Anatomy of a Provider Antitrust Merger Challenge (Part 2) [Ober|Kaler]

2015

This is the second in a six-part series discussing the Federal Trade Commission's challenges to provider mergers. Following the initial Introduction and Background (Part 1), the series discusses The Need for Early Legal Advice (Part 2), The Investigatory Process (Part 3), Analyzing the Merger's Likely Effect on Competition (Part 4), and Rebutting the Prima Facie Case (Part 5), then offers a Conclusion (Part 6) to summate the factors that must be considered in an informed approach to provider mergers.

The series is based on Mr. Miles' presentation at the American Health Law Association Physicians and Hospitals Law Institute on February 2 and 3, 2015.

Part 2: The Need for Early Legal Advice

Given the current more aggressive enforcement environment surrounding provider mergers, the antitrust advisor's role is particularly important. One of the greatest shortcomings of merging parties is their failure to involve antitrust counsel when merger discussions begin—or at least very early in the process. This is important for a number of reasons:

1. Any time competitors meet to discuss a possible affiliation or consolidation, they should, from the beginning, have antitrust counsel to guide them regarding what they should and should not discuss and to admonish them against reaching any agreements that might affect competition between them during that process. Otherwise, they run the risk of violating section 1 of the Sherman Act,1 for example by entering into a per se unlawful price-fixing or market-allocation agreement, an agreement to exchange competitively sensitive information, or an arrangement by which one of the parties begins to exercise some control over the other. Most antitrust counsel have boilerplate written guidelines covering these subjects that they can tailor to the particular situation and provide to the clients.

2. Counsel should determine early-on whether the potential transaction would require reporting to the FTC and Antitrust Division under the Hart-Scott-Rodino (HSR) premerger-notification requirements.2 When the transaction is reportable, the guideline above becomes particularly important.

3. Selection of a structure for the transaction is crucial, and the antitrust attorney can provide helpful advice to the parties in choosing the structure that minimizes post-transaction antitrust risk. Ideally, at least for antitrust purposes, the parties should select a structure that results in their becoming a single entity for antitrust purposes so section 1 of the Sherman Act is inapplicable to their internal "agreements" after the merger.3 In antitrust jargon, they should want to be "Copperwelded."4 Often, however, the parties want to retain as much autonomy as they can, ceding as little control of themselves to the other (or to a third party) as possible (and, in some situations, integrating as little as possible), sometimes through the use of reserved powers. This can raise the question of whether their transaction results in a merger or merely a joint venture whose actions remain subject to section 1. If the latter, their negotiation of prices may result in unlawful horizontal price-fixing agreements and their decisions about which facility will or not provide particular services may result in unlawful horizontal market-allocation agreements. Hospital joint operating-type arrangements, for example, can be suspect,5 as can loosely integrated physician limited liability companies used to "merge" physician practices.6 Early on, the antitrust attorney should work with the parties and their transactions attorney to

ensure that the degree of control and integration are sufficient for single-entity status post-merger unless this is not compatible with the business, political, or religious considerations affecting the transaction.

4. Counsel should provide the parties with an “eye-ball” antitrust analysis of the transaction's antitrust risk as early as possible. Some mergers are simply non-starters because of their potential antitrust concern, while with others, it may be obvious immediately that the transaction would raise no concern at all. The problem, of course, is that so many horizontal transactions will be in the wide gray area in between.

Typically, with the help of a map, possibly the AGA Guide, discussion with the parties' planning departments, a review of the services the potential partners provide, and examination of hospital documents showing the geography of discharges, the attorney can roughly estimate a somewhat conservative relevant geographic market and then reach some rough conclusions. The basic question is the areas and particularly the hospitals therein to which health plans and patients could turn if the merging hospitals demanded higher prices post-merger. One frequent problem is that hospital officials usually believe that their “market” is larger than that which would constitute an antitrust relevant market. It's also helpful to ask hospital officials two questions: (1) Hypothetically, if the merged hospital raised prices to health plans five or ten percent, to have a competitively viable network, would the plans have to continue to contract with the merged hospital at that new higher price or could they exclude it from their networks by easily substituting other hospitals? If the former, that's a serious danger sign. (2) If the FTC interviewed area health plans about the merger, would they support it or express concern, and, regardless of their conclusions, why? Likely payer opposition to the merger is a serious concern since health plans and self-insured employers are the ones who would feel the brunt of any anticompetitive effects (or the benefits of procompetitive effects)—and they would be important government witnesses.

The potential effect of concern in most hospital and physician-practice merger investigations and challenges is that the merged hospital will, itself, have the power to significantly raise prices post merger—so-called “unilateral effects.”7 The most important variable to examine in assessing this is the degree of direct competition between the merging providers compared to the degree of competition between them and other area competing providers—the degree of substitutability of the merging providers compared to their substitutability with others in the perceptions of health plans and patients. If, based on the services they offer, their geographic locations, their reputations, or other variables, the parties are each other's most direct competitor—e.g., if they would be the first and second choices for a significant number of patients or health plans—there is a definite danger that the merger would generate anticompetitive effects.8

The likely post-merger market share of the parties is also relevant. There is no magic market-share figure that shows a merger would be anticompetitive, but concern with hospital mergers typically begins to arise where the post-merger share exceeds around 40 percent. A large market share suggests that many patients have a preference for that provider and thus that its inclusion in a health plan's network is important for the plan's marketability. Of course, many hospital markets are already relatively, if not highly, concentrated, with one or more hospitals with substantial market shares, so this is often a concern. The post-merger level of market concentration, as measured by the Herfindahl-Hirschman Index (HHI) is typically of less concern because it says little about the increased market power of the merged firm, itself, but both the agencies and courts do rely on it, even in unilateral effects cases, in determining whether the government has proved a prima facie case.9

Examining these factors should permit counsel to reach a rough preliminary conclusion about the degree of antitrust risk and the probability of an investigation—i.e., the degree to which, if any, the transaction would be problematic. Unfortunately, it's probably true that most transactions between competing hospitals are problematic—somewhere in the middle between “non-starter” and “absolutely no problem.” Depending on how problematic the transaction appears, the next step may be to retain a consulting economist to conduct a more in-depth study, particularly of the geographic market's scope and the degree of substitutability between the potential partners.

5. Some of the FTC's best evidence in hospital-merger investigations and challenges has been the statements and documents of the parties themselves (and those of their consultants) indicating that a major purpose for the merger is to increase the parties' bargaining power with
health plans and/or that the merger is likely to (or actually did) have that effect.10 These documents are suicidal. One early role of counsel is to review the documents the parties have already created and to explain that if an important reason for the merger is their belief that it will permit price increases, the risk the merger will be challenged if investigated significantly increases. The attorney should warn the parties against making stupid statements or creating documents suggesting an anticompetitive intent or purpose for the transaction.

6. The major benefit of mergers is the efficiencies they often generate11 and, at least in theory, the efficiencies effect of a merger may offset its anticompetitive effects. And arguments of offsetting efficiencies are the most frequent argument made by providers in defending their transaction. Too often, however, hospitals considering a merger begin examining efficiencies late in the process, simply assuming early-on that they would be substantial. Often, efficiencies analysis takes an early back seat because the major effort early-on is overcoming political, cultural, and religious issues. The parties figure that if they can just get the deal done, they'll worry about how to integrate the facilities and the efficiencies integration generates later. But if the early antitrust analysis shows the transaction is problematic, delaying a careful plan of integration and efficiencies calculation is a mistake.

If the detailed efficiency work comes after the parties decide to merge and particularly if it begins after notice of an investigation, the FTC can legitimately ask how the parties could make a rational decision to do the deal if they had little or no idea of the actual benefits the transaction would generate. In addition, efficiencies work begun late in the process provides the agency and court with the impression the work resulted solely because of the investigation and the efficiencies were cooked up by the parties, their antitrust counsel, and the consultants as a last ditch effort to save a problematic transaction.12 In the case of a transaction that isn't a non-starter but appears problematic, efficiencies work should begin as soon as possible. It is almost essential that the parties retain a consultant to aid them in figuring out the most efficient way to combine the facilities and their operations and then to quantify, to the extent possible, the efficiency savings and other benefits.

7. Somewhat down the road, if the parties decide preliminarily to explore a transaction further (perhaps after a memorandum of understanding but before a definitive agreement), the parties will engage in due diligence. A primary role of the attorney during this period is to help ensure that the parties don't “jump the gun” in either of two senses. First, if the transaction is reportable under the HSR premerger-notification requirements, the parties violate that statute if one begins to exercise any type of beneficial ownership or control over the other before the transaction is cleared by the agencies. Violations can result in $16,000-per-day civil penalties.

Second, regardless of whether the transaction is reportable under the HSR requirements, the parties, for purposes of the antitrust laws, remain competitors until the transaction actually closes. Section 1 of the Sherman Act continues to apply to their activities. Thus, if they enter into any type of agreement that unreasonably restrains competition between them prior to closing, such as some type of agreement not to compete for customers or to exchange highly competitively sensitive information such as prices, serious problems can arise.13

Again, antitrust attorneys typically have written guidelines covering gun-jumping, which they can provide to the parties early-on. Pricing and other competitively sensitive information can be exchanged at some point in the transaction process well prior to closing, but the appropriate point is subject to judgment and not all attorneys agree on when it can occur. If the transaction is reportable, the exchange of competitively sensitive information should not occur prior to the agency's clearing the transaction. In general, if the transaction is not reportable, the exchange should not occur prior to the attorney's strong belief that the transaction indeed will close and not crater.14 Other guidelines apply to the exchange or provision of competitively sensitive information in the due-

diligence process relating primarily to limiting the information to that which the parties need to examine in determining whether to do the deal, the persons who should and should not be provided access to the information, and the like.

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1 15 U.S.C. § 1.

2 15 U.S.C. § 18a.

3 *See generally* Jeff Miles, *The Importance of Integration in Health Care Counseling: Yakima and Susquehanna*, AHLA Health Lawyers News, 2004.

4 *See Copperweld Corp. v. Independence Tube Corp*., 467 U.S. 752 (1984) (seminal decision discussing the circumstances under which two nominally separate entities constitute a single entity for purposes of Sherman Act § 1.)

5 *Compare Med. Ctr. v. Premier Health Ptrs*., 2014-2 Trade Cas. (CCH) ¶ 78,950 (S.D. Ohio 2014) (single entity); *New York v. St. Francis Hosp*., 94 F. Supp.2d 399 (S.D.N.Y. 2000) (separate entities);*HealthAmerica Pa., Inc. v. Susquehanna Health Sys*., 278 F. Supp.2d 423 (M.D. Pa. 2003) (single entity).

6 *See Surgical Specialists of Yakima*, 136 F.T.C. 840 (2003) (consent order).

7 *See Evanston Northwestern Health Care Corp*., 2007-2 Trade Cas. (CCH) ¶ 75,814 at 108,585 through -588 (FTC 2007); U.S. Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* § 6 (2010) (Merger Guidelines).

8 E.g., *FTC v. ProMedica Health Sys*., 749 F.3d 559, 569 (6th Cir. 2014) (ProMedica) (noting that unilateral effects are most likely where purchasers of the relevant product consider the merging parties their two best choices for the products).

9 E.g., *St. Alphonsus Med. Ctr.-Nampa v. St. Luke's Health Sys*., ___ F.3d ___, ___, 2015 WL 525540 at *7 (9th Cir. Feb. 10, 2015) ("The extremely high HHI on its own establishes the prima facie case.").

10 E.g., *ProMedica*, 749 F.3d at 571 (noting that "the Commission's best witnesses were the merging parties themselves" because in regular-course documents they admitted that the merger would generate much negotiating clout with health plans); *see also Merger Guidelines* § 2.2 ("Explicit or implicit evidence that the merging parties intend to raise prices . . . can be highly informative in evaluating the likely effects of a merger.")

11 *Merger Guidelines* § 10 ("a primary benefit of mergers . . . is their potential to generate efficiencies and thus enhance the merged firm's ability to compete, which may result in lower prices, improved quality, enhanced service or new products.").

12 *See FTC v. ProMedica Health Sys*., 2011-1 Trade Cas. (CCH) ¶ 77,395 (N.D. Ohio 2011) (suggesting that the efficiencies study in the case came late and was the product of antitrust counsel and the parties' consultant; also noting that "[p]rojections of efficiencies may be viewed with skepticism, particularly if they are generated outside of the usual business planning process").

13 *See United States v. Flakeboard Am., Ltd.*, 2014-2 Trade Cas. (CCH) ¶ 51,029 (N.D. Cal. 2014) (proposed consent decree) ($ 3.8 million civil penalty for violation of premerger-notification requirements; $ 1.15 million disgorgement for violation of Sherman Act §1.)

14 For helpful guidance on this subject, *see* Robert W. McCann, et al, *Getting to the Finish Line: Avoiding Gun-Jumping and Other False Starts in Preclosing Antitrust Compliance*, Chapter 6 in 2014*Health Law Handbook* at 230 (A. Gosfield ed. 2014); John Roberti & Scott Perlman, *Avoiding Antitrust Exposure from Information Exchanges During Transactions*, Antitrust & Trade Reg. Rep. (BNA), Apr. 11, 2014; Noah Brumfield, et al., *Omnicare: Seventh Circuit Gives Judicial Guidance on Premerger Information Exchanges*, Antitrust Source, June 2011 at 1; William Blumenthal, Michael C. Naughton,*Gun-Jumping and Premerger Information Exchange: Counseling the Harder Questions*, Antitrust, Summer 2006, at 66; *The Scope of Permissible Coordination Between Merging Entities Prior to Consummation*, 63 Antitrust L.J. 1 (1994); Willliam Blumenthal, General Counsel, FTC, “The Rhetoric of Gun-Jumping,” Text of Remarks before the Association of Corporate Counsel Annual Antitrust Seminar of Greater New York Chapter (Nov. 10, 2005); Remarks of Mary Lou Steptoe, Acting Director, Bureau of Competition, FTC, on Premerger Collaboration (Apr. 7, 1994).