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Ninth Circuit Affirms Divestiture of Consummated Physician Practice Acquisition

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The ***U.S. Court of Appeals for the Ninth Circuit*** affirmed an ***Idaho*** federal district court's decision ordering the divestiture of a physician practice group that had been acquired by a competing health system. The case, which pitted the health system against private plaintiffs as well as the *Federal Trade Commission (FTC)* and the state attorney general, illustrates some of the key issues hospitals and health systems must evaluate as they consider potential acquisitions.

Summary of Court's Opinion

Background and Procedural History

In 2012, *St. Luke's Health System*, based in Boise, Idaho, proposed to acquire the assets of the *Saltzer Medical Group* and enter into a five-year professional services agreement with Saltzer for the services of its physicians. Two competing health care systems that operated facilities in Nampa, Idaho—*St. Alphonsus Health System, Inc*., and *Treasure Valley Hospital*—challenged the proposed acquisition in a private antitrust action filed with the federal district court in Idaho. Plaintiffs' motion for a preliminary injunction to prevent consummation of the transaction was denied, however, and St. Luke's and Saltzer closed their transaction effective December 31, 2012. The FTC and the Idaho Attorney General filed a complaint in March 2013 challenging the transaction, and the cases were consolidated in federal district court. The district court conducted a bench trial in October and November 2013 and issued an opinion on January 24, 2013. An appeal by St. Luke's to the Ninth Circuit followed.

Standard of Review

The Ninth Circuit reviewed the district court's findings of fact for clear error and its conclusions of law *de novo*. The district court's choice of remedy was reviewed for abuse of discretion.

Relevant Market

Noting that the parties agreed upon the relevant product market (adult primary care services sold to commercially insured patients), the Ninth Circuit focused on whether the lower court erred in the definition of Nampa, Idaho, as the relevant geographic market. Although St. Luke's rigorously contested this definition—presenting evidence that a sizeable share of Nampa residents currently receive care 22 miles away in Boise, and contending that employers and payors could steer additional patients to Boise—the Ninth Circuit found no clear error in the district court's decision. Indeed, the Ninth Circuit held that district court had properly focused on the transaction's potential impact on insurers when defining the geographic market. The court found there was ample testimony that insurers could not market a health care network in Nampa that did not include Nampa primary care physicians (PCPs).

The *Prima Facie* Case: Market Share and Anticompetitive Effects

The district court held that plaintiffs met their *prima facie* case by showing that the combined entity would have a high market share, the ability to negotiate higher reimbursement rates for PCPs with insurers, and the ability to raise prices for ancillary services. The Ninth Circuit examined each finding for clear error.

Market Share

The district court calculated the post-merger Herfindahl–Hirschman Index (HHI) to be highly concentrated at 6,219, with an increase of 1,607. St. Luke's did not challenge the HHI calculation, and the Ninth Circuit agreed with the district court's conclusion that the HHI numbers "are well above the thresholds for a presumptively anticompetitive merger (more than double and seven times their respective thresholds, respectively)."

Impact on PCP Reimbursements

The district court concluded that the post-merger entity would have the ability to raise reimbursements from insurers for PCP services. The Ninth Circuit found that the district court's finding was supported by the evidence and thus not clearly erroneous. The evidence showed that St. Luke's and Saltzer were each other's closest substitutes. Documents produced in the investigation showed internal discussions of using the increased bargaining power of the post-transaction entity to raise reimbursements. The Ninth Circuit also noted evidence that St. Luke's had used a previous transaction to raise reimbursements.

Impact on Ancillary Services

The district court found that the combined entity would have increased bargaining power such that it would be able to negotiate higher prices for ancillary services. The Ninth Circuit did not agree with this finding, because the district court did not make any findings as to St. Luke's market power in the ancillary services market. The Ninth Circuit cautioned against using potential tying effects to condemn a merger. The documents the district court cited to support its finding stated only that St. Luke's desired to increase its revenue in ancillary services, and did not state prices. Ultimately, the Ninth Circuit determined that the district court's ancillary services findings were not supported by the record. However, the Ninth Circuit noted that the *prima facie* case had been established by the extremely high HHI calculation, notwithstanding its disagreement with the district court's ancillary services finding.

St. Luke's Rebuttal: Efficiencies

Because plaintiffs established their *prima facie* case, the burden shifted to St. Luke's to rebut the evidence of anticompetitive effects. St. Luke's argued efficiencies in the merger would lead to better health care delivery. The Ninth Circuit expressed skepticism as to whether efficiencies were a defense to an otherwise anticompetitive merger, but ultimately reviewed the record to see if the efficiencies could rebut the presumption that the merger was anticompetitive.

St. Luke's argued that the merger would allow it to move towards risk-based reimbursement and integrated care, and would allow Saltzer PCPs access to its Epic medical record system. The district court agreed that the merger might improve delivery of health care, but did not find that the merger would increase competition or reduce prices. Moreover, the district court expressly found that the claimed efficiencies were not merger specific. The Ninth Circuit agreed, finding that the district court's conclusion was not clearly erroneous. The Ninth Circuit noted that the evidence supported this conclusion because it showed that physicians can adopt risk-based reimbursement and Epic medical records without being employed by a major health system. And even if these efficiencies were merger specific, they were still insufficient to counter the anticompetitive effects of the acquisition, the Ninth Circuit noted. Although providing better service to patients was a "laudable goal," the court concluded that the "Clayton Act does not excuse mergers that lessen competition or create monopolies simply because the merged entity can improve its operations."

Remedy

Although St. Luke's argued that the district court's divestiture order would not restore competition, that it would eliminate the procompetitive benefits of the transaction, and that other remedies were preferable, the Ninth Circuit found no abuse of discretion in the district court's remedy. The Ninth Circuit found ample evidence in the record to support the divestiture order, including the fact that St. Luke's had argued that divesture was feasible in opposing the preliminary injunction, and that Saltzer employees had been assured that they would have jobs in a viable independent entity regardless of the outcome of the litigation. Moreover, the district court had appropriately determined that any benefits of the merger were outweighed by the anticompetitive concerns and had case support for rejecting a conduct remedy in favor of divestiture.

Key Implications

Prior Conduct

Parties should be mindful that potential competitive effects of a transaction may be presumed from actual competitive effects of a buyer's prior acquisitions. For example, if a buyer has a record of raising the prices of practices it acquires, or if the effect of those transactions is a price increase to payors, it may be inferred that the buyer will take similar actions with respect to the transaction under review. Hospital buyers should be mindful that if they convert free-standing physician practices to hospital outpatient provider-based facilities post-closing, payors may take the position that they will be paying more for the same services post-acquisition—even though such a price increase would not be the result of reduced competition. Similarly, if the buyer's existing payor contracts are more favorable than the seller's payor contracts, and the buyer places the seller's providers on its contracts post-closing, payors may take the position that they will be paying more for the same services post-acquisition. Both of these actions pertain to existing contracts and not to contracts renegotiated post-acquisition, so they are not the result of increased bargaining power through the reduction in competition. Providers planning additional acquisitions should be mindful of the potential implications of their conduct for future acquisitions as well as the current transaction.

Conversely, buyers that are able to demonstrate that they improve the quality or reduce the cost of care rendered by providers they acquire may have pro-competitive efficiency arguments in subsequent acquisitions. Providers planning additional acquisitions should contemporaneously document quality improvements and cost reductions realized by groups they acquire.

Merger-Specific Efficiencies

Although the Ninth Circuit expressed skepticism about efficiencies arguments generally, efficiencies that are cognizable and merger specific should have the potential to offset a transaction's presumed anticompetitive effects. However, as a practical matter, the success of contractual arrangements spurred by the Affordable Care Act may undermine the ability to argue that some efficiencies are merger specific. For example, parties asserting that their merger or acquisition will better enable the parties to engage in population health management will have to demonstrate why they cannot achieve the same benefits through a contracting network, such as an accountable care organization or clinically integrated network, in order for the efficiency to be credited as merger specific.

Parties to merger and acquisition transactions planning to assert efficiency defenses should carefully evaluate whether the transaction benefits they have identified can only be achieved under common ownership and control, and whether the efficiencies will benefit patients and competition, rather than necessarily the providers themselves.

Remedies

Except in unusual circumstances, such as a material amount of time since a transaction's closing, parties should assume that the federal antitrust enforcement agencies will seek divestiture as a remedy for a transaction the agencies view to be in violation of the antitrust laws. As the Ninth Circuit noted from previous case law, divestiture is clean and simple, while conduct remedies require ongoing government involvement. Parties should note that several state attorneys general, notably those in Maine, Massachusetts and Pennsylvania, have entered into consent decrees containing conduct remedies for provider transactions. These have included restrictions on the providers' abilities to raise prices post-closing. These approaches are not without their own challenges, however, as demonstrated by the recent Massachusetts state court decision rejecting a proposed hospital merger case settlement agreement negotiated by the former state attorney general, after the new state attorney voiced concerns about the arrangement.

Network Composition

Parties to provider consolidations should be mindful that the antitrust agencies will focus on viable alternatives to the merging parties within existing provider networks, and on the views of payors regarding the providers that must be in the payors' networks in order to market a competitive plan to employers and other constituencies within the geographic area. This issue will become more complicated with the rise of narrow and tiered networks. For purposes of transaction planning, parties should also assume that payors and the antitrust enforcement agencies may define very local geographic markets, particularly with respect to primary care services.

Any Size Deal

This case reaffirms that providers should assume that no deal is too small for the antitrust enforcement agencies to conclude that competitive concerns exist. The St. Luke's case involved the combination of 24 PCPs. In the last several years, the FTC also challenged a health system's

acquisition of a 15-bed surgical hospital. Antitrust due diligence is a necessary component of any size deal.

Document Creation

Parties to transactions should seek to ensure that both parties abide by document creation protocols that identify those individuals who are authorized within each organization to create documents pertaining to the transaction, especially those that contain statements about the purpose and effect of the transaction. Identification of these individuals and a review process helps to ensure that documents are representative of the organization's views. The same process should apply to documents created by external consultants retained by the parties.

Entry

Although not discussed in the Ninth Circuit opinion, since St. Luke's did not dispute the district court's barriers-to-entry finding, whether and to what extent potential new entrants can reduce presumed competitive effects remains part of the competitive effects analysis. Entry into the physician services market will be presumed to be more likely if there is demand in the marketplace for additional physician services in that specialty, and if other providers have successfully recruited physicians in that specialty to the market. Providers contemplating transactions that raise potential competitive concerns should be mindful of community needs assessments that show the current community supply of physicians in specialties they are targeting for acquisitions, as well as patient demand for physicians in those specialties. Parties' entry arguments are more likely to be credited when the community needs study shows a deficit in the physician specialty. Parties to transactions that raise potential competitive concerns may also benefit by documenting successful recruiting efforts by other providers of physicians in these specialties in the market.

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