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“The Federal Trade Commission’s Bureau of Competition and  
the U.S. Department of Justice’s Antitrust Division”

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Chairman Johnson, Ranking Member Coble and other members of the committee, I am David Balto, a Senior Fellow at the Center for American Progress, where my work focuses on antitrust enforcement, intellectual property, and health care. I am the former policy director of the Federal Trade Commission and have practiced antitrust law for over a quarter of a century. I am pleased to submit this testimony for today's important hearing on oversight of our antitrust enforcement agencies.

We have reached a critical juncture in antitrust enforcement. Increasingly, the markets consumers depend upon the most—health care, consumer goods, telecommunications and airlines, just to name a few—are becoming more concentrated. The bulwarks of the competitive marketplace, choice and aggressive rivalry, have been diminished and many of these markets are plagued by deceptive conduct. Moreover, our typical reliance on an entirely “free market” unshackled from any form of regulation has been shattered by recent economic events. Increasingly, we recognize the need for more intensive and thoughtful regulation as it is evident that the mantra, that deregulation or “regulation lite” is the best result is a recipe for consumer harm, not consumer welfare.

Fortunately, President Barack Obama selected exceptional leaders for both the antitrust division of the Department of Justice and the Federal Trade Commission. Both Assistant Attorney General Christine Varney and FTC Chairman Jon Leibowitz bring a keen perception about the important role of antitrust enforcement as a bulwark to a competitive marketplace. Both are strong leaders who know how to make the most of the limited resources of their agencies, and both are supported by talented career lawyers and economists who are dedicated to the mission of protecting consumers.

My testimony today provides observations on four important areas.

- The role of regulation and the need for antitrust enforcers to support and strengthen regulation. For instance, this has been demonstrated by an innovative collaboration between DOJ and USDA addressing chronic competitive problems in agriculture markets. This innovative collaboration should be applied to other markets, especially health care.
- The need for a realignment of enforcement priorities to support health care reform. In particular, the need for far greater enforcement against health insurers and greater acceptance of collaboration by health care providers.
- The need for the enforcement agencies to use their full range of powers, especially when investigating and challenging conduct by dominant firms.
- The need for Congress to enact new legislation to eliminate some of the most harmful anticompetitive practices. These include manipulation of the exclusivity period in pharmaceutical patent settlements, declare resale price maintenance per se illegal, and eliminate the antitrust exemption for health insurance.

## The role of regulation and antitrust

For years, antitrust enforcers strongly believed that the only good regulation was a dead regulation. In fact, the antitrust enforcement agencies played a critical role in efforts to deregulate numerous markets. As we have recognized in the past two years, some of those efforts to deregulate may have been overgenerous in their faith in the working of the market. As FTC Commissioner Tom Rosch observed “if not dead [the Chicago School] is on life support.... [M]arkets are not perfect; imperfect markets do not always correct themselves; and business people do not always behave rationally.” To give just one example, the failure of effective financial service regulation has led to the chronic fraud and deception that Congress addressed in their financial service reform bills. The newly enacted Consumer Financial Protection Act allows regulators the access and authority needed to monitor financial products and protect consumers from being preyed upon by unscrupulous financial entities.

It is important for the antitrust enforcement agencies to learn to work more effectively with both federal and state regulators to help find solutions to competitive and consumer protection problems. Perhaps the most important observation by any antitrust enforcer in the past several years has been the comments of AAG Varney that, in many cases, **a competition problem may not necessarily have an antitrust enforcement solution.** Antitrust enforcement may have limited tools to adequately challenge ongoing anticompetitive conduct. Moreover, in many cases, a regulatory solution may be a more effective way of dealing with competitive problems in the market than a narrow antitrust enforcement action. Thus, antitrust enforcers must work to strengthen regulation so that it fully protects consumers.

Nowhere is the observation about the importance of antitrust enforcers and regulators working together more important than in agriculture markets. As I documented in my testimony before this Committee last year, there are chronic competitive problems in agricultural markets—particularly dairy, beef, and poultry—where increasingly consumers pay more while farmers receive less. These problems have grown only worse in the past year, especially in dairy, where countless farmers increasingly face the prospects of closing their farms that have been in their families in decades.

Make no mistake about it, the demise of competitive agricultural markets costs consumers dearly in higher food prices and less choice. Food processing markets are increasingly dominated by a small handful of firms with the power threaten the viability of producers in many markets.

Fortunately, the Obama administration has recognized the need for a comprehensive approach to this problem. As many members of this Committee know, in the past year the USDA and Antitrust Division of the Department of Justice have begun a series of hearings to learn about problems in agricultural markets. The agencies have scheduled five hearings throughout the United States and the results to date are promising. Both Attorney General Holder and Secretary Vilsack attended the first two hearings and heard from dozens of farmers about the egregious and harmful practices in various agricultural markets. Over 500 farmers attended each of these hearings.

The importance of the innovative nature of the hearings and the coordinated approach of the USDA and DOJ cannot be understated. Typically, enforcement officials wait for problems to come across their desks in Washington and do not act proactively to seek out concerns. And too often agencies respond to problems with, “That’s not my job, it is someone else’s jurisdiction.” The problems in agriculture markets are so severe that we cannot afford bureaucratic finger pointing. The coordination between DOJ and USDA will hopefully lead to comprehensive approach in both strengthening USDA regulations and bring enforcement actions to correct the chronic problems in the market. The DOJ can play a critical role in providing assistance to USDA in strengthening its regulatory powers. This model of cooperation hopefully will serve as a model in the future collaborative approaches by antitrust enforcement agencies and regulators to strengthen regulation and antitrust enforcement.

There are at least two other areas in which enforcement of the antitrust enforcement agencies can work with regulators to improve competition in regulated markets.

- **Reform of the antikickback provisions in healthcare.** There are chronic competitive problems in medical device markets because dominant medical device manufacturers pay kickbacks to group purchasing organizations to give them exclusive or near exclusive arrangements. These kickbacks reinforce the dominant positions of these firms and exclude more innovative, lower-cost alternatives produced by smaller competitors. Although the industry has promised to “self-regulate” those efforts have had minimal effect on the exclusionary conduct of dominant firms that have found ways to work around the so-called regulations. The Federal Trade Commission should investigate these practices and challenge them where appropriate. The FTC should also work with the appropriate regulators to try to eliminate the safe harbor for these kickback payments.
- **Addressing fundamental problems in the market for pharmacy benefit managers (PBMs).** The conduct of pharmacy benefit managers raises substantial competition and consumer protection concerns. The three largest PBMs have paid over \$370 million in penalties and fines for consumer protection violations in the past five years. Consumer groups, unions, community pharmacists and health care plans have called for greater transparency in PBM operations. As part of the healthcare reform legislation, Congress enacted basic transparency requirements for PBMs that provide services to health care plans in the public exchanges. Unfortunately, in the past the Federal Trade Commission has aggressively lobbied against PBM regulation. It is time for the FTC to reconsider those views and work together with both state and federal regulators on improving both state and federal PBM regulation.

### **Health care enforcement priorities must be realigned**

If one fact is clear from over a year of healthcare debate, it is that health insurance markets are broken. Members of Congress heard testimony from dozens of individuals who described how they were harmed by egregious, deceptive, and anticompetitive conduct by dominant health insurance companies. Congress also heard from scores of employers who testified that they were unable to provide basic health insurance for the employees because of escalating premiums and other forms of anticompetitive conduct. Congress appropriately

enacted significant reforms that hopefully will begin to restore greater protections for consumers. The Department of Health and Human Services has established a new agency, the Office of Consumer Information and Insurance Oversight, to implement these reforms, help create health insurance exchanges, and regulate health insurers. It should be a central priority for both the Federal Trade Commission and the Antitrust Division to work with the new federal regulators to make these reforms as effective as possible.

Unfortunately, the antitrust agencies are not as well-positioned as they should be to fully assist the new federal regulators in beginning to reign in health insurers. First, in the prior administration there were no enforcement actions against anticompetitive or deceptive practices by health insurers. In addition, the administration permitted a tremendous number of health insurance mergers to occur with relatively few challenges. As I have described in prior testimony, this is largely because of misplaced enforcement priorities in which almost all of the enforcement actions were brought against doctors. In addition, there are jurisdictional obstacles. Because of the McCarran-Ferguson Act, the FTC believes that it does not have jurisdiction to challenge health insurance consumer protection violations.

The problem of misdirected priorities is unfortunate. The agencies pride themselves on setting priorities that bring the greatest benefit to consumers. In the past administration over 30 cases were brought against doctors for alleged price fixing. Did the consumer benefit from these enforcement actions? Only one of them resulted in a private antitrust suit seeking damages — and the insurance company plaintiff lost. Over 40 percent were in rural markets that suffer from chronic shortages of providers. Almost all the cases are settled since provider groups can rarely afford a battle of a protracted antitrust suit. The settlements rarely allege consumers had to pay more; rather to the extent they allege harm, it is that the physicians sought higher reimbursement from insurers. The fact that a powerful insurer may not be able to secure lower reimbursement from physicians does not mean consumers suffer; rather, any lower reimbursement may have simply ended up in higher profits for insurers or reductions in reimbursement may have led to worse health care.

Are these physician negotiation groups a significant competitive problem? Congress exhaustively examined problems in health care markets for over a year. There was no mention of these alleged physician negotiation groups. Nor does the academic literature on rising health care costs identify these entities as a significant cause of rising health care expenditures.<sup>1</sup> The results of the Congressional health care examination are clear—the problem is in a lack of competition and deceptive conduct in health insurance markets and that is where the agencies' resources must be focused.

Recently, the DOJ has started to set a better balance in enforcement priorities and pay some much-needed attention to broken health insurance markets. At a recent meeting of the American Bar Association, AAG Varney described the results of a study they conducted on barriers to entry in health insurance markets in which the DOJ found that these barriers are indeed significant, and as a result, the antitrust enforcers must take action to protect existing competition and choice in health insurance markets. The DOJ took such an action when it threatened to challenge the merger of two Michigan health insurers, Blue Cross Blue Shield of Michigan and Physicians Health Plan of Mid-Michigan this past March. The merger would have

created an insurance behemoth with about 90 percent of the market in Lansing. Because of the DOJ's threat, the companies called off their merger, maintaining some level of competition in that market.

Besides misdirected enforcement priorities, the enforcement agencies have taken an extremely limited approach to permitting collaboration by health care providers. The most recent statement of guidance on permissible collaboration is the agencies' joint Statements of Antitrust Enforcement Policy in Health Care, last revised in 1996, over fourteen years ago. Obviously the healthcare market has changed dramatically during this period. Moreover, under these Guidelines, the agencies have taken an extremely limited approach to permissible collaborations by health care providers. For instance:

- During the Bush Administration, they approved only four provider collaboration groups, compared to over 25 in the Clinton Administration.
- The costs of securing a business review letter to permit collaboration have grown exponentially. The cost of securing a business review letter now exceeds well over \$100,000, clearly out of reach for any group except a very large group of providers, and can take over a year to obtain.
- Because of the elaborate standards necessary to satisfy the enforcement agencies, these groups must increasingly involve large numbers of physicians. Most of the approved entities involve well over 100 physicians. Ironically, the standards applied by the agencies are effectively forcing physicians to form groups that are so large that they basically acquire market power; precisely the problem the antitrust laws want to avoid.
- Even when these groups can overcome the severe and costly gauntlet required to get necessary approval, insurance companies often refuse to deal with these groups.

There is a simple fact that is becoming increasingly clear. Insurance companies are often not interested in the efforts of health care providers to improve health care quality. Instead, they simply want to secure the services of health care providers at the lowest possible cost. The ultimate result is health care providers are forced to do more with less and consumers suffer the result of assembly line health care.

Senators Kohl, Leahy, Feinstein, Whitehouse and Specter recognized the need to revise these Guidelines in a letter to AAG Varney and Chairman Leibowitz this past November. They wrote, "The *Statements* are now 15 years old and while their success in providing clear and concise guidance is a testimonial to both antitrust agencies and an excellent model of agency collaboration, an updated version including a broad and clear statement of enforcement policy is needed. Similar to the early 1990s when the agencies issued the Statements, we are in another time of 'fundamental and far-reaching change' in the health care field. Clear and user-friendly guidance would reduce barriers to coordination and innovation ultimately leading to cost efficiencies in the health care delivery system."<sup>2</sup>

The challenge of allowing providers to collaborate under the existing health care Guidelines is significant. We should be clear about the cost of the antitrust enforcers' overly narrow approach to permitting health care collaboration. Doctors are prevented from providing a full range of services to improve health care quality and lead to better health care results. Ultimately, consumers suffer when physician reimbursement is reduced and consumers are relegated to assembly line health care.

This issue is particularly critical because an essential part of health care reform is the formation of accountable care organizations; systems which provide incentives for the various providers delivering a patient's care to cut costs by coordinating care, focusing on prevention, or otherwise improving quality of care. ACOs can arguably raise some of the same concerns of permissible integration under the health care guidelines. Conceivably, the agencies may impose very strict requirements, or may see physician cartels lurking behind these arrangements. Indeed, at a recent ABA conference, representatives of both the FTC and DOJ cautioned that ACO-like collaboration would only be permissible for CMS-sanctioned programs, leaving open the significant risk that the same ACO-like collaboration would be deemed illegal if applied to commercial insurance contracting. This approach would make it difficult for ACOs to be formed. Ironically, with respect to those ACOs that are formed, the agencies' approach might permit for-profit commercial insurers to free ride on the benefits derived through clinical integration. It should be a top priority of the enforcement agencies to promptly provide guidance to permit the significant formation of ACOs.

There is a recent, hopefully positive sign that the antitrust enforcers are beginning to recognize the need to take a new approach to physician collaboration. Last month, FTC Chairman Leibowitz in a speech to the AMA announced that the agencies would hold a series of workshops this fall on competition policy, payment reform, and the new models for delivering high-quality, cost-effective health care.<sup>3</sup> We hope that the agencies deliver on this promise with a significant revision of the Guidelines. Workshops alone are not sufficient—earlier workshops in 2003 and 2008 did not lead to any revision of the Guidelines; hopefully this time will be different.

### **Using the agencies' full range of powers against exclusionary conduct by dominant firms**

As I suggested earlier, antitrust enforcement is facing unique challenges because of the significant changes in the economy. One of the most critical problems is the fact that there are an increasing number of dominant firms in significant markets. Sometimes the fact that a firm has a dominant share is simply the sign of appropriate success, but when a dominant firm uses various types of exclusionary conduct consumers suffer from the lack of competition.

Last year when I submitted testimony to the Senate Judiciary Committee for the confirmation hearing for Assistant Attorney General Varney, I recommended that the antitrust division rescind the report of dominant firm conduct issued during the Bush Administration. Soon after taking office, AAG Varney did precisely that, bringing alignment between the FTC and the DOJ on the issue of dominant firm conduct.

In a program at the Center for American Progress where AAG Varney spoke last spring, we highlighted the increasingly limited scope of Section 2 of the Sherman Act, and the question

of whether it is adequate to police dominant firm conduct. As many commentators have noted, recent Supreme Court decisions have severely restricted the scope of Section 2.

In the most important monopolization case brought in the past year, the FTC case against Intel, the FTC has challenged alleged anticompetitive conduct not only under Section 2, but also Section 5 of the FTC Act which declares illegal “unfair methods of competition” and “unfair acts or practices.” Some people have criticized this use of Section 5, but those criticisms are misplaced.

The FTC case against Intel is a traditional Section 2 case that highlights exclusionary conduct by a firm that has had a market share between 80 and 98% for over a decade. The practices at issue in the FTC litigation have been condemned by the Japan Fair Trade Commission in March 2005, by the Korean Fair Trade Commission in June 2008 and by the European Commission in May 2009. In the U.S. Advanced Micro Devices, Inc., Intel’s sole significant rival, sued Intel for a broad range of exclusionary practices in 2005 and settled those charges for over \$1 billion.

Intel has had its day in court in proceedings before the EC, KFTC and JFTC — and lost. Each of those tribunals found that Intel engaged in two distinct anticompetitive practices: Intel promised discounts or rebates to computer manufacturers so long as they purchased microprocessors exclusively from Intel, and Intel paid computer manufacturers to cancel or delay the launches of product lines that included AMD-based central processing units (CPUs).

There are two important reasons why the FTC action is necessary. First, although the AMD settlement resolved AMD’s concerns, it did not fully protect the interests of consumers. Second, the FTC complaint includes another set of concerns not challenged in the earlier enforcement actions. The FTC complaint challenges exclusionary conduct in the emerging and critically important graphic processing unit (“GPU”) market. The complaint alleges that Intel has sought to thwart competition from GPU manufacturers, because “these products have lessened the need for CPUs, and therefore pose a threat to Intel’s monopoly power.” In order to diminish the potential competitive threat from GPU manufacturers, according to the complaint Intel engaged in deception, degraded connections between GPUs and CPUs, and unlawfully bundled Intel’s GPUs with its CPUs, resulting in “below-cost pricing of relevant products.” This set of concerns is sufficient alone for enforcement.

The FTC’s use of Section 5 is wholly appropriate. Moreover, the Intel case is a model of the type of enforcement action antitrust authorities should pursue because it focuses on protecting dynamic competition. It is critical that enforcement agencies use all of their powers to challenge conduct that deters competition especially engaged in by dominant firms.

One particular area where the FTC’s Section 5 powers can be critical is health care. As I documented in testimony before the FTC, Section 5 can be used to attack competitively harmful conduct by healthcare intermediaries such as group purchasing arrangements.<sup>4</sup> Well conceived enforcement actions involving GPOs would eliminate artificial barriers to competition, help reduce healthcare costs, and lead to safer and more innovative products.



The problem of dominant firm conduct can be prevented in the first instance through aggressive merger enforcement. Unfortunately, the DOJ did not seize the first opportunity to strengthen merger enforcement when it failed to challenge the Ticketmaster LiveNation merger that combined the largest ticketing firm with the largest concert promoter. Over 50 Congressmen wrote to AAG Varney expressing very significant competitive concerns with the merger. Rather than challenging the merger, the DOJ entered into a complex consent decree that attempts to create a new rival through a divestiture to AEG Group.

The DOJ attempts to address possible anticompetitive conduct by the merged firm through provisions of the proposed consent order that seek to prevent various forms of retribution, bundling, and anticompetitive information sharing. Many people have filed Tunney Act comments questioning whether the consent order provisions are sufficient to protect rivals in the market including independent concert promoters. One positive sign is that there is evidence that the DOJ staff is reaching out to market participants in an effort to make the order as effective as possible.

The DOJ must continue to be tremendously vigilant because the merged firm has tremendous power and a history of attempting to stifle new forms of competition. One particular area of concern for competition enforcers is the secondary market, which provides consumers with a vast number of opportunities to attend events that they may not otherwise be able to attend. Last year when the CEO of Ticketmaster appeared before the Senate Judiciary Committee he stated, "I don't believe there should be a secondary [tickets] market at all." Ticketmaster would like to eliminate the secondary market for tickets through vertical integration and closed loop paperless ticket distribution schemes. The DOJ should be skeptical of any effort by Ticketmaster to stifle other forms of ticketing competition.

### **The need for antitrust legislation**

In no period in recent history has legislation to reform the antitrust laws been as critical to restoring effective antitrust enforcement. There are three pieces of legislation that have passed this Committee and are supported by major consumer groups. It should be a major priority for the House and for the Congress as a whole to have this legislation enacted.

- **Pharmaceutical patent settlements.** This House has demonstrated its leadership in addressing the pharmaceutical patent settlement problem by passing legislation, which would amend the antitrust laws to clarify the standards for litigating challenges of these settlements. As the FTC has noted, these settlements will cost consumers over \$3.5 billion a year over the next decade. However, as many of the leading consumer groups have made clear, legislation amending the antitrust laws is a necessary but not sufficient approach to addressing the patent settlement problem. In essence, the pay-for-delay problem occurs because of manipulation of the Hatch-Waxman exclusivity provision, and the most effective means of attacking that problem is amending that provision. Fortunately, Congressman Hastings has sponsored H.R. 3777, which would reform the exclusivity provision so that a later patent challenger that successfully challenges the patent could share the exclusivity period. A coalition of consumer groups, including Families USA, Consumers Union, U.S. PIRG and Consumer Federation of

America, wrote to Congressional leadership earlier this year that “Expanding the exclusivity period is vitally important, since it removes the barrier to entry that has protected collusive settlements between brands and first-filing generics.”<sup>5</sup>

- **Resale price maintenance.** The Supreme Court's 2006 decision in *Leegin Creative Leather Products v. PSKS* abandoned the rule that resale price maintenance — the practice of a manufacturer dictating resale prices to its distributors — was per se illegal. The results have been increased obstacles for discounters — especially Internet-based discounters — to aggressively compete and significantly higher prices for consumers. Fortunately, this Committee has passed H.R. 3190, which would reinstate the role of per se illegality. Major consumer groups, including the National Consumers League, the American Antitrust Institute, Consumers Union, U.S. PIRG and the Consumer Federation of America, support this legislation and have called upon Speaker Pelosi to make its passage a major priority.<sup>6</sup>
- **Repeal of the McCarran-Ferguson antitrust exemption for health insurers.** The antitrust exemption for health insurers under the McCarran-Ferguson Act has simply outweighed its usefulness. Appropriately, the House has enacted legislation to repeal this exemption.

## Conclusion

The antitrust enforcement agencies face unprecedented challenges in their enforcement missions because of the significant recent changes in this economy. Fortunately, President Obama has selected thoughtful leaders for these agencies and with the continued attention of your Committee the agencies will be more than capable of facing these challenges.

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<sup>1</sup> This is not to suggest that these physician negotiation groups can never be a problem. But to the extent they pose a competitive concern, the insurance companies certainly have the resources and the incentive to protect themselves through private antitrust litigation. There is no reason the antitrust enforcers should be using such a large portion of their limited resources to attack these practices where far greater harm occurs in health insurance markets.

<sup>2</sup> Letter from Sens. Herb Kohl, Patrick Leahy, Dianne Feinstein, Sheldon Whitehouse, and Arlen Specter to Assistant Attorney General Varney and Chairman Leibowitz, November 3, 2009.

<sup>3</sup> Jon Leibowitz “A Doctor and a Lawyer Walk into a Bar: Moving Beyond Stereotypes,” Remarks by FTC Chairman Jon Leibowitz As Prepared for Delivery American Medical Association House of Delegates (June 14, 2010).

<sup>4</sup> David Balto, “Reviving Competition in Healthcare Markets: The Use of Section 5 of the FTC Act” (2008).

<sup>5</sup> Letter from Families USA, U.S. PIRG, Consumer Federation of America, Consumers Union, Community Catalyst, the National Legislative Association on Prescription Drug Prices, and the American Antitrust Institute to Speaker Nancy Pelosi and Leader Harry Reid, January 11, 2010.

<sup>6</sup> Letter from National Consumers League, the American Antitrust Institute, Consumers Union, U.S. PIRG and the Consumer Federation of America to Representative Johnson, May 18, 2009.