off in health care antitrust matters. As yet, no advisory opinion has concluded that benefits from probable efficiencies outweigh competitive harms and hence justify an otherwise

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54. *Id.* For a discussion of the benefits and risks associated with multiprovider integration, see Thomas L. Greaney, *Managed Competition, Integrated Delivery Systems and Antitrust*, 79 CORNELL L. REV. 1507, 1533–37 (1994).

55. 1994 Health Care Policy Statements, *supra* note 1, at 20,789, 20,797.

56. *Id.*

57. For example, one observer has interpreted the Policy Statements' discussion of the efficiencies offset in cases involving physician network joint ventures to mean that assumption of financial risk by physicians will trump most concerns about anticompetitive risks. *See* William McD. Miller, Physician Networks After the Statements of Antitrust Enforcement Policy in the Health Care Area 17–18 (Feb. 15, 1994) (unpublished manuscript, available from the National Health Lawyers Ass'n) ("The clear signal being given by the Agencies is that where physician networks make themselves available for contracts wherein the network bears a significant financial risk for the delivery of medical treatment, the agencies are unlikely to challenge the arrangement.").

objectionable collaboration. In the only advisory letter disapproving a proposed transaction issued after the adoption of the Policy Statements, the FTC did not closely analyze the offsetting efficiencies justification that might have outweighed anticompetitive harms.[58] For its part, however, the DOJ's business review letters have increasingly invoked efficiency justifications as additional grounds for approving proposed transactions that it also found posed no significant competitive threats.[59] This appears to be something of a departure from past practices, although given the cursory discussion of efficiencies contained in these letters, it may be argued that the Antitrust Division is only paying lip service to the trade-off analysis suggested by its Policy Statements.[60] It is notable, however, that these business review letters accept efficiency justifications of various sorts, including cost savings attributable to network operation,

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58. *See* Letter from Mark J. Horoschak, Assistant Director, Bureau of Competition, FTC, to Paul W. McVay 4–5 (July 5, 1994) (on file with FTC Bureau of Competition) (finding inadequate evidence of substantial risk sharing so as to justify close appraisal of costs and benefits under the rule of reason).

59. *See* Letter from Anne K. Bingaman, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, to Steven F. Banghart 3 (Dec. 8, 1994) (on file with DOJ Office of Legal Procedure) [hereinafter Banghart Letter]; Letter from Anne K. Bingaman, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, to Dee Hartzog 3 (Oct. 27, 1994) (on file with DOJ office of Legal Procedure [hereinafter Hartzog Letter]; Letter from Anne K. Bingaman, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, to Andrew N. Meyercord 3 (Mar. 23, 1994) (on file with DOJ Office of Legal Procedure) [hereinafter Meyercord Letter]; Letter from Anne K. Bingaman, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, to Maureen E. Corcoran 2 (Feb. 18, 1994) (on file with DOJ Office of Legal Procedure). The Antitrust Division is not entirely consistent on this practice, however, as a number of post-Policy Statements business review letters contain no mention of an efficiencies trade-off. *See, e.g.*, Letter from Anne K. Bingaman, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, to Eugene E. Olson (July 6, 1994) (on file with DOJ Office of Legal Procedure).

60. None of the Antitrust Division's business review letters contains more than a few sentences discussing possible efficiencies and, for the most part, the analysis is highly conclusory and gives no indication that any effort was made to quantify or otherwise closely evaluate efficiencies. *See* Banghart Letter, *supra* note 59, at 3 (noting "significant, efficiency-related benefits" associated with radiologists' network based on potential users of network who supported contentions that program would "help[] to control costs to payers by educating referring physicians on more effective utilization of radiologist services"); Hartzog Letter, supra note 59, at 3 (stating collaborative chiropractor network "will offer significant[] efficiency-related benefits" as evidenced by interviews with potential users who stated that they would only offer chiropractic services if they could do so by contracting with a network that offered utilization controls and other network benefits); Meyercord Letter, *supra* note 59, at 3 ("[The proposed group purchasing association] has the potential to create efficiencies in delivering health care services that could result in lower health care costs. To the extent that occurs, the formation and operation of the proposed purchasing group could be procompetitive.").

"educational" or information-generating benefits, and scale economies associated with lower unit costs of purchasing.

In practice, the most serious attempts to quantify and evaluate efficiencies are found in hospital merger cases and investigations. The economic inquiry in these cases has usually focused on whether the merger would realize scale economies,[61] particularly those associated with consolidations of clinical services.[62] The argument frequently advanced is that declining demand (prompted by changing payor policies and technological progress) has caused many hospitals to provide services at an inefficient scale.[63] Careful economic analysis of each hospital service is usually required because each hospital has its own minimum efficient scale.[64] In addition, however, hospitals need to offer a variety of services to be efficient, so some economies of scope are often also present.[65] Antitrust courts have on occasion attempted to quantify efficiencies, but have

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61. Economists commonly define economies of scale in situations in which unit costs of production decline as the level of output increase. Vita et al., *supra* note 33, at 95. An FTC official has described the agency's analysis of claimed efficiencies in hospital mergers as follows:

> Typically, four types of efficiency claims arise in hospital merger cases—cost of capital, shared inputs, better use of fixed-cost assets, and elimination of duplicative services. Of these, the first two tend to be discounted because they generally can be attained through less restrictive, joint venture arrangements. . . .
>
> Commission staff tends to be more impressed with efficiency justifications involving substantial consolidations of hospital departments or clinical services, especially if the increased volume of the consolidated facility enables it to bring new or better health services to the community. Of course, it is necessary to show that the hospitals are firmly committed to prompt implementation of their consolidation plans, and that the benefits from such consolidations will be passed on to consumers.

Horoschak, *supra* note 41, at 144.

62. For a clear account of the methodology used by an economist to appraise efficiencies claims in hospital merger cases, see Barry C. Harris & William P. Hall, *Balancing Efficiencies and Competition in Evaluating Hospital Mergers*, 8 A.B.A. SEC. ANTITRUST HEALTH CARE CHRON., No. 3, at 2, 2–3 (1994).

63. *See* Frank Cerne & Jim Montague, *Capacity Crisis*, HOSPS. & HEALTH NETWORKS, Oct. 5, 1994, at 30, 34 (finding excess bed capacity forces financially strong hospitals to price below fully allocated costs in many markets).

64. *See* Harris & Hall, *supra* note 62, at 3 (concluding that for most clinical services the most efficient scale is in the range of 30 to 40 beds).

65. Economies of scope occur when common inputs are used in multiple outputs so that the cost of producing those multiple outputs is less than producing them separately. Vita et al., *supra* note 33, at 97. Economists conclude that economies of scope are less likely to be of great magnitude in hospital consolidations than are scale economies. *Id.* at 100 (summarizing literature finding diseconomies of scope in the production of hospital services and concluding "[t]he evidence on economies of scope is mixed and probably should not be used to indicate strong support for an acquisition").

usually relied on flaws in the defendants' methodologies to reject the defense.[66]

IV. THE RAPIDLY CHANGING HEALTH INDUSTRY CONTEXT: INTEGRATED DELIVERY SYSTEMS, CONCENTRATION, AND EFFICIENCY

The extraordinary reorganization currently underway in the health care industry is the product of a confluence of changing governmental policies, intensified private sector attention to cost containment, and technological innovation.[67] Together, these developments have reversed financial incentives for providers and payors that had previously encouraged both capital investment and institutional arrangements that lacked any nexus to market-based principles.[68] The byproducts of these newfound competitive incentives can be seen throughout the industry: third-party payors insisting on risk sharing from providers and devising contractual and organizational arrangements to assure cost-effectiveness in the health care services they purchase; hospitals seeking to shed excess capacity and avoid uneconomical investments; and physicians scrambling to join groups that will enable them to engage in competitive contracting and practice cost-effective medicine.[69]

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66. *See, e.g*, FTC v. University Health, Inc., 938 F.2d 1206, 1223–24 (11th Cir. 1991) (accepting efficiencies defense in principle, but finding proof lacking to explain how efficiencies would be created or how magnitude of efficiencies compared to costs of merger's adverse effects on competition); United States v. Rockford Memorial Corp., 717 F. Supp. 1251, 1289 (N.D. Ill. 1989) (faulting quantitative efficiencies study for failure to consider expenses brought on by proposed merger), *aff'd,* 898 F.2d 1278 (7th Cir.), *cert. denied,* 498 U.S. 920 (1990); *In re* American Medical Int'l, 104 F.T.C. 1, 93–94 (1983) (initial decision) (faulting efficiencies calculations for ignoring capital costs, depreciation, and regulatory costs which would "reduce the potential savings"), *aff'd in part, rev'd in part,* 104 F.T.C. 1, 177–240, *modified,* 104 F.T.C. 617 (1984).

67. *See* Mary Lou Steptoe, Acting Director, Bureau of Competition, FTC, Efficiency Justifications for Hospital Mergers, Remarks Before the Practising Law Institute 6, 24–25 (June 17, 1994) (transcript on file with FTC Bureau of Competition); *see also* Robert Pear, *Revolution in Health Care Industry Means Big Business for Specialist Lawyers,* N.Y. TIMES, Jan. 13, 1995, at B8, B14 (reporting health care lawyer characterizing industry change as "one of the largest industrial reorganizations in history").

68. *See* PAUL STARR, THE SOCIAL TRANSFORMATION OF AMERICAN MEDICINE 428–49 (1982); Jeff Goldsmith, *Death of a Paradigm: The Challenge of Competition,* 3 HEALTH AFFS. 5, 7–10, 18–19 (1984).

69. *See generally* Frank Cerne, *The Fading Stand-Alone Hospital,* HOSPS. & HEALTH NETWORKS, June 28, 1994, at 20, 28 (reporting survey of hospitals stating 67% of respondents believed it necessary to adopt integrated delivery system and 33% have one under way or operational); *Provider-Owned Managed Care Networks Take Off,* MANAGED CARE WEEK, Oct. 31, 1994, at 1 (Managed Care Perspectives

Behind all of these developments, one finds powerful, indeed dominant, "efficiency" motivations. However, the fact that providers and payors are now vigorously responding to market-based incentives does not by itself justify suspending or weakening antitrust principles for these entities. This author and others maintain that claims that antitrust exemptions will improve competitive performance in the health care sector are facially deficient.[70] For example, the torrent of reorganization now underway belies the contention that antitrust laws are inhibiting the much-needed rationalization of the industry.[71] Moreover, one cannot plausibly claim that the remedy adopted by many states—an open-ended regulatory mandate to state health departments and/or attorneys general to consider the public-convenience and necessity justifications for cooperative activities—would produce a superior economic analysis of costs and benefits.[72] Contrary to the assumptions underlying the antitrust exemption movement, the greater risk to competitive reform may well lie with underenforcement rather than overenforcement of antitrust law. Under this view, the economic goals of greater productive and allocative efficiency are imperiled by enforcement policies or exemptions that do not adequately foster development of multiple integrated networks.[73]

Even those who support vigorous application of antitrust principles to the health care industry might nevertheless support adop-

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Supp.) (estimating 15% to 20% of managed care entities are controlled by physicians or hospitals or combinations thereof).

70. *See* Blumstein, *supra* note 36, at 1501–05; Greaney, *supra* note 36, at 139–46; David L. Meyer & Charles F. Rule, *Health Care Collaboration Does Not Require Substantive Antitrust Reform*, 29 WAKE FOREST L. REV. 169, 170–71, 200–05 (1994); *see also* Anne K. Bingaman, *The Importance of Antitrust in Health Care*, 1995 UTAH L. REV. 373, 378–79. For the industry's arguments on behalf of legislative exemptions, see *Medical Malpractice and Antitrust Issues in Health Care Reform: Hearings Before the Senate Comm. on Finance*, 103d Cong., 2d Sess. 42–44 (1994) (testimony of Dr. Richard F. Corlin, American Medical Ass'n); Fredric J. Entin et al., *Hospital Collaboration: The Need for an Appropriate Antitrust Policy*, 29 WAKE FOREST L. REV. 107, 134–38 (1994).

71. *See* Marx & Murphy, *supra* note 35, at 27 (reviewing Policy Statements and government enforcement policies and concluding that agencies and courts have applied antitrust laws so as to encourage cooperation among providers to reduce costs or increase efficiency).

72. *See* Blumstein, *supra* note 36, at 1493–501. As Professor Blumstein has pointed out, the more plausible and understandable rationale for state hospital-cooperation laws is not that they are designed to promote economic efficiency but that they promote access by permitting existing patterns of cross-subsidization to continue. *Id.* at 1498. On state provider-cooperation statutes and their potential for conferring state action immunity upon participants, see Sarah S. Vance, *Immunity for State-Sanctioned Provider Collaboration After* Ticor, 62 ANTITRUST L.J. 409, 420–23 (1994).

73. *See* Greaney, *supra* note 54, at 1525–32.

tion of the efficiency trade-off on the grounds that such a rule would advance consumer interests without corresponding risks. In particular, some might argue that in an era of extensive organizational and technological innovation, antitrust policy should be especially receptive to possibilities of enhancing efficiency in exchange for some increases in market power. As will be developed in Part VI, however, the judiciary and enforcement agencies lack the necessary information to perform such a fine balancing of costs and benefits. Moreover, as also argued below, the changing dynamic of the industry greatly complicates the issues involved in reaching such determinations.

By itself, the sheer pace of change occurring in the industry should give pause to anyone hoping to quantify and compare benefits and harms. With organizational and other innovations developing at a frenetic pace, deriving reliable estimates of expected cost savings attributable to collaboration and proving their superiority to alternatives is likely to be impossible. Moreover, separating those gains truly attributable to collaboration from those likely to be achieved through diffusion of information in the market may pose an insurmountable challenge. For example, in a recently litigated challenge to a hospital merger, the defendants sought to prove that the merger would speed the adoption of "best practices" within the acquiring hospital.[74] This claim was based on the view that a merger would materially improve the hospitals' delivery of services by enabling them to compare their clinical practices. Though scale economies may exist in gathering information, it is very likely they can be achieved by accessing databases other than those belonging to rivals in a relevant market.

Employing trade-off analysis in health care matters is also questionable on the grounds that it may be impossible to determine the net effect of collaboration. To do so requires one to assess with passable accuracy the extent of market failure and the degree to which the activity itself will mitigate these imperfections, or the extent to which health care reform legislation or other economic change will do so. Put another way, "second best" problems are particularly acute in the presence of market failure because one can never be certain that improving one aspect of the market will lead to any gains in consumer welfare.[75] Thus, what might appear to be

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74. *See* Trial Transcript at 1619–21, United States v. Mercy Health Servs., Civ. No. C94-1023 (N.D. Iowa 1994).

75. *See* Jonathan E. Fielding & Thomas Rice, *Can Managed Competition Solve the Problems of Market Failure?*, 12 HEALTH AFF. 216, 217 (Supp. 1993). *See generally* R.G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 REV.

a cost-lowering collaboration, such as consolidating clinical services at two hospitals, might offer little economic benefit if third-party payors lack information to appraise the adjusted quality/price value of the combination.

Moreover, in some instances claimed efficiencies may be illusory in light of market failures or other problems in the market. An illustrative example is provided by the question of how antitrust law should treat provider networks. A critical problem posed by consolidation is whether a sufficient number of efficiently sized provider networks will develop to support effective competition. Demographic evidence recently reported in the *New England Journal of Medicine* suggests that a significant proportion of local health care service markets lack the population base to support the minimum number of integrated networks necessary for interplan rivalry.[76] In antitrust terms, the concern is that the demographic features of many parts of the country dictate that only monopolistic or oligopolistic provider networks will emerge. Importantly, however, these markets will be unlikely to realize the corrective effects of competitive networks upon market imperfections. Thus, claimed cost savings attributable to network formation must be weighed against not only the deadweight losses attributable to concentrated market structures, but against the losses attributable to market failures that are likely to remain unchallenged in such circumstances.

ECON. STUDIES 11, 17–18 (1956) (criticizing use of "piecemeal welfare economics" to achieve increase in consumer welfare).

76. Richard Kronick et al., *The Marketplace in Health Care Reform: The Demographic Limitations of Managed Competition*, 328 NEW ENG. J. MED. 148, 150–51 (1993) (examining staffing patterns at several large staff-model HMOs and comparing that data to demographic evidence of population patterns in markets around the country). Assuming that at least three independent health plans are necessary to avoid oligopolistic interdependence and support effective competition, the Kronick study found that only 42% of the nation's population lives in market areas that could support three "classic HMOs" offering referral hospital services and using their own staff physicians; 63% of the population lives in markets that could support three plans providing most primary care and most acute-care hospitals; and 71% lived in markets that could support three plans providing primary care and many basic specialty services, but would have to share certain specialty services such as cardiology and urology. *Id.* at 150–51, 174; *see also* Greaney, *supra* note 54, at 1521–23 (suggesting demographics may limit health care industry's movement toward integrated health plans).

V. ANTITRUST ENFORCEMENT TRANSMOGRIFIED: THE ANTITRUST DIVISION, THE FTC, AND STATE ATTORNEYS GENERAL AS REGULATORS OF THE HEALTH CARE INDUSTRY

A striking feature of the DOJ and FTC's approach to health care industry matters is the agencies' increasing reliance on regulatory modes of law enforcement. Though part of a broader trend in federal antitrust policy, this phenomenon has been more prominent in the agencies' approach to the health care industry than in any other sector. In adopting a decidedly rule-oriented, administrative approach to imposing competition norms upon health care providers and payors, the agencies have subtly shifted the locus of much decision-making authority in federal antitrust matters to themselves and away from the federal courts. This change offers undoubted benefits in reducing uncertainty and costs; however, because it operates without the protections normally applied to administrative procedures, it also poses significant risks.

As Professor Kauper has put it, in recent years the FTC's Bureau of Competition and the DOJ's Antitrust Division have moved away from a "law enforcement" model in which "the exercise of discretion [was] bounded by consideration of factors already judicially recognized."[77] In its place, the agencies have substituted regulatory techniques more analogous to the quasi-legislative decision-making processes of administrative agencies. Specific examples include the issuance of guidelines and policy statements; the negotiation of consent decrees and other settlements of actual or threatened litigation; the increasing level of resources devoted to issuing advisory opinions; and the numerous speeches, testimony, and other pronouncements of agency officials.

In many respects these efforts resemble agency rulemaking more than law enforcement through litigation.[78] In contrast to litigation, in which authoritative rules emanate exclusively from the judiciary, standards of conduct under quasi-rulemaking derive principally from the agencies' pronouncements or, in the case of litiga-

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77. Thomas E. Kauper, *The Justice Department and the Antitrust Laws: Law Enforcer or Regulator?*, *in* 1 THE ANTITRUST IMPULSE: AN ECONOMIC, HISTORICAL AND LEGAL ANALYSIS 435, 466 (Theodore P. Kovaleff ed., 1994); *see also* E. Thomas Sullivan, *The Antitrust Division as a Regulatory Agency: An Enforcement Policy in Transition*, 64 WASH. U. L.Q. 997, 1001–02, 1045–46 (1986) (contending shift to regulatory scheme is more cost effective than enforcement scheme).

78. Kauper, *supra* note 77, at 466. Rulemaking is broadly analogous to legislating because the agency frequently has wide discretion to adopt rules, interpret statutes, and exercise prosecutorial discretion in enforcing prohibitions. *See* RICHARD PIERCE ET AL., ADMINISTRATIVE LAW AND PROCESS 307, 329 (1985).

tion settlements, from explicit regulation of conduct through negotiation of consent decrees. At the same time, private remedies, which once served as a check on such exercises of governmental authority, have been undermined by stringent rules on standing, antitrust injury, and the like.

This trend is especially pronounced in the agencies' approach to the health care industry. Both the FTC and DOJ have devoted enormous resources to issuing speeches, guidelines, business review letters, and advisory opinions.[79] In addition, the great majority of federal civil lawsuits and administrative proceedings are settled by negotiation and consent decrees or orders in lieu of litigation. In these instances the enforcement agencies, not the courts, have the final say in determining the boundaries of acceptable conduct. Moreover, the Health Care Policy Statements, which represent a broad synopsis of analytic methodology and delineation of safe-harbor conduct and relevant evidence, can be seen as a top-down directive designed to influence the nature of industry collaboration. Like the Merger Guidelines, the Policy Statements will probably have enormous practical impact in shaping the behavior of industry participants. Because of the absence of clear precedent in many areas, risk-averse providers and payors will undoubtedly be inclined to conform to safe harbors contained in the Policy Statements or otherwise follow their dictates.

It bears noting that the federal agencies are not alone in adopting highly regulatory forms of antitrust interventions. Perhaps the most complete union of regulation and adjudication has occurred in the several instances in which state attorneys general have negotiated highly prescriptive consent decrees in settling antitrust challenges to hospital mergers. In Pennsylvania, for example, the state approved a hospital merger on the condition that the hospitals provide $31.5 million worth of free or low-cost health services against their promised $40 million in net cost savings.[80] Similarly, Massachusetts recently settled its concerns about a hospital merger on the promise that prices at the acquired hospital would not be raised to a level higher than those charged by the acquiring hospital.[81] Nota-

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79. *See* 1991 A.B.A. SEC. ANTITRUST L., COMPENDIUM OF INFORMAL ANTITRUST ENFORCEMENT AGENCY ADVICE IN HEALTH CARE (collecting advisory opinions and speeches); 2 JOHN J. MILES, HEALTH CARE & ANTITRUST LAW: PRINCIPLES AND PRACTICE (1992) (same).

80. Pennsylvania v. Providence Health Sys., No. 4CV-94-772, 1994 WL 374424, at *2–3 (M.D. Pa. May 26, 1994).

81. *Massachusetts Hospitals Resolve State's Concerns About Merger Plans*, 67 Antitrust & Trade Reg. Rep. (BNA) 16 (July 7, 1994); *see also Hospitals Resolve State Concerns About Merger's Effects on Competition*, 3 Health L. Rep. (BNA) 3

bly, in both instances the states were willing to bargain for a straightforward cash payment in return for granting the merged entities increased market power. Indeed, this can be seen as a direct application of the efficiency trade-off in a regulatory context.

This emergence of regulatory modes of antitrust enforcement has its good and bad points. It is no doubt useful for the agencies to lead the way and help resolve uncertainties in areas in which precedent is scarce, antiquated, or uninformed by economic developments. These processes may also reduce costs and delays associated with litigation while allowing government agencies to retain a firm hand on antitrust's application to an important sector of the economy undergoing rationalization.[82] On the other hand, it is precisely where the agencies are "out in front" that they run the risk of inappropriately biasing marketplace results. When these quasi-regulatory processes are unchecked by judicial review, public participation, or the benefits of the inductive method of decision making,[83] concerns about adverse consequences become heightened.

To some extent, the informal decision making exemplified by the DOJ/FTC regulatory juggernaut may be seen as a crude means of industrial policy making. For the health care sector, this means the federal antitrust agencies are called upon to assess which mergers and joint ventures possess the potential to reduce costs; what information on patient costs and outcomes may be shared among providers or buyers; how many physicians' noses may go under the tent of an integrated delivery system or PPO; and how many hospitals may share in the ownership of an MRI, PET scan, or laundry service.

Perhaps, however, the greater risk is that this process will become highly politicized. Though the magnitude of this delegation

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(Jan. 1, 1994) (settling state's competition concerns about merger on hospitals' agreement to maintain prices at annually adjusted levels); *Merging HMOs Agree to State Plan on Social Spending, Contract Approvals*, 4 Health L. Rep. (BNA) 6 (Jan. 20, 1995) (settling state's objections to merger of second and third largest HMOs on agreement to freeze group rates for one year, double enrollment in Medicare risk program, and spend $4 million on social services such as health care for the homeless, violence prevention and AIDS prevention).

82. *See* Sullivan, *supra* note 77, at 1048–49.

83. *See* John J. Flynn, *Antitrust Policy and Health Care Reform*, 39 ANTITRUST BULL. 59, 67–69, 88 n.71 (1994); *see also* H.R. REP. NO. 399, 99th Cong., 1st Sess. 11 (characterizing DOJ Vertical Restraints Guidelines as "an amicus brief 'form book', designed primarily to influence courts in private cases to which the Division is not a party and with the further intended effect of reducing the incidence of such cases in the future" and failing "to see the need for a clarification of the Division's enforcement intentions in an area where it has unmistakably shown its intention not to enforce the law").

might strike some as inconsistent with the widespread sentiment evident in the health reform debate in the 103d Congress to "keep the government out of health care,"[84] the more precise problem lies in the nature of the government's involvement in these decisions. Operating as a quasi-regulator, the agencies face a number of practical constraints that will undermine their ability to effectively perform the efficiency trade-off. For example, responding to a large number of requests for advisory opinions on a self-imposed ninety-day schedule and analyzing mergers within statutory time constraints leaves little room to gather reliable information on efficiencies.[85] As Dennis Yao has written, in such circumstances information vital to performing ex ante reviews of business conduct is asymmetrically distributed and potential defendants are often able to manipulate the process to their advantage.[86] Even more problematic is the lack of safeguards and transparency that both agency adjudication and explicit regulation afford. That is, the process lacks open disclosure of underlying facts, there is no separation of decision makers from advocates, the give and take of the adversary process is absent, and the rationale for outcomes is often not fully elaborated.

VI. PERFORMING THE EFFICIENCY TRADE-OFF: EVIDENTIARY HURDLES AND DOCTRINAL LANDMINES

As even its proponents acknowledge, the efficiency trade-off poses extraordinarily difficult practical problems and entails a host of judgments and assumptions that have not been resolved or, in some cases, even addressed by the courts. The magnitude of this predicament raises questions about the sincerity and feasibility of the government's professed willingness to undertake the challenge.

The Health Care Policy Statements sketch a straightforward approach to analyzing efficiencies arising from health care joint ventures and mergers.[87] Where competitive problems are identified under the rule of reason or merger analysis, the agencies will un-

84. *See* 140 CONG. REC. S9655-01, 9659 (daily ed. July 29, 1994) (statement of Sen. Bob Kerrey); 139 CONG. REC. S7815-04, 7847 (daily ed. June 24, 1993) (statement of Sen. Bob Kerrey).

85. The Policy Statements invite requests for advisory opinions, and promise to respond within 90 days for most matters (120 days for mergers). 1994 Health Care Policy Statements, *supra* note 1, at 20,771.

86. Dennis A. Yao & Thomas N. Dahdouh, *Information Problems in Merger Decision Making and Their Impact on Development of an Efficiencies Defense*, 62 ANTITRUST L.J. 23, 23–24, 32 (1993).

87. *See* discussion *supra* part III (summarizing specific provisions contained in 1994 Health Care Policy Statements governing efficiencies).

dertake a trade-off analysis of harms and benefits. Efficiencies of all kinds (including qualitative improvements) will be identified and evaluated.[88] Unless achievable by less anticompetitive means, these benefits will be balanced against potential competitive harms, perhaps with the caveat that consumers should benefit from these savings. The agencies' skeletal account of their methodology raises a host of questions regarding what shortcuts, benchmarks, or rules of thumb they will use and what policy judgements they will make regarding the merits of claimed efficiencies. This section describes a few of these unaddressed problems and the particular difficulties they pose in dealing with collaboration in the health care industry.

A. *Can Efficiencies Be Measured?*

Problems associated with measuring efficiencies and the resulting harm to competition supply the principal objection to incorporating the Williamson trade-off in antitrust analysis. As one scholar put it, "to admit an economies defense that proceeds by measurement would force us to an unacceptably narrow horizon. Economists, like other people, will measure what is susceptible of measurement and will tend to forget what is not, though what is forgotten may be far more important than what is measured."[89] Some observers may be surprised to learn that the author of that statement is Robert Bork, who, along with Judge Posner and other authorities identified with the Chicago school, oppose recognition of an efficiencies defense in merger cases.[90] These critics are quick to point to the fact that trade-off analysis requires at least an approximate quantification of allocative and other efficiency losses associated with the merger. This in turn requires knowledge of complex economic facts such as demand and supply elasticities, the magnitude of entry barriers, and other information that is beyond the capacity of the litigation process to acquire.

Even proponents of the defense acknowledge that efficiencies are "easier to assert than prove" and that they can be measured

88. *See* Mark J. Horoschak, Assistant Director, Bureau of Competition, FTC, Remarks Before the Washington State Hospital Association 17 (Sept. 25, 1993) (on file with FTC Bureau of Competition) ("[W]e evaluate the impact of procompetitive efficiencies attributable to the joint venture, including such things as reduction in per service costs and potential improvement in quality flowing from providers gaining experience and skill from performing a larger number of procedures.").

89. BORK, THE ANTITRUST PARADOX, *supra* note 12, at 127.

90. POSNER, *supra* note 19, at 112 ("[T]he measurement of efficienc[ies] . . . [is] an intractable subject for litigation . . . ."); *see also* BORK, THE ANTITRUST PARADOX, *supra* note 12, at 125 ("Passably accurate measurement of the situation is not even a theoretical possibility . . . .").

only in the roughest sort of way.[91] Notably, most proponents of the defense acknowledge the existence of problems and would fence in the inquiry with presumptive rules or categorical limits on the kinds of efficiencies that count.[92] Unfortunately, the Health Care Policy Statements give no indication of whether or how their inquiry will be bounded. Moreover, one cannot expect to learn much from the accretion of precedent given the agencies' emphasis on quasi-regulatory procedures that lack transparency and precedential force.

In any event, any attempt to measure efficiencies must confront a number of thorny problems.

1. Quality

A merger or joint venture may affect quality as well as costs. Thus, a rigorous Williamsonian welfare analysis must consider not only the trade-off between cost savings and consumer prices, but must proceed along three dimensions. As Fisher and Lande framed the problem, the question is "How much of a decrease in costs would compensate for an x percent increase in price, if we also expect quality to increase by y percent (or to decrease by z percent)?"[93] This already Herculean task becomes even more difficult when one considers the complexities of analyzing quality issues in health care.[94] A sizeable literature stresses the conundrums associated with both identifying quality (what counts—inputs, outcomes, amenities, "caring," waiting times, etc.?) and measuring quality.[95] Leaving quality out of the equation, however, is no solution. A large number of epidemiological studies demonstrate the very real and important quality advantages associated with having a sufficient number of procedures performed by providers.[96] Hence, quality factors present a paradox: they are likely to be of central importance to evaluating the net effects of collaborative undertakings but are of

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91. Pitofsky, *supra* note 19, at 206–27.

92. *See infra* part VII.

93. Fisher & Lande, *supra* note 19, at 1634.

94. Courts have generally avoided the issue by faulting defendants' proof for failure to prove that less restrictive means of achieving the benefits were not available. *See* United States v. Rockford Memorial Corp., 717 F. Supp. 1251, 1290–91 (N.D. Ill. 1989) (rejecting claimed efficiencies based on standardization of clinical practices because savings could be achieved by hiring consultant in lieu of merger of hospitals), *aff'd*, 898 F.2d 1278 (7th Cir.), *cert. denied*, 498 U.S. 920 (1990).

95. *See* AVEDIS DONABEDIAN, THE DEFINITION OF QUALITY AND APPROACHES TO ITS ASSESSMENT 27–28 (1980); Avedis Donabedian, *A Primer of Quality Assurance and Monitoring in Medical Care*, 20 U. TOL. L. REV. 401 *passim* (1989).

96. *See* Barry R. Furrow, *The Changing Role of the Law in Promoting Quality in Health Care: From Sanctioning Outlaws to Managing Outcomes*, 26 HOUS. L. REV. 147, 160–62 (1989).

uncertain dimension and not susceptible to measurement (or "monetization") so that they could be used to offset economic losses associated with the transaction.

2. Timing

The trade-off inquiry must take into account the timing of the various predicted effects of the collaboration or merger. Thus, estimates of costs and benefits must be adjusted for the discounted present values of those quantities over time.[97] A host of facts would be required to rigorously perform this calculation, such as the length of time the collaborating firms' market power will last before being eroded by entry or changing technology, and the likelihood and time period within which the firms would have achieved the efficiency without combining.[98] Again, the rapidly changing technology and shifting organizational structures occurring in the health care industry render such appraisals of future contingencies hopelessly speculative. Finally, the uncertain and volatile regulatory climate in health care introduces additional uncertainty because it is impossible to predict whether future monopoly harms will be curtailed or mitigated by government intervention.

3. Market-Wide Effects

The efficiency trade-off calculation also requires an assessment of market-wide effects. Evaluation of the harmful effects must include an estimate of whether unilateral market power, umbrella pricing, tacit collusion, or express collusion is likely, in addition to an estimate of the magnitude of the harm.[99] Again, calculating these effects in even the roughest sort of way is likely to prove impossible, especially in a market subject to rapid regulatory, technological, and organizational change. On the other side of the coin, the possibility that the merger could cause a more rapid diffusion of efficiencies throughout the market should be considered.[100]

4. "Real" and "Net" Efficiencies

Economists draw an important distinction between "real" and "pecuniary" efficiencies. While the former involve resource savings in per-unit costs associated with production, the latter include savings that do not make the economy more productive or conserve

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97. *See* Fisher & Lande, *supra* note 19, at 1635–36.
98. *Id.*
99. *Id.* at 1636–38.
100. Roberts & Salop, *supra* note 13, at 33–35.

resources, but instead merely transfer costs to some other person.[101] In certain health care collaborations it may be especially difficult to distinguish pecuniary economies. In many instances, purported savings associated with collaboration result from discounting by vendors or buyers; thus, costs may be passed on to others. The phenomenon of "cost shifting," which is prevalent in health care markets,[102] should not count as real cost savings because the lowered costs caused by the joint venture are actually passed on to others and no real resource savings occur.

Further, there is substantial agreement that only "net efficiencies" should be balanced against possible harms. Hence, a court or agency must first estimate the costs and possible diseconomies of the transaction and then subtract those costs from the credit column.[103] For example, in a case involving the merger of two small hospitals in Ukiah, California, the FTC claimed that the substantial capital expenditures necessary to build a facility to accommodate the patients of the combined entity outweighed any efficiency savings from the merger.[104] Thus, an "offset to the offset" was claimed: even though the merger would help the hospitals approach minimum efficient scale, capital and other costs necessary to achieve those benefits needed to be placed in the calculation of net efficiencies.[105]

Calculating net efficiencies poses several problems. First, measuring the costs of the combination depends on assumptions about the costs of acquisition, value of divested plants and equipment, and the time period within which those costs are to be evaluated. Moreover, proof of diseconomies may be particularly speculative, as in the case of inefficiencies lost by "clashes of corporate culture" and other adjustment problems associated with mergers. Although these risks are virtually impossible to establish ex ante, the economic literature concerning the large proportion of unsuccessful mergers that ended in spinoffs suggests that the risks may be substantial.[106]

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101. For example, tax savings associated with mergers are "pecuniary" rather than real because while they reduce the merging firms' costs, they are offset by revenue losses to the government. HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE 455 (1994); John E. Kowka, Jr. & Frederick R. Warren-Boulton, *Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis*, 31 ANTITRUST BULL. 431, 433–34 (1986).

102. *See* PAUL STARR, THE LOGIC OF HEALTH-CARE REFORM: WHY AND HOW THE PRESIDENT'S PLAN WILL WORK 38 (1994).

103. *See* Fisher & Lande, *supra* note 19, at 810–11.

104. Adventist Health Sys./West, 5 Trade Reg. Rep. (CCH) ¶ 23,591 (FTC Apr. 1, 1994).

105. *See* Steptoe, *supra* note 67, at 10–12.

106. *See* DAVID J. RAVENSCRAFT & F.M. SCHERER, MERGERS, SELL-OFFS AND ECO-

5. *Assessing Probabilities*

Ideally, weighing efficiencies should also entail assessments of probabilities. Most commentary suggests that the required showing of efficiencies should vary inversely with the magnitude of the competitive harm from the merger. A sliding scale approach would allow, for example, courts to approve moderately concentrative mergers on a showing of substantial efficiencies while not allowing modest efficiencies benefits to save a merger that creates a monopoly. In its decision in the *Honickman* case,[107] the Federal Trade Commission approved certain acquisitions based not only on the magnitude of potential efficiencies and harms, but on the degree of certainty that each would occur.[108] Skeptics point out that courts and agencies lack experience to make fine judgments of this sort, especially given the lack of experience in dealing with efficiencies defenses in litigated cases.[109]

B. *Are There Less Anticompetitive Alternatives?*

The prevailing wisdom, reflected by the Merger Guidelines[110] and most commentary,[111] is that efficiencies attainable by less anticompetitive means should not be permitted to offset anticompetitive harms. This qualification entails a number of subsidiary factual determinations. First, is the joint venture/internal expansion feasible given market demand, the "capacity effect," rivalries in the market, regulatory constraints, and so forth? Second, is the internal expansion, though possible, likely to occur? For joint ventures, an often overlooked factor lessening feasibility is the significant transaction costs (opportunism, contracting problems, uncertainties—especially regarding legal risks) that inhibit contracting, especially among rivals. The most common obstacles resulting in the failure of hospitals to agree on joint operation of costly equip-

NOMIC EFFICIENCY 1–2 (1987).

107. Harold A. Honickman, [1987–1993 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 23,286 (FTC Nov. 16, 1992).

108. *Id.* at 22,966 (approving soft drink bottler's acquisitions of only those franchises where efficiencies were certain to occur).

109. Pitofsky, *supra* note 19, at 220 n.87.

110. Merger Guidelines, *supra* note 23, § 4.

111. *See, e.g.*, Kattan, *supra* note 19, at 528 ("The one requirement on which there is a broad consensus is that cognizable efficiencies must be merger-specific, that is, they cannot reasonably be attained through means that are less restrictive of competition."); Pitofsky, *supra* note 19, at 220 (contending no efficiency defense should apply in merger cases if efficiencies are achievable "in a *substantially* less restrictive way").

ment or services include the inability to agree on geographic location, concerns about strategic steps such as "gaming" referrals, and the inability to specify contingencies or their remedies.

C. Will Cost Savings Be Passed Along to Consumers?

Some authorities have suggested that efficiencies should be taken into account in merger cases only if the merging parties can demonstrate that the savings resulting from efficiencies will be passed on to consumers.[112] This requirement, characterized by Pitofsky as a "killer qualification" because of the impossible proof standard it entails,[113] makes little sense. Even a monopolist will respond to lower marginal costs by reducing price and increasing sales. Presumably, advocates of this prerequisite to the efficiencies defense are to be understood to mean that *all* cost savings will be passed on to the consumer in the form of lower prices and increased output. However, as Professor Pitofsky has argued, the only sure proof that such a pass-along would occur requires establishing that the market was nearly perfectly competitive—circumstances in which no merger defense would be required in the first place.[114] The only situation in which the agencies could be reasonably assured that consumers will reap the benefits is where the claimed efficiencies involve quality-of-care improvements from enhanced specialization, new services, or improved outcomes. In the end, the attempt to discern whether benefits will be passed along to consumers reflects the general failure of antitrust to resolve the fundamental issues regarding the appropriate welfare standard to be applied in efficiencies analysis, as discussed above in Part II.B.

D. Network Efficiencies and Exit Externalities

Certain efficiency claims that may have particular relevance to the health care industry have as yet received little attention from the enforcement agencies or courts. Because of inherent difficulties in estimating their magnitude, however, they are unlikely to be considered in any rigorous way even under the most ambitious application of the efficiency trade-off. Nevertheless, these efficiencies embrace some of the most significant potential cost savings likely to be realized in the current environment.

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112. *See, e.g.*, Judy Whalley, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, Remarks at the 29th Annual Antitrust Seminar of the Practising Law Institute 19–20 (Dec. 1, 1989).

113. Pitofsky, *supra* note 19, at 207, 221.

114. *Id.* at 207–08.

The first, which has been raised in several recent merger investigations, concerns "network efficiencies"—the possibility, for example, that a merger expanding a hospital's product or geographic range produces "positive externalities."[115] That is, the broader network offering of hospitals made possible by the merger may enable consumers to realize the benefits associated with having wider choice. Thus, employers purchasing health insurance for their employees may desire to contract with a network offering wide geographic coverage and access to a large choice of physicians because their employees are widely dispersed and many families are served by multiple physicians. In such circumstances, the whole can be greater than the sum of the network's parts because consumers benefit from having a large number of other consumers use the network in a manner roughly analogous to ATM networks. This issue, which was raised in a recent hospital merger case examined by the FTC,[116] suggests the possibility that broad networks may realize important economies that partly offset anticompetitive harms.

A second efficiency associated with reorganizing industries is attributable to externalities of exit. In these circumstances, consolidations may reduce the losses experienced in declining industries by easing the path of exit for some participants and counteracting strategic incentives that block efficient industry rationalization.[117]

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115. "Network externalities" exist when the utility that a user derives from consumption of a product or service increases with the number of other persons consuming the good. Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424, 424–25 (1985). For example, a consumer of personal computers would be interested in the number of other individuals purchasing similar hardware because the amount of software available will vary according to the number of hardware units that have been sold. *Id.* These so-called consumption externalities can give rise to economies of scale. That is, "if consumers expect a seller to be dominant, then consumers will be willing to pay more for the firm's product, and it will, in fact, be dominant." *Id.* at 425; *see also* Michael L. Katz & Carl Shapiro, *Technology Adoption in the Presence of Network Externalities*, 94 J. POL. ECON. 822, 824 (1986) (discussing effects of network externalities on industry development).

116. *See In re* Healthtrust, Inc., 59 Fed. Reg. 38,176 (FTC July 27, 1994) (consent order). In *Healthtrust*, the merging parties contended unsuccessfully that the merger would permit the formation of a hospital network for managed-care contracting and that the required divestiture would deprive it of a critical link (a tertiary care facility in the Salt Lake City metropolitan area) in that network necessary to achieve network and operational efficiencies. *See id.* at 38,183 (Yao, Comm'r, dissenting). Another factor noted by Commissioner Yao was the inadequacy of joint ventures or contracting as an alternative to merger because of the need to deter "gaming" of referrals, that is, passing on costly patients to other hospitals. *Id.* (Yao, Comm'r, dissenting).

117. *See* Malcolm B. Coate & Andrew N. Kleit, *Antitrust Policy for Declining*

It should be stressed, however, that recognition of such efficiencies could be effected in only a very general way. Accordingly, such innovation should probably await development of a more acceptable methodology for incorporating efficiencies analysis in general.

VII. PROPOSALS FOR RATIONALIZING EFFICIENCY TRADE-OFF ANALYSIS

The courts and the enforcement agencies have made little progress in addressing the difficult problems discussed above. As noted, the prevailing approach in dealing with joint ventures or other cooperative activity has been to avoid explicit balancing by using "screens" of market power or less restrictive alternatives that can truncate the inquiry. Likewise, the litigated merger cases, which have only recently begun to weigh efficiencies against possible anticompetitive effects, have employed comparable screening devices such as asking whether claimed efficiencies are "merger specific."[118]

Several commentators have advanced proposals for developing a workable methodology for performing trade-off analysis in antitrust cases. It should be remembered that these reforms involve a number of normative and empirical judgments. As previously discussed in Part II.B, the contours of any efficiencies defense will rest largely upon which efficiencies one believes should count: whether wealth transfers should be an appropriate part of the equation, whether dynamic effects can or should be included, and the degree of uncertainty attached to each proposed proof requirement.

While a comprehensive synthesis of the proposals is beyond the scope of this Article, this section describes some of the options available to courts and the enforcement agencies. It suggests that the FTC and the DOJ consider adopting a structured efficiencies defense that incorporates some of the proposals set forth below, and that they explain in greater detail their methodology for performing the trade-off analysis.

A. Identification and Measurement of Efficiencies

To deal with the intractable problem of calculating the magnitude of efficiencies, several authorities have suggested means by which rough-and-tumble qualitative assessments may be undertak-

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Industries, 147 J. INST. & THEORETICAL ECON. 477, 480–81, 494 (1991) (advocating efficiency defense for mergers taking place in declining industries).

118. *See supra* notes 31–32 and accompanying text (discussing courts' use of screening devices).

en. For example, Professor Pitofsky has proposed that factfinders make a rough calculation of whether efficiencies are "high, medium or low."[119] He posits that the degree of integration undertaken by the venture offers a broad proxy for the efficiencies that can be presumed to result from the collaboration.[120] Others, including Professors Areeda and Turner, propose recognizing only certain categories of efficiencies, or that proponents of certain kinds of efficiencies meet a higher standard of proof.[121] Ultimately, such rules rest on judgments about the probability of the occurrence, measurability, and speculativeness of each category. A final approach, and one that leads to a more expansionary view of permissible efficiency claims, emphasizes the potential of mergers and joint ventures to speed up the process of diffusion of innovation through markets. This analysis proposes an assessment of the efficiencies resulting from the merger-induced emulation and imitation. Under some circumstances, this may include effects on fixed costs as well as variable costs.[122]

B. *When May the Efficiencies Defense Be Asserted?*

Some supporters of the efficiencies defense in merger cases have suggested that it may be confined by limiting its use to "close" cases, presumably those involving only moderate levels of concentration and where it is most likely that efficiencies will outweigh risks.[123] Others have suggested quantitative minimum efficiencies for asserting the defense.[124] Such thresholds are justified by their propensity to reduce the costs and the chances of error in adminis-

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119. Pitofsky, *supra* note 19, at 206.

120. *Id.* at 218.

121. 4 AREEDA & TURNER, *supra* note 23, ¶ 949 (finding little ground for recognizing specialization economies, capital cost, procurement, overhead, or combination of complementary resources; finding economies defense weak when based on distribution, promotion, or research and development, but finding defense strong when based on scale economies); *see also* Merger Guidelines, *supra* note 23, § 4 (recognizing "economies of scale, better integration of production facilities, plant specialization, lower transportation costs, and similar efficiencies relating to specific manufacturing, servicing, or distribution operations . . . [and allowing for possibilities of others but noting such efficiencies] will be difficult to demonstrate"); Pitofsky, *supra* note 19, at 217–18 (rejecting efficiencies claims based on superior management, distribution savings, joint advertising, and cost of capital).

122. *See* Roberts & Salop, *supra* note 13, at 63–74.

123. Pitofsky, *supra* note 19, at 219–21 (contending efficiencies defense should be allowed only in moderately concentrated markets where merged firm holds less than 35% of market); *see also* 4 AREEDA & TURNER, *supra* note 23, ¶ 961 (contending that merging firms must be "inefficiently small" to assert efficiencies defense).

124. *See, e.g.*, 4 AREEDA & TURNER, *supra* note 23, ¶ 946e (suggesting defense should require proof of 5% cost savings).

tering the defense.

C. *Market Failure as a Prerequisite*

Some commentary questions the basis for efficiencies offsets whenever they entail subordinating consumer interests to productive or allocative efficiency gains. These scholars, who view antitrust goals as embracing the preservation of consumer surplus and preserving competitive opportunities, insist upon a showing that a competitive market failure exists.[125] This view would limit application of the trade-off to situations in which the consumer is better off in the long run because the temporary sacrifice of the consumer's interest will result in long-term production or other efficiencies that increase total social wealth.[126] Another suggestion is to limit the defense to those industries in which market forces are unlikely to foster internal expansion or other less anticompetitive means of realizing efficiencies. Thus, Areeda and Turner would permit the efficiencies defense only where market demand is "declining, stable, or expanding very slowly."[127]

D. *Time Horizon and Ex Ante Analysis*

A critical problem with assessing efficiencies is that the inquiry is almost always prospective; factfinders must appraise the potential efficiencies and harms before the collaborative activity begins. This adds to the speculativeness of the inquiry and, perhaps, to the unwillingness of courts and agencies to undertake the task. Some commentators have suggested that a two-stage procedure be devised so that antitrust enforcement agencies can undertake an ex post review of whether claimed efficiencies were in fact realized.[128] This approach might lessen the burden at the ex ante stage of review, for example, by requiring only that efficiencies be plausible and are the least restrictive means for achieving the procompetitive ends.

A related issue is the time horizon within which efficiencies must be realized. Given the uncertainties involved in calculating efficiencies and harms, no hard and fast time frame is likely to prove administrable. However, courts need to have in mind some time limit which frames the occurrence of harms and efficiencies in order to meaningfully balance harms and benefits.[129] The logic of

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125. Brodley, *supra* note 8, at 1038–39, 1045–47.

126. *Id.* at 1045–46.

127. 4 AREEDA & TURNER, *supra* note 23, ¶ 946e.

128. *See, e.g.*, Brodley, *supra* note 8, at 1048.

129. Ideally, this analysis would entail balancing short-run harms against long-run gains by discounting the future. *See* Roberts & Salop, *supra* note 13, at 61–62

such a proposal follows the application of a time horizon in entry analysis: consumers should not have to endure serious economic problems for promised benefits that may take many years to come about.[130]

E. "Sliding Scales" and Threshold Requirements

As pointed out in Part VI.A, the actual mechanics of performing the balancing raises enormous practical difficulties. Assuming no precise measurement is possible, the issue for antitrust doctrine becomes whether a predictable and administrable formulation can be devised for performing that balancing.[131] There are a number of means available to reduce both the risks of judicial error and the incentives for unmeritorious litigation involving claimed efficiencies.

The most straightforward and obvious requirement is to align the substantive rules governing efficiencies with the underlying economic theory that supports their consideration as a defense in the first place. Thus, most authorities and commentators agree that efficiencies and harms should be assessed on a sliding scale.[132] That is, an efficiencies analysis should insist that the greater the anticompetitive threat, the greater the magnitude of efficiencies required to offset competitive concerns. Another approach would set a minimum threshold for efficiency showings.[133] Presumably, this would serve the salutary purpose of obviating the need for detailed

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(summarizing procedure as "estimating the present value of the gains and losses and permitting only those combinations in which gains exceed losses, taking the time value of money into account in the form of a discount rate").

130. *Cf.* Merger Guidelines, *supra* note 23, § 3.2 (defining "timely entry" as occurring within two years). *See generally* Paul T. Dennis, *An Insider's Look at the New Horizontal Merger Guidelines*, ANTITRUST, Summer 1992, at 10; John C. Hilke & Philip B. Nelson, *The Economics of Entry Lags: A Theoretical and Empirical Overview*, 61 ANTITRUST L.J. 365, 365–67 (1993) (noting time of entry may vary between industries).

131. Professor Brodley has characterized the challenge posed by incorporating an efficiencies defense as follows:

> An efficiencies justification applied to individual transactions greatly complicates antitrust analysis and has the potential to weaken antitrust enforcement . . . The challenge for antitrust is to devise simple and transparent legal tests that will effectively screen efficiency claims and that will not be used to undermine the competitive principle.

Brodley, *supra* note 8, at 1046.

132. *See* Kattan, *supra* note 19, at 518–19; Roberts & Salop, *supra* note 13, at 58; *see also* Merger Guidelines, *supra* note 23, § 4 ("expected net efficiencies must be greater the more significant are the competitive risks").

133. *See, e.g.*, 4 AREEDA & TURNER, *supra* note 23, ¶ 946e (suggesting that cost savings exceed 5% of total costs); Muris, *supra* note 19, at 419–20 (proposing 1% to 2% threshold).

evaluation of trivial economies and thus discourage unmeritorious litigation. A third approach would establish heightened evidentiary standards for an efficiencies defense that would discourage needless litigation.[134]

VIII. Conclusion

The current movement to reinvent health care delivery and financing finds providers and insurers adopting a wide variety of collaborative arrangements. These changes reflect intensified concerns about efficiency as the industry strives to find the most cost-effective methods of doing business. Contemporary antitrust doctrine supports the growth of joint ventures, mergers, and other forms of vertical and horizontal integration necessary to achieve these objectives. But at the same time, antitrust enforcement's proper focus must be to prevent overly broad ventures and other collaborations that may retard the spread of these incentives.

In limited instances, it is undoubtedly true that efficiency improvements come at the cost of greater market power. In an ideal world, antitrust tribunals and enforcers would perform a trade-off analysis to appraise whether potential benefits exceed potential harms. Unfortunately, there is little evidence that courts, agencies, or economists are up to performing this task with any reasonable degree of accuracy. Nevertheless, the FTC and DOJ have leaped into the fray in their Health Care Policy Statements claiming they will entertain claims that significant efficiencies justify competitive harms, and that they will incorporate such analyses in deciding whether to prosecute antitrust violations. Rather than embark on an open-ended inquiry into all possible efficiencies without the tools to measure or balance them, this Article suggests that the agencies articulate a structured methodology for recognizing efficiencies offsets.

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134. *See, e.g.*, United States v. Rockford Memorial Corp., 717 F. Supp. 1251, 1289 (N.D. Ill. 1989) (requiring "clear and convincing" evidence of efficiencies), *aff'd*, 898 F.2d 1278 (7th Cir.), *cert. denied*, 498 U.S. 920 (1990); 1984 Merger Guidelines, *supra* note 29, § 3.5 (same).