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Federal Trade Commission Rules Evanston Northwestern Merger Violated Antitrust Law

Revised Remedy Orders Separate Contracting, Not Divestiture of Highland Park Hospital

The federal antitrust enforcement agencies have lost more than a half-dozen merger cases in the courts over the last decade. The Federal Trade Commission ("FTC" or "Commission") responded to this adverse precedent by embarking on a retrospective analysis of hospital mergers, targeting the January 2000 merger of Evanston Hospital ("Evanston") and Highland Park Hospital ("Highland Park")—which formed the Evanston Northwestern Healthcare Corporation ("ENH"). The agency hoped to demonstrate the anticompetitive effects such mergers produce and to create new jurisprudence that would reinvigorate the hospital merger enforcement program. After more than three years of litigation, the full Commission issued an opinion and order on August 2, 2007, upholding the October 2005 conclusions of an administrative law judge ("ALJ"), that the merger violated Section 7 of the Clayton Act, 15 U.S.C. § 18.

In the words of the opinion authored by FTC Chairman Deborah Majoras:

> Considered as a whole, the evidence demonstrates that the transaction enabled the merged firm to exercise market power and that the resulting anticompetitive effects were not offset by merger-specific efficiencies. The record shows that senior officials at Evanston and Highland Park anticipated that the merger would give them greater leverage to raise prices, that the merged firm did raise its prices immediately and substantially after completion of the transaction, and that the same senior officials attributed the price increases in part to

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increased bargaining leverage produced by the merger.

Commissioner Rosch agreed with the decision but wrote a separate concurrence, which Commissioner Leibowitz joined, to emphasize his view that there was enough evidence to sustain liability without rigorously defining a relevant product or geographic market.

Although the ALJ decision had required the merged hospital to divest Highland Park, the full Commission rejected that remedy. Instead, it ordered the hospital to submit a proposal for structurally separated contracting to allow healthcare buyers (insurance companies) to choose whether or not to buy services from both hospitals. According to public reports, an appeal has not been ruled out by ENH. If one is filed, it will likely be before the Seventh Circuit and could stretch the resolution of the case out for another year.

Background

In the complaint to the ALJ, staff alleged that the merger of ENH and Highland Park had substantially lessened competition in the market for general acute care inpatient services sold to managed care organizations in an area along Lake Michigan in Chicago's North Shore area. In the event that the evidence was so strong that the precise definition of product and geographic markets was unnecessary, complaint counsel also alleged that the merger of ENH and Highland Park had substantially lessened competition without alleging a relevant product or geographic market. On appeal, the full Commission reviewed the record *de novo*.

The Decision

The FTC reviewed the dynamics of the hospital services marketplace, the role of third-party insurance, and the role of competition among hospitals and among managed care organizations. The Commission emphasized the record evidence showing that ENH sought to gain leverage in price negotiations, gained leverage, and thereafter raised prices as a result of the merger. Testimony and documents from ENH and their consultants that "it would be…tough for [employers] to walk" from the merged hospital, and that the merger would give the combined entity enhanced "power in the…market" and "improve [its] leverage" all made an evident impression on the Commission and played a key role in buttressing its conclusions.

Three Aspects of the Decision Are Particularly Notable

First, although the Commission agreed with the ALJ that the relevant product market in this case was general acute care inpatient services sold to managed care organizations, including primary, secondary, and tertiary inpatient services, it rejected the ALJ's approach to defining a geographic market, noting the determination was based on "rough inferences" and "general findings." Interestingly, the FTC has lost hospital merger cases in the past for having failed to sustain its asserted geographic markets, especially on the basis of patient flow data (the so-called "Elzinga-Hogarty" test). *See*, *e.g.*, *FTC v. Freeman Hosp.*, 69 F.3d 260, 269–270 (8th Cir. 1995) (rejecting geographic market based on patient flow); *United States v. Mercy Health Servs.*, 902 F. Supp. 968, 978 (N.D. Iowa 1995) (same); *see also FTC v. Foster*, No. 07-352, 2007 U.S. Dist. LEXIS 47606 (D.N.M. May 29, 2007) (rejecting geographic market for natural gas pipelines). In this case, Professor Kenneth Elzinga himself testified before the ALJ on behalf of the Commission that the test he developed was not an appropriate method to define geographic markets in the hospital merger context. The FTC agreed. Although unwilling to pronounce patient flow data as always irrelevant to a determination of the relevant geographic market, the Commission stated it will approach patient flow data with extreme caution.

Instead, the Commission here relied on an analysis of post-merger pricing evidence to define a market in which ENH raised prices (11% to 18% higher or 9% to 10% higher, depending on whose expert did the calculations). In essence, the Commission found that, because prices had increased post-merger due to market power, a relevant antitrust market had been defined for analytical purposes. Pointing out that a relevant geographic market is "the area…to which the purchaser can practicably turn" for alternatives to the merging parties should they raise prices by more than 5%, the Commission found that evidence of higher price increases post-merger sufficient to indicate the presence of a relevant geographic market. The Commission noted that in unilateral effects cases a merger leads to higher prices due to the loss of competition between the two merging firms. Where a merger enables the combined firm unilaterally to raise prices by more than 5% for a non-transitory period, the merger is anticompetitive and the merging firms comprise a relevant antitrust market because they are considered to be a "monopolist" under the Merger Guidelines, §§ 1.11, 1.21 (the "hypothetical monopolist" approach). The Commission dismissed the possibility of defining excessively narrow markets by pointing out that small markets are not unusual and were defensible in this case in light of record evidence of price increases occasioned by the merger.

Second, the FTC rejected the argument that price increases were justifiably the result of the merging parties' "learning about demand" for services. Specifically, ENH had argued that some of Highland Parks' contract rates were below market and that the post-merger price increases brought its prices up to the level charged by other hospitals. Although some price increase may have been justifiable based on outdated contracts, the level to which the prices were raised was well in excess of the reasonable increase anticipated by managed care organizations. The price increases were also unjustified based on Evanston or Highland Park's status as teaching hospitals. Moreover, ENH's expert did not present viable evidence to support its theory. The FTC agreed with the ALJ that the price increases ENH was able to command after the merger were the result of a newly created market condition, namely the elimination of Highland Park as a price-restraining competitor.

Third, the FTC rejected the argument that price increases could be accounted for by post-merger "quality of care improvements" to Highland Park. The Commission noted that quality improvements could be considered an efficiency or a procompetitive justification under the competitive effects analysis of the merger. While agreeing that there had been significant improvements to Highland Park, the Commission found the record did not support ENH's argument that improvements in quality at Highland Park caused the price increases at the hospital, or that quality even improved relative to that of other hospitals post-merger. Moreover, the Commission only found one substantial, merger-specific improvement—the medical staff integration and affiliation with a teaching hospital—which was not enough to overcome the anticompetitive impact of the post-merger price increases.

What the Commission Did Not Decide

The Commission declined to decide whether the law permits establishing a violation of Section 7 without defining a relevant market. The opinion concedes that market definition is not an end in itself and, especially in retrospective merger challenges, it may not be necessary. Relying on the Supreme Court's decision under Section 1 of the Sherman Act in *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986), the Commission noted that market analysis is a surrogate for examining competitive effects and that direct evidence of market power can obviate in some circumstances the need for detailed market definition. But it declined to go further, noting that liability had already been established on the basis of properly defined markets. Commissioner Rosch, joined in concurrence by Commissioner Leibowitz, would have held that the law allows liability to be established by direct evidence of actual anticompetitive unilateral effects where the evidence identifies the "rough contours" of the market.

Alternative Remedy: A Light at the End of the Tunnel for ENH?

Perhaps the biggest "story," aside from the fundamental conclusion that the merger was unlawful, is the Commission's decision to reject the divestiture remedy ordered by the ALJ. Fundamentally, the Commission was faced with a difficult challenge. Noting that structural remedies such as divestiture are preferred for Section 7 violations, it evinced unease at the length of time that had elapsed since closing (more than seven years), the risk of unforeseen costs, and the potential negative effect on improvements made at Highland Park since closing. Accordingly, the Commission rejected divestiture and instead ordered the hospital to establish separate and independent negotiating teams and processes for Evanston and Highland Park hospitals.

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If you wish to discuss the contents of this Alert, or for assistance with issues raised by the legal developments that are the subject of this Alert, please contact the Mintz Levin lawyers listed below or any other member of Mintz Levin's Antitrust or Health Law practice groups.

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