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# Payer Support for Provider Mergers: The Importance of Being Proactive

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Health care providers are undergoing a merger wave. In part due to incentives created by the Affordable Care Act, more and more providers are combining with the goals of improving care coordination, population health management, and patient outcomes. To the extent they can achieve these goals, provider mergers can be a positive force for aligning the interests of providers, health plans, and public policy. This merger wave has not gone unnoticed by the Federal Trade Commission (FTC), the principal federal antitrust enforcement agency responsible for health care providers. In the last two years the FTC has brought several challenges to hospital and other provider mergers, including high-profile challenges in Chicago, IL and Hershey, PA. The FTC shows no signs of altering its aggressive enforcement posture, and parties to a proposed health care provider merger can comfortably assume that the agency will cast a careful eye at the competitive implications of future transactions.

When conducting antitrust merger investigations, the FTC and the Antitrust Division of the Department of Justice (DOJ) rely heavily on the Horizontal Merger Guidelines (Merger Guidelines). The Merger Guidelines reflect the agencies' attempt to describe their enforcement philosophy, and provide guidance on how they will exercise their prosecutorial discretion in merger investigations. In provider mergers, as in other industries, the agencies historically began their Merger Guidelines analysis with a consideration of the structural characteristics of the market. What are the geographic boundaries of the relevant market? What geographic coverage do health plans require to allow them to market a provider network to employers? Where can patients in the market turn when they need care? Will the merger result in a significant increase in concentration in the defined market?

The most recent iteration of the Merger Guidelines, which the agencies published in 2010, features a shift in tone from the previous versions. Where structural analysis formerly was paramount, now the agencies purport to focus initially on competitive effects, and use structural market characteristics to further refine the effects analysis. The agencies generally group competitive effects into two broad categories: unilateral effects and coordinated effects. A unilateral effects analysis asks whether, as a result of a merger, the combined firm would have sufficient market power to raise prices

unilaterally, regardless of whether other firms in the market behaved similarly. By contrast, a coordinated effects analysis considers whether a merger would create a more stable oligopolistic market—for example, by removing a pricing maverick—so that the remaining firms could more effectively raise prices with less fear of a competitive response. Under either analysis, the ultimate question the agencies consider is, regardless of the market’s structure, would the merging providers be able to raise prices to managed care plans as a result of their merger?

When merging health care providers find themselves in front of the FTC, an important aspect of making their case that a merger will not be anticompetitive can be establishing its *procompetitive* bona fides. The goals described above—population health management, care coordination, improved health outcomes—can be marshaled to argue that a transaction will have a substantial procompetitive effect. Not only will these positive outcomes improve the operations of the merging parties, they will put pressure on other providers in the market to make similar improvements or fall behind. A similar, but distinct, argument is that a transaction will generate efficiencies that can help mitigate its anticompetitive effects. The efficiencies defense is recognized in the Merger Guidelines,<sup>1</sup> but has come under attack recently by courts skeptical of whether efficiencies can ever be substantial enough to save an otherwise anticompetitive deal.<sup>2</sup> An efficiencies defense may face such skepticism in part because it typically comes into play as a defense to a merger that has already been identified as being anticompetitive. A more effective way to present the benefits of a deal is to present them up-front, as intrinsic to the deal, and a reason why the deal will actually *improve* competition.

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<sup>1</sup> “[A] primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm’s ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets.” U.S. Dep’t of Justice and Fed. Trade Comm’n, 2010 Horizontal Merger Guidelines § 10. improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets.” U.S. Dep’t of Justice and Fed. Trade Comm’n, 2010 Horizontal Merger Guidelines § 10.

<sup>2</sup> *FTC v. Penn State Hershey Med. Ctr.*, No. 16-2365, 2016 U.S. App. LEXIS 17525 (3d Cir. Sep. 27, 2016).

Given this, an important question is how merging parties can effectively demonstrate the procompetitive benefits that support and flow from their deal. One answer might be found in the views of the parties' customers. Under either a traditional structural analysis or the more recent view that stresses competitive effects, the FTC and DOJ place great weight on the views of the merging parties' customers when conducting a merger analysis. As the agencies state in the Merger Guidelines, "[t]he conclusions of well-informed and sophisticated customers on the likely impact of the merger itself can also help the Agencies investigate competitive effects, because customers typically feel the consequences of both competitively beneficial and competitively harmful mergers."<sup>3</sup> For mergers involving hospitals, physician groups, or other health care providers, the "well-informed and sophisticated customers" are very likely to be health plans.

## **Payer Input**

Within the past few years, as the FTC has taken on a more aggressive enforcement agenda with respect to provider mergers, input from payers has played a particularly significant role in provider merger challenges. The FTC has relied on payer input to support its proposed market definitions, to establish the competitive interaction between the merging parties, to predict competitive effects flowing from the mergers, and to challenge efficiencies defenses, among other things. Four recent FTC provider merger challenges, in particular, are instructive.

### *ProMedica/St. Luke's*

A provider merger in which payer testimony played a particularly significant role was the FTC's 2011 challenge to the acquisition by ProMedica Health System of St. Luke's hospital. The FTC's briefing in the matter is illuminating as to some of the reasons why the antitrust enforcement agencies and courts take payer testimony so seriously: "The MCO witnesses are independent third parties who, unlike ProMedica's witnesses,

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<sup>3</sup> 2010 Horizontal Merger Guidelines § 2.2.2.

received no paycheck from the party calling them to testify at trial. The MCOs must continue to deal with ProMedica and St. Luke's regardless of how this case turns out; they have no reason to give false, misleading, or biased testimony against them."<sup>4</sup>

As in other provider mergers, the FTC cited payer testimony in ProMedica/St. Luke's for the proposition that the merging parties were particularly close substitutes, arguing that "[t]he major MCOs are unanimous in the view that ProMedica was St. Luke's closest competitor."<sup>5</sup>

MCOs stated that an independent St. Luke's was important to competition in Lucas County. . . . No third party testified – as ProMedica would have the Commission believe – that ProMedica would be constrained in its post-Acquisition pricing by health plans, the two remaining hospitals in Lucas County, or physician steering. Instead, all third parties who testified on the subject expect rates at St. Luke's, and potentially ProMedica's other Lucas County hospitals, to rise significantly.<sup>6</sup>

ProMedica/St. Luke's provides particular insight into the level of detailed information that payers can provide regarding provider mergers. The payer testimony in ProMedica/St. Luke's went not just to market definition, competitive interaction, or predictions about whether prices were likely to rise post-transaction. The FTC also cited the payers for a wide range of detailed information on the operations of the merging parties.

[T]he MCO witnesses here gave detailed testimony about their specific concerns and the basis for those concerns, relying on reviews of utilization data and pricing analyses, decades of first-hand experience negotiating with health plans and evaluating provider networks, and bargaining

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<sup>4</sup> *In the Matter of ProMedica Health Systems, Inc.*, Complaint Counsel's Answering Brief, p. 23; available at [www.ftc.gov/sites/default/files/documents/cases/2012/01/120119ccansweringbrief.pdf](http://www.ftc.gov/sites/default/files/documents/cases/2012/01/120119ccansweringbrief.pdf).

<sup>5</sup> *Id.* at 13.

<sup>6</sup> *Id.* at 5.

dynamics and provider-network marketability in Lucas County as the foundation for their concerns about the Acquisition.<sup>7</sup>

Significantly, the payer witnesses in ProMedica/St. Luke's also spoke to their views on the parties' reputations for quality and cost-effectiveness. "MCO witnesses attributed ProMedica's ability to command such high rates to the size of its system and its market power, rather than to competitively-benign factors such as higher costs or better quality. At the same time MCO witnesses characterized St. Luke's as a cost-effective, high quality hospital located in an especially desirable location."<sup>8</sup>

#### *Penn State Hershey and Pinnacle*

Although the FTC relied particularly heavily on payer testimony in ProMedica/St. Luke's, that case was by no means unique. The most recent example of the significant role payers can play in a provider merger can be found in the Third Circuit's opinion in the Penn State Hershey/Pinnacle matter. The Third Circuit relied on the testimony of health plans in reaching its decision ordering the district court to enter a preliminary injunction against the merger. The court devoted multiple pages of its opinion to a discussion of various payers' testimony, which it characterized as "extensive evidence showing that insurers would have no choice but to accept a price increase from a combined Hershey/Pinnacle in lieu of excluding the Hospitals from their networks."<sup>9</sup>

#### *Advocate and NorthShore*

The other very recent hospital merger challenge to go to trial was the FTC's challenge of the merger of Advocate and NorthShore in Chicago. Here again, the views of payers played a significant role in the FTC's complaint. But unlike the other mergers, in

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<sup>7</sup> *Id* at 21.

<sup>8</sup> *In the Matter of ProMedica Health System, Inc.*, Opinion of the Commission by Commissioner Julie Brill, p. 37; available at [www.ftc.gov/sites/default/files/documents/cases/2012/03/120328promedicabrillopinion.pdf](http://www.ftc.gov/sites/default/files/documents/cases/2012/03/120328promedicabrillopinion.pdf).

<sup>9</sup> *FTC v. Penn State Hershey Med. Ctr.*, No. 16-2365, 2016 U.S. App. LEXIS 17525, at \*34 (3d Cir. Sep. 27, 2016).

Advocate/NorthShore the payers were also instrumental in the merging parties' defense. As in Penn State Hershey/Pinnacle, the FTC relied on payer testimony to argue that "a network that offered access to neither Advocate nor NorthShore hospitals would be unmarketable to employers in the northern suburbs."<sup>10</sup> The FTC offered the specific example of a Blue Cross product which it claimed failed in the marketplace due to its failure to include either of the merging parties. "BlueCross currently offers the BlueChoice network, which excludes Advocate and NorthShore but includes numerous downtown hospitals. That product has failed to attract employers despite marketing efforts."<sup>11</sup>

In contrast to the Penn State Hershey/Pinnacle matter, the Advocate and NorthShore health systems introduced payer testimony on their side as well. Payer testimony supporting the merging hospitals' views of the relevant geographic market and competitive interaction among competing health systems was among evidence considered by the district court in refusing to grant an injunction against the merger.<sup>12</sup>

### *St. Luke's/Saltzer*

In 2013, the FTC brought suit to challenge the acquisition of Saltzer Medical Group by St. Luke's Hospital in Idaho. The focus of the FTC's challenge was adult primary care physician (PCP) services in Nampa, ID. The FTC alleged that the combination of St. Luke's and Saltzer would create a "single dominant provider" of adult PCP services in the relevant geography, with the combined firm controlling nearly 60% of the relevant market.<sup>13</sup>

Although raised as a traditional efficiencies defense, as opposed to an affirmative argument that the deal would not be anticompetitive as an initial matter, the parties

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<sup>10</sup> *FTC v. Advocate Health Care Network*, Reply Brief of Appellants Federal Trade Commission and the State of Illinois, p. 24; available at [www.ftc.gov/system/files/documents/cases/2016-0812\\_advocate\\_health\\_care\\_ca7\\_ftc\\_reply\\_brief\\_no\\_append\\_public.pdf](http://www.ftc.gov/system/files/documents/cases/2016-0812_advocate_health_care_ca7_ftc_reply_brief_no_append_public.pdf).

<sup>11</sup> *Id.* at 26.

<sup>12</sup> *FTC v. Advocate Health Care*, No. 15 C 11473, 2016 U.S. Dist. LEXIS 79645, at \*10 (N.D. Ill. June 20, 2016).

<sup>13</sup> *FTC v. St. Luke's Health Sys.*, Complaint for Permanent Injunction, available at [www.ftc.gov/sites/default/files/documents/cases/2013/03/130312stlukescmpt.pdf](http://www.ftc.gov/sites/default/files/documents/cases/2013/03/130312stlukescmpt.pdf).

raised several merger-specific benefits that they claimed would flow from the transaction. Specifically, they asserted that the merger would allow Saltzer's physicians to access St. Luke's electronic medical records system, allowing for improved patient care.<sup>14</sup> The merging parties' efficiencies defense ultimately was unsuccessful, being rejected at both the district court and court of appeals levels. Moreover, the FTC's complaint demonstrates the skepticism with which the FTC viewed the defense. The FTC called the parties' efficiencies and quality-of-care claims "speculative," and unlikely to counteract the anticompetitive effects alleged by the FTC.<sup>15</sup> Adding significantly to the FTC's skepticism was what it called St. Luke's "track record" of failing to pass efficiency gains on in the form of lower rates:

Defendants' alleged efficiencies in this case are unfounded and unreliable. Defendants claim that the Acquisition will improve quality and lower patients' cost-of-care. But Defendants' claims are speculative, exaggerated, and lack the requisite evidentiary support. The reality is that St. Luke's track record belies any claims Defendants make regarding postacquisition cost savings being passed on to health plans or employers.<sup>16</sup>

## **Provider Response**

How, then, can providers considering a merger best take account of the importance of payers' voices in FTC merger challenges? Ideally, a merger between health care providers is motivated by a desire to achieve benefits that neither firm is able to accomplish on its own. As St. Luke's/Saltzer demonstrates, even transactions that are ultimately blocked often feature assertions by the merging parties of a desire to achieve merger-specific benefits. Frequently, these benefits take the form of more effective care management, improved patient outcomes, or a greater ability to adopt risk-based

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<sup>14</sup> *St. Alphonsus Med. Ctr. - Nampa, Inc. v. St. Luke's Health Sys.*, 778 F.3d 775, 791 (9th Cir. 2015).

<sup>15</sup> *FTC v. St. Luke's Health Sys.*, Complaint for Permanent Injunction, at 4; available at [www.ftc.gov/sites/default/files/documents/cases/2013/03/130312stlukescmpt.pdf](http://www.ftc.gov/sites/default/files/documents/cases/2013/03/130312stlukescmpt.pdf).

<sup>16</sup> *Id.* at 24.



contracting. A tool available to providers contemplating a merger might be enlisting the support—or at least preventing criticism—of payers regarding the degree to which they believe the merging parties will actually follow through on these pro-competitive benefits. Certainly, earning the goodwill of the payer community is unlikely to save a manifestly anticompetitive merger. But starting with a position of goodwill with the payers can be an important element in generating payer support, or at least reducing opposition. Conversely, as demonstrated, opposition from payers can bolster the FTC’s case against a merger and greatly damage its likelihood of success.

As a practical matter, then, how can hospitals overcome payer skepticism? Stated simply: be the maverick. Demonstrate a commitment to population health management and payment reform *before* a merger is announced. Certainly, as a legal matter, actions taken after a deal is announced are treated with heightened skepticism relative to actions for which the parties have a proven track record prior to the deal’s announcement. The Supreme Court has long held that post-transaction-announcement conduct is to be afforded diminished weight during the evaluation of a merger’s competitive effects. “The need for such a limitation is obvious. If a demonstration that no anticompetitive effects had occurred at the time of trial or of judgment constituted a permissible defense to a § 7 divestiture suit, violators could stave off such actions merely by refraining from aggressive or anticompetitive behavior when such a suit was threatened or pending.”<sup>17</sup> The same logic applies to promoting the benefits of a transaction as well.

Perhaps even more important than the legal effect of such a strategy, however, is its reputational effect. To the extent a provider has developed a reputation as being committed to care improvement goals before it pursues a merger, that reputation will improve its credibility as it advances arguments that the merger will allow it to be even more effective than it is now. By positioning themselves as among the leading edge providers on these issues, merging parties can at best bring a health plan as an important voice in their corner, or neutralize it as a critical voice at a minimum. By contrast, as *St. Luke’s* demonstrates, providers that have not demonstrated a

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<sup>17</sup> *US v. General Dynamics Corp.*, 415 U.S. 486, 504-05 (1974).

commitment to care management may find their claims of merger-specific care improvement met with heightened skepticism by enforcement officials and the courts.

FTC officials have made a similar point recently with respect to the credibility of efficiencies claims in merger investigations. In remarks delivered in September, Kevin Hahn, the Federal Trade Commission's Deputy Assistant Director of Mergers IV, noted that "timing does matter" when it comes to efficiency claims in health care mergers, and that "[w]e would expect to see some documents while the deal is being negotiated about the cost savings driving the deal. To the extent we don't see that, but we see efficiency claims come after the deal has been signed, after antitrust counsel has been retained, you can see why we might be a little more skeptical of those."<sup>18</sup>

In the end, whether it is establishing a strong reputation with payers as an innovator in care coordination and population health management, or burnishing credibility with enforcement officials about a transaction's potential for efficiencies, the time to think about these issues for a health care provider is well before a transaction comes into view. A firm that has established itself as a leading-edge participant in these innovations will only help itself when the time comes to explain why a proposed deal will allow it to be even more effective.

*Thanks go to Rachel Rasp for her assistance on this article.*

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<sup>18</sup> Curtis Eichelberger, "FTC Official Says Efficiencies Arguments are Given Greater Weight When Made From the Start," Mlex, Sept. 30, 2016.

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