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In This Issue

Canadian Competition Bureau Clears Brewers' Restrictive Contracts — For Now

By William C Myslinski

The Canadian Competition Bureau recently announced an important decision concerning alleged restrictive practices in the beer industry. On April 29, 2003, the Bureau concluded that the practices of the Molson and Labatt breweries in contracting with retailers did not substantially reduce competition in the Quebec beer market. Nonetheless, because of its concerns with brewers' market shares and the potential of the contract clauses at issue to cause harm, the Bureau reserved the right to revisit the market to determine the long-term effects of those practices. This result is noteworthy both to followers of beer distribution issues and to those interested in the application of the Competition Act in Canada.

The Bureau initiated its inquiry in response to complaints by certain microbreweries. The inquiry focused on exclusive dealing and "abuse of dominance" by Molson and Labatt in Quebec. In particular, the microbrewers were concerned with contract provisions Molson and Labatt entered into with licensed retail establishments. These provisions affected sales for both on-premises and home consumption. Among the contract clauses investigated were exclusivity clauses, shelf-space allocation clauses, clauses requiring establishments to sell certain brands at the same price as their competitors, clauses restricting advertising, and right of first refusal clauses. These clauses were potential violations of Sections 77 and 79 of the Competition Act. Section 77 prohibits exclusive agreements that substantially lessen or are likely to substantially lessen competition. Section 79 prevents a company or group of companies that controls a market from engaging in behavior that "would eliminate, penalize, or discourage" competitors and thereby substantially prevent or lessen competition.

The Bureau's decision not to intervene followed a detailed analysis of the Quebec beer market. Despite finding distinct beer segments, such as discount, specialty, and import, the Bureau adopted beer as the relevant product market because it found that the segments were "not sufficiently distinct from one another to constitute separate markets." It defined the province of Quebec as the relevant geographic market. The Bureau determined that Molson and Labatt had 90% of the sales and the broadest range of brands in the market. No other brewer had a comparable distribution network or production capacity. Thus the Bureau found Molson and Labatt had "a certain market power in the Quebec beer market."

The Bureau also found that Molson and Labatt included potentially anticompetitive clauses in their contracts with many customers. Furthermore, these contracting practices were becoming increasingly widespread. The Bureau found no evidence of fighting brands or of predatory pricing.

Nonetheless, the Bureau found no harm to competition from the practices. During the period examined (1997 to 2001), the position of all competitors was not substantially diminished. Microbrewers increased the number of brands they offered and invested in additional

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FCC Media Ownership Rules

By Bruce M. Owen

Federal Communications Commission (FCC) restrictions on ownership of broadcast properties have been justified on both antitrust and First Amendment grounds. Neither justification is persuasive. To the extent that these rules serve antitrust goals, they duplicate enforcement by the antitrust authorities and should be abolished as wasteful of public resources and a burden on consumer welfare. Furthermore, maintaining these rules is not necessary to achieve First Amendment goals.

The antitrust aspect of media ownership concentration is best approached using the standard tools of economic analysis intended for such purposes. The modern approach to analysis of ownership concentration is illustrated by the framework set out in the DOJ/FTC Merger Guidelines. The Guidelines describe methods by which the government can assess the impact of a proposed transaction. Also, the Guidelines offer the private sector a rational basis to predict the likely reaction of the authorities to a proposed merger or acquisition, thus reducing uncertainty and unnecessary transaction costs.

The FCC's traditional ownership policies use a set of rules rather than a case-by-case guidelines approach. A rules-based approach might be justified on the basis of judicial economy. It makes sense to have rules, perhaps with waivers, when the outcome of nearly every case can be readily predicted on the basis of easily ascertainable facts. Then, a general rule would save everyone involved from wasting time and effort on case-by-case analysis.

For example, the FCC has long had a rule stating that a newspaper and a TV station in the same market may not be under the same ownership. Thirty years ago, few U.S. cities had more than one daily newspaper or more than three significant commercial TV stations. A merger between the newspaper and one of the TV stations in a city would almost certainly have increased concentration significantly in local advertising markets. In those circumstances, a rule banning such cross-ownership was likely more efficient than repetitive case-by-case analysis. Today, the relevant facts vary significantly across local markets, and a rule-based approach is no longer appropriate.

When facts differ significantly from one transaction to another, a case-by-case approach that employs analytical tools that are well-defined and easy to understand is likely to be superior to a rule. If prospective applicants understand these tools, they can model the agency's decision process and predict how it is likely to respond to a given application. The Merger Guidelines are a very useful model of such a tool.

The analytical tools of competition analysis, as used in antitrust enforcement, apply directly to the FCC's concentration concerns in media economic markets, such as advertising and programming. The three key questions facing the FCC with respect to each of these markets are: Which sellers offer choices that customers find attractive? Are there enough such sellers to provide effective competition? Are there significant barriers to entry? These are the same issues addressed in the Merger Guidelines. Thus if the FCC adopts sound media ownership policies, those policies will be based on the analytical framework of the Merger Guidelines.

For the FCC to follow ownership policies based on the Merger Guidelines, however, would necessarily duplicate the work of the Antitrust Division of the Department of Justice and the Federal Trade Commission. The antitrust agencies already routinely apply Guidelines analysis to proposed media transactions in FCC-regulated industries. When the FCC applies sound economic principles to the analysis of proposed acquisitions, it ends up with essentially the same result as the Department of Justice both in terms of analysis and in terms of standards, as is demonstrated by a comparison of the DOJ complaint involving the proposed acquisition by EchoStar of DirecTV with the FCC's Hearing Order concerning that acquisition. Such duplicative regulation is inefficient, a waste of public and private resources.

Ownership restrictions may also have a First Amendment goal of promoting outlet diversity. That goal can best be achieved by pursuing economic competition and minimizing barriers to entry. Competition, backstopped by antitrust policy, protects not only consumers' economic interests but also their access to ideas and information. Media, competing against each other for audiences and consumer and advertiser dollars, will be led "as if by an invisible hand" to serve the public interest in promoting First Amendment values.

If the FCC does undertake to promote the free flow of ideas through competition, it cannot do better than to utilize the rigorous analytical framework reflected in the Merger Guidelines. There are three reasons why the FCC's responsibility to protect First Amendment values does not require a lower tolerance for concentration than that required by antitrust principles. First, markets for ideas are much broader than corresponding economic markets. DOJ, for example, has traditionally focused on extremely narrow advertising markets, stopping threats to economic competition long before consolidation poses a threat to competition in the marketplace of ideas. Second, relevant markets for ideas are generally less concentrated than economic markets. Third, entry in the marketplace of ideas is far easier than in economic markets because ideas can be introduced at much smaller scales of operation. As a practical matter, competition in economic media markets, backed by effective DOJ enforcement of the Clayton Act, likely will be sufficient to ensure competition in the marketplace of ideas.

Bruce M. Owen is a Special Consultant to EI and also Gordon Cain Senior Fellow in the Stanford Institute for Economic Policy Research and Professor, by courtesy, of Economics, Stanford University. This article is based on a paper submitted to the FCC in January of this year. On June 2, the FCC significantly reduced but did not abolish its ownership restrictions.

Challenges For The FTC Hospital Merger Retrospectives

By David A. Argue

Recently, the Federal Trade Commission has begun a series of retrospective analyses of hospital mergers to determine how these mergers affected the price and quality of hospital services. Many individuals have lauded the retrospectives as a worthwhile endeavor that will broaden the understanding of the healthcare industry, but the imprecision of the likely analyses and the costs imposed on healthcare providers suggest that the retrospectives should be conducted with considerable caution. The FTC must address a number of conceptual and practical challenges to implementing the retrospective reviews.

From a conceptual standpoint, an analysis of post-merger behavior must begin with an economically sound, internally consistent theory that links the merger and the expected post-merger behavior. Such a theory is not a mere formality, but an important guide to clear thinking and evidence gathering. The theory must posit a causal connection between the event that presumably causes the problem (i.e., the merger) and the consequences (i.e., a price increase or quality decrease). The theory must also be consistent with underlying economic assumptions regarding the source and the exercise of the market power.

Measuring prices for hospital services involves several practical difficulties as well that significantly complicate a retrospective analysis. Two commonly used methodologies for estimating prices are the calculation of average payments or average revenue and the comparison of actual contract terms. Both of these methodologies have strengths and weaknesses and both are subject to noise in the data.

Hospital records often have insufficient detail to perform the average revenue calculations. Many hospitals' records have information on the charges incurred by an individual patient, but not on contractual allowances that affect the revenue actually received for that patient's services. In some cases, hospital revenues include capitation payments, which should be included in an analysis but cannot readily be incorporated into an average revenue calculation. Another source of data—claims data from insurance payers—may also be used to calculate average payments, but the claims data have shortcomings as well. Numerous adjustments are often made to claims, not all of which are easily distinguished in the data. Also, as with revenue data, claims data for capitated contracts cannot easily be combined with other data.

Price comparisons based on contract terms rather than average revenue are also subject to problems. Contracts typically contain non-price terms that are relevant to the negotiation of the final price for the clinical services. Among these non-price terms are the duration of the contract, the extent of any exclusivity, the nature of discounts or penalties related to the speed of payment, the rates on and inclusion of other services (e.g., ancillaries, labs, etc.), and rates on Medicare/Medicaid contracts with the payer. Managed care plans often negotiate all of these terms together with the rates and trade off the more and less favorable elements of the contract. Moreover, typically several different types of contracts exist in a market, and it is difficult to convert the different types of contracts to a common basis for comparison.

Whether price comparisons are based on average revenue or contract terms, they should account for differences in services offered by different hospitals. Even the same hospital may offer different services at different times. This heterogeneity of services makes it hard to compare prices in a meaningful way. For the average revenue/average payments approach, heterogeneity of services can substantially undermine the validity of a comparison. Changes in average payments can be caused by differences in service mix or intensity of service that are unrelated to a change in payments for any specific service. Heterogeneity of services also affects contract comparisons because "clusters" of services covered under a

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Selected EI Cases

Class Certification Hearing Involving Genetically Modified Seeds

William C. Myslinski recently testified at a class certification hearing in the U.S. District Court for the Eastern District of Missouri. Myslinski was testifying on behalf of defendant Monsanto in *Frederick L. Sample, et al. v. Monsanto Company, et al*. His testimony involved both antitrust claims and tort claims. The antitrust claims alleged genetically modified corn and soybeans seeds were the subject of anticompetitive pricing agreements. The tort claims alleged that growers of conventional corn and soybean crops received depressed prices for their crops because of reduced foreign demand for U.S. crops. Plaintiffs allege foreign buyers' concerns with genetically modified crops in the U.S. distribution channels made those buyers reluctant to buy any corn and soybeans grown in the United States.

American Chiropractic Association et al. v. Trigon Healthcare

Barry C. Harris worked with McGuire Woods on behalf of Trigon Healthcare to win summary judgment against plaintiff chiropractors alleging monopolization and restraint of trade. He argued that as a health insurer, Trigon had no economic incentive to lessen the competition among healthcare providers. In addition, Harris demonstrated that Trigon did not possess market power as a seller of health insurance services or monopsony power as a buyer of chiropractic services. He noted the availability of alternative health insurers and the significant increase in the size of Trigon's chiropractic network. Harris also showed that Trigon's reimbursement system for chiropractic services did not harm competition.

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capacity. The Bureau noted that its mandate is to protect competition not individual competitors. Because it found no harm to competition, the Bureau took no action against Molson and Labatt. Although unstated in its press release, it appears that the Bureau must have concluded that on balance the contracting practices were primarily means by which the two giants of the Canadian brewing industry competed with each other rather than coordinated practices aimed at disadvantaging smaller competitors.

Despite finding no evidence of current harm or evidence of likely future harm, the Bureau clearly put Molson and Labatt on notice regarding expanding restrictive contracts with retailers. The Bureau noted that it could re-examine the industry at a later date and it issued this stern (although arguably self-contradictory) warning:

The evidence collected … does not support the argument that these contracting practices substantially harm or will harm competition. However, over the medium to long term, if the contracting practices of Molson and Labatt … were to become more widespread or to intensify, it could very likely have a negative effect on competition in the beer market.

EI Principal Bill Myslinski and other EI economists have worked on a number of matters involving the brewing industry in the United States and elsewhere. In particular, they have devoted extensive attention to vertical arrangements and distribution issues.

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specific rate may be quite different between hospitals and might change over time. One way that is sometimes used to address the heterogeneity of hospital services is to try to compare homogeneous subsets of services, but in reality, it is very difficult to find like services. Even two apparently similar services may prove to be very different on closer examination.

Healthcare services offered by different providers or at different times can also differ in terms of quality. Good measures of quality are not well established, and the quality information that is available is generally not sufficiently reliable for economic analysis. Some analysts have attempted to address this issue by using proxy measures of quality based on some measure of hospital expenditures. This approach is deficient because hospital expenditures include a large number of costs that are not directly related to quality and because some quality improvements actually lower cost.

Additional difficulties in comparing healthcare prices over time or between providers arise from differences in input costs. Average revenue or average payments may differ as a result of increased costs over time or differences in costs between providers. Inputs whose costs have changed substantially over time and differ significantly between hospitals include nursing staff, pharmaceuticals, high-tech supplies, and malpractice insurance. Some analysts attempt to address these differences by basing price comparisons on similar providers or explicitly including input costs in a price estimation, but such attempts often are inappropriate or insufficient.

It is too strong a statement to say that appropriate price comparisons can never be made. Nevertheless, there are many assumptions that are likely to be necessary in any price comparison. All comparisons must be viewed in light of the weaknesses in the particular methodologies chosen and in light of the limitations of the data available. Given the evident practical difficulties in conducting a retrospective analysis, the FTC should proceed with these analyses only with considerable caution.

EI Corporate Vice President David A. Argue has extensive experience in antitrust healthcare matters, including hospital mergers and various private litigations. This article summarizes a recent presentation at the FTC/DOJ healthcare competition hearings.

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