

Health Law Alert

A report
for clients
and friends
of the firm February 2004

Federal Government Employs Novel Market Theory to Break Losing Streak on Hospital Mergers

For almost a decade, the federal government has experienced a notable lack of success in applying traditional antitrust theories to hospital mergers.¹ However, the Federal Trade Commission ("FTC" or "Commission") recently took steps to reverse this losing streak. On February 10, 2004, the FTC issued an administrative complaint against Evanston Northwestern Healthcare Corporation ("ENH"), alleging that its January 2000 merger with Lakeland Health Services, Inc. ("Lakeland") produced anticompetitive price increases in violation of the Clayton Act (the "Act"). The complaint also alleges that ENH Medical Group violated the Act by engaging in price-fixing of physicians' services.

The Commission's action against these two entities represents the culmination of a two-year, highly visible investigation that until recently did not appear likely to result in an enforcement action. The FTC's action against ENH and ENH Medical Group also represents an important enforcement effort which incorporates new approaches to its merger analysis that focus on a hospital merger's impact upon large, commercial insurers. Accordingly, health care systems and private insurers should be conscious of this new focus as they contemplate future acquisitions, review antitrust liability exposure from past acquisitions, or negotiate contracts.

The Merger and Its Aftereffects

ENH, a non-profit Illinois corporation, merged with Lakeland in January of 2000. As a result of the merger, ENH acquired Highland Park Hospital ("Highland Park"), giving it three hospitals with a total of 836 acute-care beds in northeast Cook and southeast Lake Counties, Illinois. Through the merger, ENH also began a relationship with many physicians formerly affiliated with the Highland Park Independent Physician Association ("Highland Park IPA").

ENH used a single board of directors and management staff to control all three hospitals following the merger. ENH then collectively negotiated prices with private payers on behalf of all three hospitals. ENH Medical Group, on the other hand, negotiated on behalf of two physician groups that constituted over 900 physicians. One of the groups, ENH Faculty Practice Associates, consisted of salaried physicians for whom ENH Medical Group negotiated prices, collected fees, rented office space, and employed nurses and other staff. The other group, comprised of many former Highland Park IPA members, consisted of independent or "affiliated" physicians for whom ENH Medical Group only negotiated prices. According to the FTC, both groups included specialists and primary care physicians providing comparable services in the same geographic area.

Following the merger, ENH allegedly negotiated with private payers by offering hospital and physician services as a package. The FTC investigation concluded that through the use of its market power, ENH and ENH Medical Group succeeded in raising prices without a concomitant increase in quality or efficiency. The Commission's complaint alleges that following the merger, ENH proposed significant price increases to private payers that included CIGNA, Aetna and

¹ See, e.g., *Fed. Trade Comm'n v. Tenet Healthcare Corp.*, 186 F.3d 1045 (8th Cir. 1999); *United States v. Long Island Jewish Medical Ctr.*, 983 F. Supp. 121 (E.D.N.Y. 1997); *Fed. Trade Comm'n v. Butterworth Health Corp.*, 121 F.3d 708 (6th Cir. 1997); *United States v. Mercy Health Services*, 902 F. Supp. 968 (N.D. Iowa 1995); *Fed. Trade Comm'n v. Freeman Hosp.*, 69 F.3d 260 (8th Cir. 1995).

Humana. Rather than risk losing the ability to use any of ENH's hospitals (and, by implication, lose the ability to competitively sell health insurance to area employers and residents), all but one of these private payers accepted large price increases.

The Commission's complaint states that for one such private payer, Aetna, ENH raised inpatient care rates by as much as 50% over a three-year period. Although inpatient care rates were raised by other area hospitals over the same period, the FTC alleges that ENH's increases were disproportionate in comparison. Furthermore, no new market entrant would likely force ENH to lower its prices through competition, given Illinois' cumbersome certificate of need process and the costs associated with building a new acute-care hospital.

As for ENH Medical Group, the FTC complaint states that ENH Medical Group succeeded in greatly increasing the fee-

for-service rates charged to private payers by its salaried and independent physicians. Perhaps most indicative of its bargaining power, for its members who had been previously compensated by private payers on the basis of capitated rates, ENH Medical Group allegedly succeeded in converting these members' agreements to a fee-for-service basis. As a result, these physicians no longer took the financial risk that their payment from the private payer would not cover the actual cost of care.

Conclusion

The Commission's focus on a hospital merger's impact upon large private payers indicates that the federal government has enlisted the support of these payers to help end its losing streak. Although the FTC voiced similar concerns regarding a merger's impact upon private insurers in its April 1, 2003 advisory letter to the Louisiana Attorney General that effectively preempted Tenet Healthcare Corporation's acquisition of a hospital in the New Orleans area,² it has yet to be put to the test in an adversarial setting. Nonetheless, health systems and private insurers should not overlook the FTC's recent activity when crafting their own strategies.

Joseph E. Casson

202.778.1111

jcasson@proskauer.com

James F. Segroves

202.416.6871

jsegroves@proskauer.com

**NEW YORK LOS ANGELES
WASHINGTON BOCA RATON
NEWARK PARIS**

Proskauer's Health Care Department includes over 30 attorneys with significant and diverse health care experience. The following individuals serve as contact persons and would welcome any questions you might have:

New York, NY

| | | |
|---------------------|--------------|--------------------------|
| Robert M. Kaufman | 212.969.3285 | rkaufman@proskauer.com |
| Edward S. Kornreich | 212.969.3395 | ekornreich@proskauer.com |
| Lee A. Barkan | 212.969.3115 | lbarkan@proskauer.com |
| Ellen H. Moskowitz | 212.969.3232 | emoskowitz@proskauer.com |

Washington, DC

| | | |
|-------------------------|--------------|-------------------------|
| Mark J. Biros | 202.778.1104 | mbiros@proskauer.com |
| Joseph E. Casson | 202.778.1111 | jcasson@proskauer.com |
| Malcolm J. Harkins, III | 202.778.1103 | mharkins@proskauer.com |
| James P. Holloway | 202.778.1124 | jholloway@proskauer.com |
| Stephen D. Solomon | 202.416.6819 | ssolomon@proskauer.com |
| Susan A. Turner | 202.416.6808 | sturner@proskauer.com |

Boca Raton, FL

| | | |
|-----------------------|--------------|--------------------------------|
| Albert W. Gortz | 561.995.4700 | agortz@proskauer.com |
| Marcy Hahn-Saperstein | 561.995.4774 | mhahn-saperstein@proskauer.com |

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² See <http://www.ftc.gov/opa/2003/04/lahospmerger.htm>.