BakerHostetler

FTC Still Ramping Up Antitrust Review of Health Care Mergers

By Carl W. Hittinger and Tyson Y. Herrold

November 07, 2016

In the 1990s, Federal Trade Commission (FTC) enforcement actions to block mergers between health care providers were a rare phenomenon successfully obtained. In many instances, state Attorneys General filled the role of watchdog, especially since hospital mergers were relatively small and implicated local markets. Many, like the Pennsylvania Attorney General, were unable to convince the courts that the mergers should be stopped. That scoreboard has changed dramatically in the last decade and, even more so, over the last several months.

In 2007, the FTC came out on top in In re Matter of Evanston Northwestern Healthcare, Fed. Trade Commn., Docket No. 9315, (Aug. 6, 2007), an administrative agency action that represented the FTC's first successful challenge to a hospital merger in recent history. Seven years later, in a bench trial in the District of Idaho, Saint Alphonsus Medical Center v. St. Luke's Health System, the FTC with the Idaho Attorney General successfully challenged an already consummated merger between two small health care organizations, forcing them to divest, albeit with incriminating documents at center stage.

This trend has been precipitated, in part, by passage of the Patient Protection and Affordable Care Act, commonly referred to as the Affordable Care Act, in 2010, which has led to a sharp uptick in the number of mergers as health care providers seek to coordinate health care services to provide a better service at a lower cost. The FTC has taken notice and recently blocked two hospital mergers, demonstrating a trend in FTC enforcement and revealing the difficulty courts face in determining whether hospital mergers pose antitrust concerns.

Within the last two months, the U.S. Court of Appeals for the Third Circuit in Federal Trade Commission v. Penn State Hershey Medical Center, No. 16-2365, — F.3d —- (3d Cir. Sept. 27), and the Seventh Circuit in Federal Trade Commission v. Advocate Health Care Network, No. 16-2492 (7th Cir. Oct. 31), reversed district court decisions denying FTC-filed motions for preliminary injunctions, effectively blocking mergers between providers that, according to those courts, would have a significant impact on the price and availability of healthcare services in those markets. These two decisions demonstrate the difficult task courts have faced in defining the relevant market, which in the words of the Third Circuit, is a "necessary predicate," without which an "examination of the merger's anticompetitive effects would be without context or meaning."

In ascertaining the relevant geographic market, courts have, since the FTC introduced it in 1982, used the hypothetical monopolist test, which asks whether a single firm controlling all output within a given region could profitably raise prices above a competitive level or if consumers would defeat such a price increase by buying outside that region. If the hypothetical firm could raise prices, that region becomes the relevant geographic market; if not the court must expand the geographic region and rerun the hypothetical test. Therefore, the fundamental question is whether would a consumer be willing and able to purchase the product or service elsewhere, given a small but significant rise in price. Several unique features of the health care industry make this inquiry particularly tricky.

The first unique feature of the hospital market is the binary system of competition in which health care providers operate. As the Seventh Circuit observed, "insurance … splits hospital competition into two stages: one in which hospitals compete to be included in insurers' networks, and a second in which hospitals compete to attract patients." Accordingly, a court's inquiry whether a rise in prices would be profitable in a proposed hospital market must consider whether two sets of consumers would be

willing and able to purchase health care services outside the proposed market: patients and insurers. And these two sets of consumers place value on different aspects of care. Insurers are usually very price sensitive, so they are of primary consideration when testing the proposed market. But patients must be considered as well, although they prize location, quality of care and hospital reputation as paramount to cure their health problems.

The second unique feature of the health care market is the heterogeneous nature of health care providers. One example, which both the Third Circuit and the Seventh Circuit recognized, is the distinction between local hospitals, which frequently offer a wide range of basic care, and destination hospitals, which typically offer complex services, for example academic institutions or other specialty hospitals. In the case of the former, the hospital generally usually services a relatively local area; in the case of the latter, the hospital's expertise may draw patients from a much larger geographic area because of cutting-edge procedures or a specialization in a particular medical field. This feature appeared to play a role in both recent circuit cases. When considering the relevant market, the Seventh Circuit excluded destination hospitals outside the geographic region from its definition of the relevant market. In the Third Circuit case, the court rejected the District Court's consideration of patient flow data to destination hospitals within the proposed market, expressing skepticism that those patients, who travelled long distances for specialized care, would be likely to switch hospitals if rates were raised.

The third unique feature of the health care market, closely related to the second feature, is the heterogeneous nature of patient preferences. Treatment and care can range markedly from routine to specialized, and patients' willingness to travel outside the proposed geographic region, or into the region for that matter, may tempt courts to consider what the Third Circuit coined "patient flow data." In his opinion denying the FTC's request for a preliminary injunction, Judge John E. Jones of the Middle District of Pennsylvania used patient flow data from outside the proposed geographic market into that market as evidence that the merger of the hospitals would not have anticompetitive effects. He reasoned that those patients would divert their care to hospitals outside the proposed market if prices within the market were increased, which seems to fit with the generally accepted theory that hospital patients tend to value convenience.

The Third Circuit rejected this conclusion, noting that it drew its reasoning from an old test that had since been replaced by the hypothetical monopolist test. Writing for the unanimous court, Judge Michael Fisher explained, "the constraining effect is nonexistent because patient decisions are based mostly on non-price factors, such as location or quality of services."

The outcome of the Seventh Circuit's decision in Federal Trade Commission v. Advocate Health Care Network and the Third Circuit's decision in Federal Trade Commission v. Penn State Hershey Medical Center will likely embolden the FTC to file more cases to block health care mergers in the hospital market. And, despite the fact that hospital mergers often implicate relatively local markets with only small effects on the national economy, the FTC seems keen to pursue them no matter the dollars at issue. The Penn State Hershey case, for example, involved a largely rural area. The Third Circuit ultimately agreed with the FTC that the relevant geographic market encompassed the "Harrisburg area," which it defined broadly as Dauphin, Cumberland, Lebanon, and Perry counties. According to the Census Bureau's 2015 population estimates, those four counties have a population of 702,073 people, a far cry from the markets usually implicated in headline grabbing FTC merger challenges.

In contrast, the Seventh Circuit case involved an urban region but still a rather small geographic area. Although the Seventh Circuit remanded for further proceedings and therefore did not define the relevant market, the commission, who carries the initial burden of proposing the relevant market to satisfy its prima facie case, had proposed an 11-hospital region, six of which were the owned by the participants in the proposed merger, in "Chicago's north suburbs." The Seventh Circuit observed that "most patients prefer to receive hospital care close to home." Simply stated, while hospital mergers are usually regional, recent court decisions thus far demonstrate the FTC's newfound appetite for pursuing cases against such regional mergers which impact even small local markets. Stay tuned.

Carl W. Hittinger is a senior partner in Baker & Hostetler's antitrust group and the litigation group coordinator for the firm's Philadelphia office. He concentrates his practice on complex commercial and civil rights trial and appellate litigation, with a particular emphasis on antitrust and unfair competition matters. He can be reached at 215-564-2898 or chittinger@bakerlaw.com.

Tyson Y. Herrold is an associate in the firm's Philadelphia office in its litigation group. His practice focuses on complex commercial and antitrust litigation matters. His experience also includes judicial clerkships for U.S. District Judge Malachy E. Mannion of the Middle District of Pennsylvania, Judge C. Darnell Jones II of the Eastern District of Pennsylvania and Judge Dolores K. Sloviter of the U.S. Court of Appeals for the Third Circuit. He can be reached at 215-568- 3439 or therrold@bakerlaw.com.