Ninth Circuit Affirms FTC's Win in Challenge to Hospital's Acquisition of Physician Group; Voices Skepticism of Merger-Related Efficiency Claims

While the decision provides a number of key insights into the competitive effects analysis of health provider transactions, the decision has broader implications for merger-related efficiency claims and the importance of agency-issued Guidelines in litigated matters.

On February 10, 2015, the Ninth Circuit Court of Appeals affirmed the District Court's decision that St. Luke's Health System's acquisition of the Saltzer Medical Group was anticompetitive, handing the FTC another in a string of wins in challenges to health provider mergers. While the decision provides a number of key insights into the competitive effects analysis of health provider transactions, the decision has broader implications for merger-related efficiency claims and the importance of agency-issued Guidelines in litigated matters.

The transaction at issue in the case combined the St. Luke's Health System, a nonprofit health system, and the Saltzer Medical Group, the largest independent multispecialty physician group in Idaho.

Efficiencies

The Ninth Circuit focused much of its decision on the parties' efficiency claims. The Court agreed with the District Court's market definition conclusion and subsequent finding that the parties' high market share satisfied the FTC's *prima facie* burden of establishing that the transaction was likely to substantially lessen competition under Clayton Act § 7. The burden then shifted to the parties, which had claimed in the District Court and reasserted on appeal that the transaction did not violate Section 7 because it would improve health care by allowing "St. Luke's to move toward integrated care and risk-based reimbursement." The Ninth Circuit responded that "[w]e remain skeptical about the efficiencies defense in general and about its scope in particular." The Court noted that an efficiencies defense has never been accepted by the U.S. Supreme Court and that no court had ever held that claimed efficiencies were sufficient to rebut a *prima facie* case of anticompetitive effects.[1]

Nonetheless, the Ninth Circuit explored the parties' claims, noting that rebuttal of anticompetitive effects in a highly concentrated market required "extraordinary efficiencies" that are merger specific, i.e., can be achieved only via the proposed merger. In rejecting the parties' claims, the Ninth Circuit agreed with the District Court that the benefits that might be achieved by integrating the Saltzer physicians into St. Luke's electronic medical record system were insufficient to rebut the potential anticompetitive effects. Further, the Court held that these alleged benefits could be accomplished without the merger, noting that some independent physicians already were using St. Luke's system.

The decision serves as a reminder that while the agencies will take efficiencies into account when considering whether to challenge a deal in court, once in court, both the court and the agencies will look to existing case law, which has largely dismissed the relevance of merger-generated efficiencies. Courts typically require that the claimed efficiencies completely counteract potential adverse effects. That is, it is not enough to show that the merger will result in general consumer benefits. Rather, those benefits must specifically counterbalance any likely adverse competitive effects such that the merger ultimately is likely to enhance rather than harm competition. As the Court concluded, "the Clayton Act does not excuse mergers that lessen competition or create monopolies simply because the merged entity can improve its operations."

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The Role of Antitrust Agency Guidelines

Furthering FTC and DOJ hopes that their guidance would "assist courts in developing an appropriate framework for interpreting and applying the antitrust laws in the horizontal merger context,"[2] the Court supported several of its conclusions by citing the 2010 FTC and DOJ Horizontal Merger Guidelines ("Merger Guidelines") and the DOJ Antitrust Division Policy Guide to Merger Remedies ("Remedy Guidelines"). The Court cited these two sets of guidelines more than nine times even while noting (at least with regard to the Merger Guidelines) that the guidelines are not binding, but rather persuasive, authority. Specifically, the Court relied on Herfindahl-Hirschman Index ("HHI") thresholds from the 2010 Guidelines, finding that "[s]ufficiently high HHI figures establish the FTC's *prime facie* case that a merger is anti-competitive."[3] Clearly, structural presumptions are alive and well in the courts, which continue to cite the sections of the Merger Guidelines that hew most closely to the more formulaic structural presumptions outlined in the 1992 Merger Guidelines. Courts remain well aware of Section 7's requirement that a transaction not be likely to substantially lessen competition in "any line of commerce … in any section of the country," as reinforced by the Supreme Court, which has held that "'Determination of the relevant product and geographic markets is a necessary predicate to deciding whether a merger contravenes the Clayton Act.'"[4]

In affirming the District Court's order of divestiture to remedy the Section 7 violation, the Ninth Circuit cited the Remedy Guidelines as support for the proposition that divestiture is the preferred remedy in Section 7 cases. In supporting the FTC's request for divestiture relief, the Court highlighted the DOJ's preference, as stated in the Remedy Guidelines, for structural remedies over the sort of conduct remedies (e.g., firewalls and separate negotiating teams) requested by the parties, because structural relief prevents the antitrust authorities from becoming entangled in the competitive process. While the Ninth Circuit's references to the Merger Guidelines are not unique, they highlight the impact FTC and DOJ policy statements can have on the courts. The Court's decision to cite the Remedy Guidelines, which appears to be a first,[5] only reinforces the point, particularly since the Court relies on a *DOJ* policy statement to support an *FTC* request for relief.

Implications for Health Care Provider Transactions

The Ninth Circuit's holding indicates that health provider combinations will not be shielded from the antitrust laws by aspirational or even real improvements in health care service if those combinations are also likely to result in higher prices for insurers and ultimately consumers.

Market definition matters

The parties did not dispute the FTC's product market, but vigorously challenged the FTC's geographic market of Nampa, Idaho's second-largest city, which sits 20 miles west of Boise. The District Court, in finding that Nampa was the appropriate market in which to assess the competitive effects of the merger, rejected the parties' argument that Boise should also be included. Both the district and appellate court cited testimony by insurers, who they deemed to be the true customers in this case, as the basis for their decision. The Ninth Circuit found no clear error in the District Court's reliance on insurer testimony that Nampa residents strongly preferred local primary care physicians and therefore insurers had to contract with the merging parties, who had a 60% share of the market. The Ninth Circuit cited testimony by Idaho Physicians Network that it could not market a network that did not include Nampa primary care physicians. The Court also noted that because health care consumers pay only a small portion of the cost out of pocket, a small price increase by the merging parties in Nampa would not prompt consumers to seek health care outside of Nampa.

Quality improvements won't excuse adverse price effects

In addition to disputing the geographic market, the parties argued that the purpose of the transaction was not to limit competition, but rather to improve health care. The District Court accepted this argument, noting that it believed that the transaction would "improve patient outcomes." The Ninth Circuit viewed the claims more skeptically and, along with the District Court, deemed these intentions and potential improvements in care inadequate to overcome the likelihood that the parties would use their increased bargaining leverage to negotiate higher rates with insurers. The Ninth Circuit cited to "[a]n email between St. Luke's executives that discussed 'pressur[ing] payors for new directed agreements,'" and an exchange between Saltzer executives that '[i]f our negotiations w/ Luke's go to fruition,' then 'the clout of the entire network' could be used to negotiate favorable terms with insurers." It also cited St. Luke's history of using its market power to raise prices to insurers, referencing a previous St. Luke's acquisition in Twin Falls, Idaho after which St. Luke's "used its leverage … to force insurers to 'concede to their pricing proposal.'"

The Ninth Circuit's holding indicates that health provider combinations will not be shielded from the antitrust laws by aspirational or even real improvements in health care service if those combinations are also likely to result in higher prices for insurers and ultimately consumers. This holding, along with other recent victories by the FTC, will have an impact on the risk analysis of providers exploring mergers, integrations, joint ventures, and other types of affiliation efforts, especially if increases in reimbursement rates are part of the rationale for the transaction. Combinations that have increasing reimbursement rates as one of their goals are likely to face a challenge, even if improvements in health care also are likely to result from that combination.

1 See, e.g., *Federal Trade Commission v. HJ Heinz Co.*, 246 F. 3d 708, 720-21 (D.C. Cir. 2001) (rejecting argument that efficiencies were sufficient to rebut prima facie showing of likely harm to competition).

2 U.S. Dep't of Justice & Fed Trade Comm'n, Horizontal Merger Guidelines § 1 (2010).

3 The Court also cited to the Merger Guidelines as a justification for assessing the parties' efficiency claims, while acknowledging the often cursory treatment such claims have received in the courts.

4 *Saint Alphonsus Medical Center-Nampa Inc. v. St. Luke's Health System, Ltd.*, – F.3d –, 2015 WL 525540 14-35173, at *3 (9th Cir. Feb. 10, 2015) (quoting Marine Bancorporation, Inc., 418 U.S. 602, 618 (1974)); see also *Brown Shoe Co. v. United States*, 370 U.S. 294, 322-23 (1962) ("The 'area of effective competition' must be determined by reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country')." While the agencies downplayed its importance in the 2010 Merger Guidelines, market definition remains central to merger litigation. Even the agencies acknowledge that they "will normally identify one or more relevant markets" when bringing enforcement actions. See 2010 Merger Guidelines §4.

5 While Remedy Guidelines were cited recently in a Massachusetts Superior Court's decision rejecting the proposed settlement involving the Partners Health System's acquisition of hospitals in Massachusetts, see *Commonwealth v. Partners Health Sys., Inc.*, SUCV2014-02033-BLS2, 2015 WL 500995, at 22 (Mass. Sup. Jan. 30, 2015), it does not appear they have been referenced by any other federal court.

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