

One-Two Punch on Hospital Challenges: Is the FTC Down for the Count?

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There was a time not long ago when the odds of beating the Federal Trade Commission on a hospital merger antitrust challenge were slim. Two recent defeats, however, may change that some. Late last year, the FTC, in quick succession, mounted antitrust challenges to two pending hospital combinations^[1]: Hershey/Pinnacle in central Pennsylvania, and Advocate/NorthShore in Chicago. Both challenges face serious obstacles following two U.S. District Court decisions rejecting the agency's approach to defining geographic markets. If the agency does not prevail on appeal in one or both of these cases, the antitrust landscape for hospital mergers may change dramatically and accelerate the pace of hospital consolidations.

Penn State Hershey Medical Center ("Hershey") and PinnacleHealth System ("Pinnacle") began discussions in 2014 and entered into a formal agreement to merge in March 2015. The FTC investigated the proposed transaction for potential anticompetitive effects, and filed its complaint to block the transaction in December 2015. Hershey is a 551-bed hospital in Hershey, Pennsylvania offering a full range of medical services that include tertiary and quaternary care. Pinnacle has three community hospitals offering primarily general acute care services in central Pennsylvania, with a total of 646 beds.

According to the FTC's complaint, Hershey and Pinnacle operate the only three hospitals in Dauphin County and offer a range of general acute care inpatient hospital services, including primary, secondary, tertiary, and quaternary services. The agency alleged that Hershey and Pinnacle have competed vigorously on "price, quality of care, and services provided, both for inclusion in commercial health plan networks and to attract patients from one another." The agency's proffered relevant geographic market includes the four-county region comprised of the Harrisburg Metropolitan Statistical Area (Dauphin, Cumberland, and Perry Counties) plus Lebanon County. The agency claimed that the merged system would account for approximately 64% of general acute care services in the relevant market, and with a correspondingly high degree of overall market concentration because of the limited number of remaining significant competitors, would render the merger presumptively unlawful. The agency also claimed that the combined system's bargaining leverage in negotiations with commercial health plans would be substantially increased, and that as a result, the system would be able to raise prices and reduce quality and services – harming residents and patients.

On May 9, 2016, the Middle District of Pennsylvania denied the FTC's motion for a preliminary injunction to halt the transaction. The court placed particular import on the fact that, in 2014, 43.5% of Hershey's patients travel from outside of the FTC's proffered relevant area, and that several thousand of Pinnacle's patients also reside outside of the relevant area. Significant numbers of Hershey's patients also travelled up to an hour or more to reach the hospital. The court noted that there are 19 hospitals within a 65 minute drive of Harrisburg that provide a "realistic alternative" for patients to use and that the agency's relevant area is "unrealistically narrow and does not assume the commercial realities faced by consumers in the region." The court also found compelling that the hospitals executed contracts with CBC and Highmark, central Pennsylvania's two largest payors, to ensure that post-merger rates do not increase, "to maintain existing rate structures for fee-for-service contracts and preserve the existing rate differential between the Hospitals." The agency is appealing the decision to the Third Circuit based on claims of defects in the court's geographic market analysis. The Third Circuit has issued a stay barring the hospitals moving the transaction forward pending the appeal of the preliminary injunction denial.

Advocate Health Care Network ("Advocate") and NorthShore University HealthSystem ("NorthShore") announced their proposed merger in September 2014. Advocate is one of the largest health systems in Illinois, with 11 general acute care hospitals plus a two-campus children's hospital. Five of Advocate's hospitals are in Cook County, IL, and two are in Lake County, IL. NorthShore has four hospitals, located in Evanston, Glenbrook, Highland Park and Skokie, IL. The combination would include 15 general acute care hospitals in Illinois, including 11 in Cook and Lake Counties. Following an investigation, the FTC moved to block the transaction in December 2015.

In the Advocate/NorthShore challenge, the agency argued the combined system, with 55% of the general acute care inpatient hospital services market, would harm consumers by reducing hospital competition in the northern Chicago suburbs, defined as northern Cook County and southern Lake County. The agency also claimed that commercial payers offering health plan networks to employers with employees living or working in the relevant area need to have at least one of the systems in the network – and that Advocate and NorthShore compete for inclusion in those networks. Because competition between Advocate and NorthShore results in lower prices, higher quality, and greater service offerings, the agency alleged that the elimination of competition between them would increase their bargaining leverage with commercial payers, and enhance their ability to negotiate more favorable reimbursement rates (i.e., prices).

Following a hearing in April, the United States District Court for the Northern District of Illinois denied the agency's request for a preliminary injunction to block the transaction, saying the agency did meet its burden of showing that there is a likelihood of success on the merits of the antitrust claims. The parties agreed, as is typical in hospital mergers, that the relevant product market is inpatient general acute care services sold to commercial payers and their insured members.

The point of contention lay in the definition of the geographic market. A proffered geographic market typically meets muster under the agencies' own Horizontal Merger Guidelines where the hospitals in it are sufficiently close substitutes to make it profitable to impose a 5 percent non-transitory price increase. To make that estimation, the agency looked to diversion ratios, or the fraction of patients who use one hospital that would switch to another hospital if their first-choice is not available, leading to the northern Cook County/southern Lake County proposed market area. The hospitals maintained however, and the court agreed, that the proposed geographic market ignored commercial realities, arbitrarily excluding so-called "destination hospitals", and should include hospitals that, while outside the North Shore area, are associated with outpatient facilities or doctor's offices within the area that steer patients to those hospitals. The court noted that outpatient services are on the rise, "are a key driver of hospital admissions", and that patients' own doctors have a significant effect on their choice of hospitals. In this way, hospitals can and do extend their reach when they open outpatient centers and doctors' offices further from the hospital, and compete with and take patients from hospitals they might not have in the past. The agency's geographic market also failed to take into account hospitals that compete presently with just one of the merging parties' hospitals by excluding those hospitals as competitors and including only hospitals that presently compete with both systems – another commercial fallacy the court correctly discounted – "you can constrain the post-merger system by constraining any [one] of its hospitals".

Why did the agency suffer back-to-back losses? In both cases the FTC failed to take into account the economic reality of which area hospitals patients travel to in sufficient numbers, and thus which hospitals impose competitive constraints on the merging parties. The FTC has traditionally considered the area where 80% of a hospital's patients live to be its primary service area, and typically treats that as the relevant area for antitrust analysis and to determine what other hospitals likely are real competitors. But the relevant markets offered by the agency in both of these cases may have been indefensibly narrow by not properly taking into account local market conditions.

A dual win by the FTC on both appeals would give credence to the agency's often narrow view of the relevant geographic market in hospital merger challenges, and force hospitals to look at potential transactions more carefully. A dual loss by the FTC, on the other hand, may not be enough ultimately to stop the agency in its tracks, as its resolve on slowing the pace of local hospital mergers appears to be stronger than ever. The third possibility, however, a split between the Third and Seventh Circuit Courts of Appeal in the way they treat relevant geographic market determinations, could set up a question ripe for Supreme Court review. The high court has not shied away from opportunities in recent years to clarify and develop the law with respect to health care matters, so it's not a long shot that the Court might review the matter and provide needed authority in this area – authority the agency would follow, even if begrudgingly.

[\[1\]](#) A third challenge, to the Cabell Huntington/St. Mary's transaction in Huntington, West Virginia, is on hold as the FTC considers its options in the wake of newly-minted state legislation in West Virginia exempting the combination from federal antitrust review.

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