

# Ninth Circuit Sides with FTC; Affirms Ruling That Idaho Health Care Merger Was Unlawful

**February 11, 2015**

In a closely-watched post-merger challenge, the Ninth Circuit this week sided with the FTC and affirmed an Idaho federal court's determination that the 2012 merger of two health care providers in the same city violated federal antitrust laws. The decision is the latest in a string of successful efforts by the FTC to stop health care mergers, and provides important takeaways for health care systems to factor into their growth strategies and any merger-related litigation strategies.

The FTC has for the last 15 years continued to challenge relatively small-sized mergers in the health care industry, even in the wake of the Affordable Care Act. This particular litigation centered on a three-year old merger between two local health care providers in Nampa, Idaho, a Boise suburb. Effective December 31, 2012, St. Luke's – a health care provider in Nampa – acquired a local independent physician practice group named Saltzer Medical Group in an effort to "move away from fee-for-service reimbursement" and instead "to move toward integrated care and risk-based reimbursement." According to the district court's findings of fact, Saltzer's assets were acquired for \$16 million, plus "\$9 million in payment for goodwill and intangibles [that] does not have to be paid back if the Acquisition is undone."

St. Luke's and Saltzer were two of the three largest adult primary care physician (PCP) providers in Nampa. The combined entity, the district court found, included 80% of the PCPs in Nampa. The second largest adult PCP provider in Nampa – St. Alphonsus – and another local rival together challenged the acquisition, alleging that the merger would anticompetitively affect various markets, including the market for adult PCP services. Chief Judge Lynn Winmill of the District Court for the District of Idaho initially allowed the acquisition to proceed by denying the two rivals' request for a preliminary injunction. In doing so, the district court relied in part on the merging parties' assertions that the purchase agreement "provided a process for unwinding the transaction if it were declared illegal."

The FTC and the Idaho Attorney General subsequently filed their own case challenging the merger, and the cases were consolidated. After a bench trial, Judge Winmill found that the merger violated Section 7 of the Clayton Act and Idaho state antitrust laws because of the anticompetitive effects it would have on the adult PCP market in Nampa.

On appeal, the Ninth Circuit assessed four primary legal questions: (1) whether the district court abused its discretion by ordering divestiture as the remedy, instead of adopting St. Luke's proposed conduct remedy; (2) whether the district court properly determined the geographic market to be limited to Nampa; (3) whether, under Section 7 of the Clayton Act, the district court properly held that the plaintiffs had proven "that the merger will probably lead to anticompetitive effects in that market;" and (4) whether the district court properly found that any post-merger, pro-competitive efficiencies did not negate the anticompetitive effects of the merger.

### ***Divestiture as the Chosen Remedy***

Notably, St. Luke's efforts to oppose divestiture on appeal were hamstrung by positions it had taken at the preliminary injunction stage. St. Luke's, "in opposing a preliminary injunction, had assured the court that divestiture was feasible" and had represented to the Court that it would "not oppose divestiture on grounds that divestiture cannot be accomplished." Nevertheless, at trial, St. Luke's had proposed a conduct remedy involving the establishment of separate bargaining groups to negotiate with insurers. The district court rejected this proposal, relying on the rejection of a similar proposal in another recent FTC challenge to a health care merger in *In re ProMedica Health Sys., Inc.*, No. 9346, 2012 WL 1155392, at \*48 (FTC June 25, 2012). The Ninth Circuit held that the district court in this instance did not abuse its discretion by instead opting for divestiture of the physician group that St. Luke's had acquired.

### ***Relevant Geographic Market***

The Ninth Circuit's decision is particularly notable because it affirmed the method applied by the district court to define the relevant geographic market for PCP providers. Specifically, the district court in this case generally adopted the FTC's view that health care markets may be defined by the economic reactions to price increases of insurance companies rather than of the ultimate consumers, and that geographic markets for health care services may be limited to an 80,000-person region without including surrounding cities.

Although the parties agreed that the relevant product market was adult PCPs, St. Luke's argued that the district court had committed clear error by finding the relevant geographic market to be limited to Nampa. The Ninth Circuit disagreed and affirmed the district court's application of the SSNIP method to determine the relevant geographic market. The SSNIP method measures "whether a hypothetical monopolist could impose a 'small but significant nontransitory increase in price ('SSNIP') in the proposed market." Acknowledging the "two stage model" of health care consumption, the district court focused on the probable reactions of insurers rather than that of consumers because the insurers are the ones that negotiate directly with health care providers. The Ninth Circuit found that: (1) the district court was correct to focus on the "likely response of insurers to a hypothetical demand by all the PCPs in a particular market for a [SSNIP];" and (2) the district court's finding that a "hypothetical Nampa PCP monopolist could profitably impose a SSNIP on insurers" was supported by fact and expert witness testimony.

There had been evidence entered into the record that one-third of Nampa residents travelled to Boise (20 minutes away) for PCPs and that at least one Nampa employer had successfully incentivized its employees to switch to non-Nampa PCPs. However, the district court had found this evidence to be unpersuasive, and the Ninth Circuit held that this was not a clear error.

### ***Plaintiffs' Prima Facie Case of Anticompetitive Effects***

Under Section 7 of the Clayton Act, a plaintiff must first establish a prima facie case by proving "that the merger will probably lead to anticompetitive effects in that market," and only then does the burden shift to the defendant to rebut the prima facie case. The Ninth Circuit affirmed 3 of the 4 findings of fact supporting the district court's determination that plaintiffs had met their initial burden: (1) the merger would result in an entity with market shares, as reflected by the Herfindahl-Hirschman Index ("HHI"), that "are well above the thresholds for a presumptively anticompetitive merger;" (2) that "St. Luke's would likely use its post-merger power to negotiate higher reimbursement rates from insurers for PCP services;" and (3) "entry into the market has been very difficult and would not be timely to counteract the anticompetitive effects of the Acquisition." However, the Ninth Circuit found that the district court had committed clear error by finding that "St. Luke's would raise prices in the hospital-based ancillary services market," which includes services like x-rays and diagnostic testing that are performed in conjunction with PCP examinations. The district court had not made any market power findings and had relied on factual evidence that the Ninth Circuit described as "suspect."

In support of its affirmation, the court relied on internal pre-acquisition emails in which St. Luke's employees "indicated that the merged companies would use this increased bargaining power to raise prices" in their negotiations with insurers. The Ninth Circuit also found it convincing that the district court's analysis of a prior acquisition by St. Luke's demonstrated that St. Luke's had actually used its leverage to force insurers to "concede to their pricing proposal."

### ***St. Luke's Post-Merger Efficiency Defense***

Next, the Ninth Circuit held that the district court had not committed clear error by finding that the post-merger efficiencies presented by St. Luke's did not negate the anticompetitive effects of the merger. Although the Ninth Circuit discussed the significant support in the case law for a post-merger efficiencies defense in Section 7 cases, it stated that it "remained skeptical" about the defense and its scope, opining that "[t]he Supreme Court has never expressly approved [it]."

Assuming as the district court did that such a defense exists, the Ninth Circuit held that defendants had not adequately proven that the "merger, is not, despite the existence of a prima facie case, anticompetitive." The court explained that "[c]laimed efficiencies must be verifiable, not merely speculative," and held that "[i]t is not enough to show that the merger would allow St. Luke's to better serve patients." Even though health care delivery in the Nampa market would improve, the defendants had not shown "that the merger would increase competition or decrease prices." In addition, the Ninth Circuit affirmed the district court's finding that the claimed efficiencies were not merger specific. For example, there was evidence showing that physicians that were not part of large health care systems were able to access analytical tools and to adopt risk-based reimbursement – which were two of the claimed efficiencies of this particular merger. As the court explained, better service to patients "is a laudable goal, but the Clayton Act does not exclude mergers that lessen competition or create monopolies simply because the merged entity can improve its operations."

### ***Takeaways***

In what was the most closely watched health care antitrust case of the last few years, the Ninth Circuit affirmed the latest victory for the FTC in its ongoing efforts to challenge health care mergers. The case provides some important takeaways that hospitals and health care systems should factor into future growth strategies and litigation-preparedness plans.

1. First, the FTC continues to be focused on challenging even small acquisitions involving health care providers. Despite the Affordable Care Act's incentives for health care providers to integrate care, health care systems seeking to enhance patient care or reduce costs through acquisitions must carefully assess the antitrust risks of any such opportunities. Moreover, the FTC remains willing and able to litigate merger challenges through trial, even where private litigants are already pursuing a case.

2. Second, once a merger has been challenged in court, the merging parties must carefully consider the longer term implications of any positions they take in opposing a preliminary injunction at the outset of the proceedings. Specifically, defendants must carefully weigh the benefits and risks of taking positions regarding divestiture that may be understood by the court to mean that the deal can be unwound at any time in the future without any effect on competition. Courts may later rely on such positions in ordering divestiture instead of a more appropriate remedy.
3. Third, future health care mergers must consider the likelihood that the relevant geographic market will not encompass nearby cities and health care hubs. Relevant geographic markets may be limited to smaller cities or regions even where there is evidence, as in the St. Luke's case, that many consumers travel outside that region to receive health care services.
4. Fourth, courts and the FTC will likely continue to focus on insurers and not consumers when defining product and geographic markets in the health care industry. As the Ninth Circuit stated in a footnote, "the 'two-stage model' of health care competition is 'the accepted model'" and "[t]hus, antitrust analysis focuses on the first stage."
5. Fifth, courts presented with post-merger challenges are increasingly focusing on the bargaining power that the combined entity would be able to leverage in negotiations with purchasers. This emphasis on monopsony continues a trend found in earlier health care cases.
6. Sixth, even with relatively small-sized deals, it remains imperative for in-house counsel to actively and regularly remind deal-oriented employees to comply with well-documented best practices and antitrust guidelines. As internal emails relied on by both the district court and the Ninth Circuit decisions make clear, implementing best practices may avoid having business language misconstrued in a merger challenge. And enforcing those best practices can further the company's interest in ensuring an accurate evidentiary record of pro-competitive business goals.

7. Seventh, while the efficiencies defense remains alive and available to defendants in merger challenges, those efficiencies must be "verifiable," merger-specific (*i.e.*, can only be obtained through the merger), and negate the anti-competitive effects of the merger. Companies may be well-served by incorporating this learning into early assessments of potential acquisitions.

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