

Suggestions on Framing the Benefits of Hospital Mergers

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As hospital systems contemplate acquisitions, they should anticipate that the antitrust authorities may scrutinize the likely effects of their proposals on competition. Regardless of whether such acquisitions are generally motivated by the pressure of health care reform to reduce costs and enhance quality, if merging hospitals have been competitors historically, they will likely need to demonstrate to these authorities that the benefits that they seek through combination are likely to be achieved and that these benefits cannot be similarly accomplished unilaterally or through looser affiliations.¹

Based on our discussions with hospital leaders, as well as our experience in assisting hospitals in presenting the benefits of their proposed mergers to the antitrust agencies, the following benefits should be documented as concretely as possible to be viewed as credible.²

- **Scale-related benefits that reduce costs:** These include a combination of back-office functions such as supply chain, general operations, revenue cycle management, as well as the ability to spread the substantial costs associated with development and operation of the IT systems necessary to support value-based payment initiatives. In addition, planned consolidation of some clinical service lines at one or another hospital campus can demonstrate commitment to cost reduction and quality enhancement.
- **Access to capital:** Acquired hospitals often require substantial investments in physical plant and physician recruitment to stem declining trends in admissions. Because of their often weak financial condition, they are unable independently to access the capital markets at reasonable rates. Substantial capital cost savings can also accrue when major capital investments needed by one

of the hospitals (generally the acquirer) to reconfigure existing property or to build new structures can be foregone by the substantially less costly rearrangement of existing services across the merging facilities.

- **Standardization of clinical protocols:** Adherence to standard clinical processes and procedures is generally viewed as key to reducing costs associated with supply and equipment purchases, inventory management and staff training. Even more importantly, the enhanced quality of care attributable to protocol-facilitated reductions in adverse outcomes and shortened lengths of stay also serves to reduce costs. The likelihood of the acquired hospital benefiting from the clinical expertise of the acquiring system may be greater if there are specific protocols or measures that have been adopted by the acquirer and have resulted in demonstrable cost or quality benefits, and concrete plans to export them to the acquired hospital.

Key in presenting persuasive arguments for these benefits is both demonstration that they are likely to be achieved and compelling explanations as to why they cannot be achieved without the proposed merger. Needless to say, it is difficult to demonstrate specific savings and quality benefits prospectively, particularly given legal limitations on independent parties sharing detailed information. Engaging a third party facilitates the assessment of confidential information from both parties. Concrete modeling can identify likely cost savings by distinguishing existing fixed and variable costs and determining how much additional volume can be handled without requiring an increase in fixed infrastructure. Such modeling can be applied to estimate savings associated with both back-office and clinical program consolidations.

It is also critical to demonstrate medical staff support for any clinical program changes, such as service line consolidation or new physician recruitment. While pre-merger restrictions on sharing confidential information may limit final determination of program changes, any claims of savings related to such initiatives will be viewed as dubious without evidence of support from both hospitals' medical staff for post-merger changes.

Capital cost savings can be addressed by documenting and quantifying needed investments at the acquired hospitals, comparing these needs to existing available capital, as well as comparing the acquired and acquiring hospital bond ratings and implied effects on capital costs. Estimates of the savings from capital expenses that can be foregone should rely on detailed budgets for any building projects that a merging party would have to take unilaterally (preferably official budgets such as those filed with a Certificate of Need or other regulatory authority). These budgets should be compared to the likely expenditures that would need to be made to reconfigure facilities across the two merging hospitals in order to accommodate the planned service reorganizations and capacity realignments. Such estimates should also be accompanied with explanations for why the expenditures are necessary.

The benefits of clinical protocol standardization are probably best demonstrated by reliance on historical experience at one or both merging hospitals. To the extent that past adoption

and enforcement of standard clinical protocols has produced measurable cost savings or quality enhancements, such benefits should be documented as specifically as possible. The antitrust agencies are much more likely to be favorably disposed to such arguments when the merging parties can demonstrate that they have successfully generated such benefits through previous comparable initiatives. In most cases, such examples will originate from the acquiring hospital system that has deployed such protocols in previous acquisitions or across its existing hospital departments. It may also be useful to document differences in the quality of care currently provided by both the acquiring and acquired hospital: large differences in quality measures may suggest room for improvement at the acquired hospital and that the acquiring hospital possesses the requisite expertise to bring about the changes.

In all cases, the most difficult arguments to make convincingly relate to the "merger-specificity" of the planned benefits. As we noted in the introduction to this report, the antitrust agencies have been skeptical of arguments that the extent of benefit achieved in a hospital combination directly relates to the extent of the combination itself: i.e., that looser affiliations can produce modest benefits from narrowly-focused, limited initiatives, while full asset combinations that are organized to unify financial and clinical incentives can produce much more substantial gains. To the extent that the merging hospitals have experience with such looser affiliations and can provide concrete examples of how they have met with limited success (or failed), such arguments are likely to be most compelling.

ENDNOTES

1. *Federal Trade Commission; Commonwealth of Pennsylvania v. Penn State Hershey Medical Center; PinnacleHealth System. United States Court of Appeals for the Third Circuit.* No. 16-2365, Opinion. September 27, 2016, p. 33. (Available at: <https://www.ftc.gov/system/files/documents/cases/160927pinnacledecision.pdf>)

2. Support for these observations is described in our accompanying study, *Hospital Merger Benefits: Views from Hospital Leaders and Econometric Analysis*. January 25, 2017.

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