Update: Carolinas Healthcare Cites DOJ Second Circuit Loss in Anti-Steering Case

October 2016 Update:

We have been following the suit filed in June by the Department of Justice and the North Carolina Attorney General against Carolinas Healthcare System ("CHS"). The case involves a Sherman Act Section 1 challenge to "anti-steering provisions" in CHS' contracts with insurers.

Last week, CHS filed a supplemental brief arguing that the case should be dismissed because a new Second Circuit decision rejected many of the government's arguments in an anti-steering case involving American Express. CHS' brief extends on its line of attack on the DOJ's complaint, arguing that the complaint fails to allege facts showing that the steering provisions create actual competitive harm.

The Second Circuit decision involved contract provisions that prohibited merchants who accept American Express credit cards from encouraging customers to use other competitor cards, which have lower fees for merchants, at the point-of-sale. The district court ruled in favor of the government, concluding that the provisions were anti-competitive. The district court focused on American Express' ability to exert leverage over merchants because of its high level of customer loyalty, based on evidence showing that customers insist on paying with their American Express cards, and will avoid shopping in stores that do not accept American Express. The Second Circuit reversed the district court decision, finding that the anti-steering provisions were not inherently anti-competitive, and that DOJ failed to show that the provisions produced anti-competitive effects in the market.

According to CHS, the Second Circuit decision demonstrates the need to fully analyze whether steering provisions will produce anti-competitive effects in the real world, taking into consideration all the competitive dynamics in the market. CHS argues the new decision shows that direct competitive harm must be proven using facts showing that the provisions have caused reduced output, decreased quality, or supracompetitive pricing, which the government has not alleged. CHS also claims that its "premium pricing" and market power are not sufficient to show indirect competitive harm because, like American Express, its market power is based customer loyalty created by the quality of the services it provides. The DOJ could point out that one problem with this comparison is that American Express is an outsider product competing with many other companies in the credit card market, so it's more apparent that customers choose American Express out of customer loyalty. Unlike American Express which had only a 26% market share, according to the DOJ CHS is a dominate provider with around 50% market share, giving it much more market leverage.

In its decision, the Second Circuit also focused on how the provisions protect American Express' legitimate interest in protecting the benefit of its bargain with merchants. Merchants get the benefit of attracting American Express cardholders, who generally spend more than others, in exchange for agreeing not to encourage customers to use competitor cards. In CHS' brief on the case, it said that similarly, its contract provisions protect the benefit of the its bargain with insurers. Insurers get discounted rates from CHS, in exchange for CHS' agreement to not steer customers to other providers.

Although the Second Circuit decision is not binding on the North Carolina district court, the DOJ has cited to the now reversed decision from the district court in American Express in several of its filings, and has discussed some of the

similarities between the two cases. Now, the DOJ must change course and focus on distinguishing the credit card markets at issue in *American Express* from the healthcare markets at issue in this case.

There's a great deal at stake for the DOJ in the case. This one of the first cases where the DOJ has challenged anti-steering provisions in the healthcare context, as the DOJ seeks new strategies for dealing with anti-competitive concerns in healthcare markets.

We will be continuing to follow any developments in the case, so stay tuned for more updates!

Earlier Posts on this Case:

September 2016 Update

We previously blogged about the suit filed in June by the Department of Justice and the North Carolina Attorney General against Carolinas Healthcare System ("CHS"). The case involves a Sherman Act Section 1 challenge to anti-steering provisions in CHS' contracts with insurers. In August, CHS moved for judgment on the pleadings. CHS filed its reply brief in support of the motion on Wednesday.

In its brief, CHS argues that the DOJ complaint is insufficient as a matter of law because it fails to show that the anti-steering provisions create any actual competitive harm. CHS' position is that the DOJ complaint only alleges that the provisions cause potential harm to the competitive process. According to CHS, DOJ must specify how the provisions have actually caused harmful effects on pricing or quality in order to sufficiently allege that the provisions pose an unreasonable restraint on trade. CHS contends that the complaint provides no concrete facts about the provisions' harmful effects.

In its opposition brief, DOJ argues that the complaint explains in detail how the provisions unreasonably interfere with competition by raising prices and restricting options for consumers. The government says that prohibiting insurers from using tiered or narrow networks to freely steer consumers causes actual harm by discouraging competition. DOJ also denies that its claim is speculative, stating in its brief that "interference with the competitive process is actual competitive harm."

June 14, 2016 Post

Last week, the Justice Department's Antitrust Division, along with the North Carolina Attorney General's Office, filed suit against Carolinas Healthcare System ("CHS"), challenging the large provider's use of certain contract provisions in its agreements with insurers. DOJ claims that CHS, the dominant and most expensive provider in the Charlotte, North Carolina area, uses its market power to insist that the four largest insurers in the area agree not to steer their subscribers to lower-cost/higher-value providers. The last major DOJ case involving insurer-provider contracts was the Antitrust Division's 2010 challenge to Blue Cross/Blue Shield of Michigan's use of most-favored nations clauses, which prevented providers from negotiating competitive rates with BC/BS' competitors. DOJ agreed to drop that case after the Michigan state legislature banned the contested clauses. Here, DOJ claims that the steering restrictions CHS uses in its insurer contracts violate Section 1 of the Sherman Antitrust Act, and request that the court declare the steering restrictions illegal under the Sherman Act and enjoin CHS from using the provisions and from retaliating against insurers who engage in lawful steering.

DOJ is challenging CHS' inclusion of various contract provisions it categorizes as "steering restrictions." These

provisions inhibit insurers from using financial incentives to steer subscribers to non-CHS, lower-cost providers. Typically, insurers accomplish steering through tools including (1) tiered networks and (2) narrow-network plans. In a tiered network, the insurer separates "better value" (low-cost/high quality) providers and high-cost providers into distinct tiers, each of which is assigned its own co-pay. In this system, a better value provider in a top-tier is assigned a lower co-pay—i.e., the patient bears less of the cost—than a lower-tier provider. Accordingly, the patient has a financial incentive to obtain healthcare services from the top tier, lower-cost provider, and visiting that provider saves both the patient and the insurer, who typically foots the bill beyond the co-pay, money. In the same vein, insurance companies often offer "narrow-network plans" to consumers who pay lower premiums and co-pays in exchange for agreeing to a more limited set of provider options. Under CHS' contracts, both tiered networks and narrow-network plans are prohibited, so patients have no reason to obtain healthcare services from CHS' lower-cost competitors. Also, because the contracts also contain confidentiality provisions, the patients don't even have the price and quality information they would need to shop around. And, because they can't really compete, CHS's competitors end up raising their own prices and don't bother innovating, and the entire market suffers.

Why would insurers agree to these contract provisions that end up costing them and their subscribers more money? DOJ says it's because CHS' contracts with insurers are not the products of arm's-length negotiations—instead, CHS uses its market power to obtain more-than-favorable, anticompetitive terms. DOJ explains that the same market power allows CHS to charge "premium rates," in addition to one-sided contract terms. According to the complaint, CHS has a 50% share of the relevant market (general acute care in-patient hospital services in Charlotte), and makes more than twice as much in revenue as its closest competitor. Importantly, CHS is

considered a “must-have” provider, meaning that insurers need to include the provider in their networks to meet consumer demand, so they end up agreeing to the unfavorable terms.

If this all sounds familiar, and strikingly similar to a private antitrust enforcement case filed in state court in California, you’re thinking of UFCW & Employers Benefit Trust v. Sutter Health. In that case, the self-funded payer plaintiffs are challenging dominant California provider Sutter’s use of similar contract provisions they call “anti-incentive” terms, or terms that prevent self-funded payers from giving enrollees incentives to select lower-priced alternatives to Sutter from the network. Those plaintiffs are also challenging Sutter’s use of “price secrecy” terms that conceal the provider’s prices from self-funded payers and their enrollees, so that they are unable to shop for providers based on price, and insurance entities who could otherwise compete horizontally with one another based on the prices they each negotiate with Sutter. The Sutter plaintiffs’ case was brought under California’s Cartwright Act, whereas DOJ’s case is under the Sherman Act, but the facts and legal similarities are striking. We are following both cases closely and hope that others are connecting the dots here, too.