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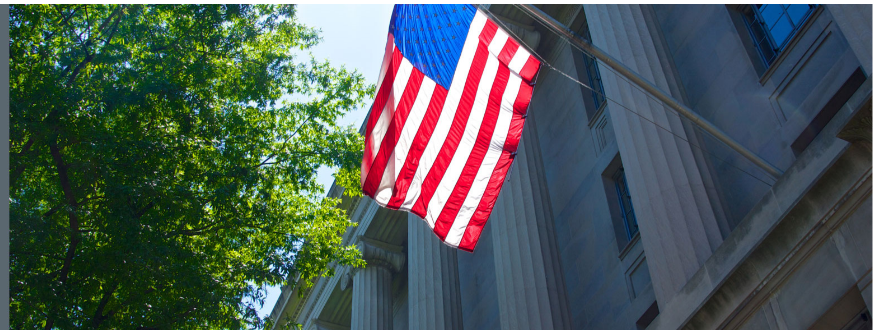
Antitrust



March 2014

Federal Trade Commission and Competitors Successfully Challenge Hospital's Acquisition of Physician Practice

In this Issue:

A federal judge recently ordered a hospital system to unwind its year-old acquisition of an independent physician practice, which created a "dominant provider" with "80% of the primary care physicians" in Nampa, Idaho. This is the first time the Federal Trade Commission (FTC) has successfully challenged a physician practice acquisition in federal court. The ruling reminds us that the FTC will challenge a health care transaction that it views as anticompetitive, even if the transaction does not involve a hospital merger, is not reportable under the Hart-Scott-Rodino Act, and has already closed. It also reminds us that even a transaction that lowers costs and increases quality of care may nonetheless violate the antitrust laws if it reduces competition and increases prices. The decision is *Saint Alphonsus Medical Center – Nampa, Inc. v. St. Luke's Health System, Ltd.,* 1:12-CV-00560-BLW, 2014 WL 40446 (D. Idaho 2014).

What Providers Should Know

- The FTC is increasingly targeting physician practice acquisitions that create high market shares in particular specialties in local markets.

- A physician practice acquisition may violate the antitrust laws *even if* its purpose and effect is to better coordinate care, reduce costs, and improve quality. Despite these benefits, a deal that leads to higher prices may be found anticompetitive and unlawful – especially if the same

benefits could have been achieved without the acquisition.

- In merger cases, the parties' internal documents and emails are the best evidence of the likely effects of a transaction, and "bad documents" can sink a good deal.

Background

In 2012, St. Luke's Health System, Ltd. (St. Luke's), Idaho's largest hospital system, agreed to acquire Saltzer Medical Group (Saltzer), Idaho's largest independent physician group. The transaction included a 5-year exclusive professional services agreement between St. Luke's and the Saltzer physicians. Two of St. Luke's competitors sued, seeking a preliminary injunction to block the deal. The court denied the competitors' request, explaining that a preliminary injunction was not necessary because the transaction could be unwound later after a trial on the merits. St. Luke's and Saltzer then closed the acquisition.

The FTC and the Idaho Attorney General then sued for an injunction to unwind the transaction. The complaint alleged, among other things, that St. Luke's purchase of Saltzer violated Section 7 of the Clayton Act because it gave St. Luke's market power to demand higher prices from insurers, and would ultimately lead to higher costs for consumers.

In response, St. Luke's and Saltzer asserted an efficiency defense: they argued that the acquisition would allow them to transition from fee-for-service medicine to integrated and value-based care, which would reduce costs and improve quality of care, leading to better patient outcomes.

Ruling

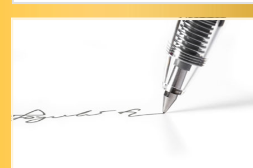
The court found the transaction would reduce competition and lead to higher prices, based mainly on three kinds of evidence: (1) market shares, (2) the parties' own documents predicting that they would be able to increase prices to insurers, and (3) testimony from insurers who agreed that the deal would lead to higher prices.

The market share evidence was straightforward: the transaction combined 80% of primary care physicians in Nampa, Idaho, and increased the HHI (an index of market concentration) by 1,607 to 6,219. This made the acquisition "presumptively anticompetitive under § 7 of the Clayton Act," and shifted the burden of proof to the defendants.

The defendants' documents reinforced the court's conclusion that this market share would give St. Luke's a dominant position in the Nampa market, which St. Luke's would use to increase prices to insurers. Both St. Luke's and Saltzer's internal emails predicted that the transaction would give them new "clout" with which to "pressure" insurers to pay more. St. Luke's even quantified the expected price increase: "St. Luke's planned to fund a 30% pay raise for its physicians in connection with the Acquisition by obtaining 'higher hospital reimbursement' from the health plans."

Insurers also predicted higher prices. Blue Cross of Idaho testified that "that costs under its commercial contracts would increase by 30 to 35 percent" after the acquisition. The insurers also pointed out St. Luke's record of increasing prices after previous acquisitions.

Turning to the efficiencies defense, the court accepted St. Luke's and Saltzer's argument that the transaction would lower costs and improve quality of care. The court found as a fact that "The Acquisition was intended by St. Luke's and Saltzer primarily to improve patient outcomes. The Court believes that it would have that effect if left intact."



However, the court also found that the transaction was not necessary to achieve those results, because "there are other ways to achieve the same effect that do not run afoul of the antitrust laws." Noting that "efficiencies must be merger-specific – that is, they must be efficiencies that cannot be achieved by either company alone," the court held that "St. Luke's has not carried its burden of showing convincing proof of significant and merger-specific efficiencies."

St. Luke's has appealed the district court's decision, and has asked the court to stay the divestiture order while the appeal is pending. The district court has not ruled on that motion.

The FTC has recently expanded its focus from horizontal hospital mergers to investigating and challenging physician practice acquisitions. Hospitals, physician practices, and other health care entities contemplating mergers and acquisitions should consult antitrust counsel to evaluate antitrust risks well before the transaction closes.

Private parties also can challenge their competitors' deals. St. Luke's competitors were the first to sue to enjoin the acquisition, and they continued as active plaintiffs after the FTC joined the fight. This shows that private parties can significantly affect the outcome of federal merger reviews, by forcefully asserting their own rights under the antitrust laws. Competitors who are concerned about the anticompetitive effects of transactions in their markets should consult counsel to evaluate their options under the antitrust laws.

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