Client Update
Ninth Circuit Affirms District Court Order to Unwind Hospital Merger

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In a closely watched case that attracted nationwide attention, the U.S. Court of Appeals for the Ninth Circuit (the "Ninth Circuit" or "Court") this week upheld a district court's ruling that ordered a healthcare system to unwind its consummated purchase of a physician practice group due to the likelihood that the transaction would have anticompetitive effects. Notably, the decision in *St. Alphonsus Medical Center-Nampa Inc. v. St. Luke's Health System Ltd.*[1] held that even if the merged entity might provide better service to its patients, the antitrust laws do not allow a merger that lessens competition "simply because the merged entity can improve its operations." This ruling continues the recent trend of close scrutiny of healthcare mergers and reaffirms that antitrust regulators can convince courts to unwind consummated transactions that were not subject to pre-merger review under the Hart-Scott-Rodino Act if they establish the likelihood of anticompetitive effects.

BACKGROUND

In late 2012, St. Luke's Health System Ltd. ("St. Luke's"), an Idaho-based, not-for-profit healthcare system that operated an emergency clinic in Nampa, Idaho, purchased the assets of Saltzer Medical Group, P.A. ("Saltzer"), the largest independent multi-specialty physician practice group in Idaho, which had 34 physicians practicing at its Nampa offices. At the time of the merger, St. Luke's and Saltzer were two of the three largest providers of adult primary care physicians ("PCPs") in Nampa.

In March 2013, the Federal Trade Commission ("FTC") and the State of Idaho filed a lawsuit challenging the merger, which had been completed after the district court denied a preliminary injunction sought by two private hospitals to enjoin the merger. The district court determined after a bench trial that the merger should be enjoined under federal and Idaho antitrust laws. Although the

[1] *St. Alphonsus Medical Center-Nampa Inc. v. St. Luke's Health System Ltd.*, No. 14-35173, 2015 WL 525540 (9th Cir. Feb. 10, 2015).

district court expressed its belief that the merger would "improve patient outcomes," it found that the combined entity's "huge market share" in the adult PCP market in Nampa created a "substantial risk of anticompetitive prices."

NINTH CIRCUIT RULING

On appeal, the Ninth Circuit first analyzed the scope of the relevant market. Although the parties agreed that the relevant product market was adult PCPs, St. Luke's disputed the district court's determination that Nampa was the relevant geographic market, arguing that if the merged entity raised its prices, customers would consider adult PCP providers outside of Nampa. The Ninth Circuit affirmed the district court's holding that the relevant geographic market was limited to Nampa because consumer behavior indicated that the strong preference of most Nampa residents for local PCPs would not change in the event of a price increase by St. Luke's. This conclusion was driven by the fact that "health care consumers only pay a small percentage of health care costs out of pocket" and by the Court's finding that insurers, which pay the bulk of the costs, could not defend against a post-merger price increase by steering customers to non-Nampa PCPs. The Court observed that the evidence showed that insurers generally need local PCPs to market a health plan and that consumers choose PCPs based on factors other than price, including location.

The Ninth Circuit next examined whether the plaintiffs had established a *prima facie* case that the acquisition was anticompetitive. The court held that the "extremely high HHI [a measure of market concentration] on its own establishe[d] the *prima facie* case." The Court also determined that the likelihood of anticompetitive effects was supported by evidence that the merging parties had been one another's closest substitutes, the uncontested finding of high barriers to entry, and "statements and past actions by the merging parties" that made it likely that St. Luke's would demand increased reimbursement rates from insurers.

The Court then concluded that St. Luke's had failed to rebut the presumption that the transaction would result in anticompetitive effects through evidence of post-merger efficiencies and procompetitive benefits of the merger. The Ninth Circuit stated that it was "skeptical" about the viability of an efficiencies defense, which the U.S. Supreme Court has never expressly approved in a merger case. However, noting that other circuits and the FTC have recognized the possibility of an efficiencies defense, the Court assumed for purposes of its analysis that evidence of "extraordinary" and "merger-specific" post-merger efficiencies could rebut the presumption. The Court agreed with the district court that St. Luke's had not satisfied this high standard, rejecting arguments that the acquisition

would create a team of physicians with access to St. Luke's superior electronic medical records system and would have a beneficial effect on patient care and outcomes. The Court held that "provid[ing] better service to patients . . . is a laudable goal," but "the Clayton Act does not excuse mergers that lessen competition or create monopolies simply because the merged entity can improve its operations."

Lastly, the Ninth Circuit affirmed the district court's holding that the customary merger remedy of divestiture was appropriate. The Court reasoned that divestiture of the acquired assets is a "simple, relatively easy to administer, and sure" remedy that offers fewer future difficulties of administration than St. Luke's proposed conduct-based remedy, which "would risk excessive government entanglement in the market."

IMPLICATIONS

Increasingly, health care systems are consolidating into integrated delivery networks. The *St. Luke's* case highlights the need to keep in mind that merging parties cannot justify a transaction that is likely to result in higher prices by arguing that the merger will yield better patient outcomes. Courts are likely to find that a transaction is anticompetitive unless the claimed efficiencies will promote competition and thereby eliminate the risk of higher prices.

This case is also another example of post-merger enforcement actions that have sought to unwind consummated mergers. The fact that a transaction is too small or is otherwise exempt from pre-merger review under the Hart-Scott-Rodino Act does not mean that antitrust regulators will not review the transaction after it closes and seek divestiture if they believe the deal was anticompetitive. Parties are therefore cautioned to consider the potential competitive implications of any transaction prior to its consummation, whether or not the transaction is reportable under the antitrust laws.

In addition, the ruling underscores the role that pre-merger documents and statements may play in a subsequent review of the transaction. Both the district court and the Ninth Circuit found highly relevant pre-acquisition correspondence indicating that the merged companies would leverage their post-merger position to raise prices. Parties to a potential transaction must take care to avoid creating documents that will provide support for a later challenge to the transaction.