Health Care Alert: Ninth Circuit Affirms Order Requiring Divestiture of a Hospital–Physician Group Merger

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In a much anticipated opinion, the U.S. Court of Appeals for the Ninth Circuit upheld an Idaho district court's order mandating the unwind of a merger between two health care providers in Nampa, Idaho after determining that the merger violated § 7 of the Clayton Act. In the wake of the FTC's recent and heightened enforcement in the health care industry, *St. Alphonsus Medical Center-Nampa, Inc. v. St. Luke's Health System, Ltd.*, No. 14-35173, (9th Cir. Feb. 10, 2015), offers important insight into the hotly debated interplay between the integration encouraged under the Affordable Care Act and the operation of federal antitrust laws.

The parties to the transaction in *St. Alphonsus* were St. Luke's Health Systems, Ltd., a health system and hospital operator that employed eight of Nampa's primary care physicians (PCPs), and Saltzer Medical Group, P.A., the largest adult PCP group in the area, with a total of 16 PCPs. The other primary competitor in the market was Saint Alphonsus, which employed nine PCPs. In 2012, St. Luke's acquired Saltzer's assets and entered into a five-year professional service agreement (PSA), purportedly as part of its larger goal of integrating patient care and implementing risk-based reimbursement instead of the more traditional fee-for-service model. Shortly thereafter, competing providers and the FTC challenged the transaction as anticompetitive.

Section 7 of the Clayton Act prohibits acquisitions when the likely effect "may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18. The FTC has the initial burden of demonstrating the probability of such an effect, at which point the defendants have an opportunity to show that no practical alternatives apart from merger can achieve the desired efficiencies.

In its successful case to the district court, the FTC relied on four aspects of the transaction: (1) the post-merger entity's large market share; (2) the post-merger entity's ability to negotiate higher reimbursement rates from insurers for primary care services; (3) the post-merger entity's ability to charge higher hospital-based rates for services

previously performed in physician offices; and (4) the high barriers to entry in the Nampa market. The Ninth Circuit affirmed the district court's reasoning on all but the third.[1]

With respect to market share, the Ninth Circuit focused primarily on the Herfindahl-Hirschman Index (HHI), which calculates post-merger market concentration and the change between pre- and post-merger market concentration. In *St. Alphonsus*, as has been the case in other recent merger cases such as *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559 (6th Cir. 2014), these figures alone rendered the merger presumptively anticompetitive.

On the reimbursement issues, the Ninth Circuit approved the district court's conclusion that the acquisition would inhibit third-party insurers' ability to negotiate primary care pricing, highlighting internal St. Luke's correspondence that identified this likely effect of the transaction. The court's reasoning on this issue reinforces two points. First, in analyzing the potential antitrust concerns of a merger, the most relevant buyers in the health care market tend to be insurers rather than consumers because it is most commonly the insurers that directly purchase health care services. Second, it underscores the importance of managing internal communications during the merger process to avoid communications and documentation that may undermine an entity's position on the merger's procompetitive effects.

To rebut the FTC's case, the defendants maintained that the transaction would result in procompetitive efficiencies—such as integrated patient care, the possibility for risk-based reimbursement, and consolidation of electronic medical records (EMRs)—that outweighed the potential competitive harm. Although both the district court and the court of appeals recognized that the merger was intended to improve patient care outcomes and population health in the region, they nevertheless concluded that the merger should be dissolved because it was not likely to result in increased competition or decreased prices.

The most striking aspect of the opinion was its treatment of the possible efficiencies that may have resulted from the merger. Initially, the opinion expressed strong skepticism that *any* evaluation of post-merger efficiencies should support a Clayton Act § 7 defense, but stopped short of barring it. Nevertheless, the court took a decidedly narrow view of the types of efficiencies that may be relevant in a merger defense, noting that they must be verifiable, merger-specific (meaning that they cannot be achieved with any action short of merger), and likely to result in a merger that enhances rather than hinders competition:

> *"It is not enough to show that the merger would allow St. Luke's to better serve patients. The Clayton Act focuses on competition, and the claimed efficiencies therefore must show that the prediction of anticompetitive effects from the prima facie case is inaccurate."*

Applying that standard to the transaction at issue, the court affirmed the district court's finding that there was no evidence to support that the employment of additional primary care physicians was necessary to create an integrated care network, particularly given that proposed efficiencies such as risk-based reimbursement and EMR access were available to physicians who remained independent from St. Luke's. One important takeaway from this analysis is that improved patient care and coordination may well fall short of what is needed to justify a merger in an already concentrated market, particularly if there is no evidence that the merger has a positive effect on prices or competition.

The Ninth Circuit also affirmed the district court's divestiture order, which required a complete unwind of the transaction. Although St. Luke's had proposed a "conduct remedy" that would have established separate bargaining groups to negotiate with third-party payors, the district court rejected the request, citing the difficulties administering it. In affirming that order, the Ninth Circuit's decision reinforced that divestiture is generally the default remedy in these actions, signaling courts' continued reluctance to permit remedies short of a complete unwind in the face of a merger that has been deemed anticompetitive under § 7.

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[1] The Ninth Circuit's opinion did not affirm the district court's reasoning relating to the possibility of obtaining higher hospital-based rates, noting a lack of supporting evidence in the district court record.