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Placing Limits on the State Action Doctrine, the Supreme Court Subjects Local Government Hospitals to Scrutiny under the Antitrust Laws

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Recent major regulatory and technological developments have brought forth historic changes to the health care market. Health care providers have responded to these developments in several ways. One such mechanism, hospital consolidation, has in particular risen to historical levels. Last week, however, the Supreme Court appears to have put the brakes on some of these efforts.

In *FTC v. Phoebe Putney Health System, Inc.*, the Supreme Court *reversed* the prevailing view that acquisitions by county and municipal hospitals are entitled to immunity from the antitrust laws under the "state action" doctrine. This is significant because almost 1,000 of the 5,000 hospitals in the United States are owned by governmental bodies. After *Phoebe*, the FTC is likely to increase its scrutiny of hospital mergers that it may previously have felt powerless to challenge.

Indeed, *Phoebe* was widely recognized as a test case for the FTC, intended to limit or reverse a 1994 Eleventh Circuit decision, *FTC v. Hospital Bd. of Directors of Lee Cty.*, 38 F. 3d 1184 (11th Cir. 1994), which had virtually immunized all governmental hospital mergers in Alabama, Florida, and Georgia. There, the Eleventh Circuit held that the state action doctrine immunizes anticompetitive acquisitions by government-owned hospitals because such acquisitions were "foreseeable" by the state legislature when, decades earlier, the government hospital was granted the authority to acquire hospital property.

Because the *Lee County* decision put a significant limit on the ability to challenge mergers by government-owned hospitals, the FTC long sought an opportunity to reverse, or at least limit, its broad principle. *Phoebe* provided such a vehicle.

Its facts are straightforward. In 1941, the Georgia State Legislature enacted a statute that created a local hospital authority for each major city and county in Georgia. These authorities were vested with general corporate powers to purchase health care facilities and operate hospital networks, and endowed with certain uniquely governmental powers, like the power of eminent domain.

The Hospital Authority of Albany-Dougherty County shortly thereafter acquired Phoebe Putney Memorial Hospital, the county's largest hospital, treating about 75% of the population. The Authority, however, did not operate the hospital itself, but outsourced this function to a private nonprofit corporation. In 2010, the private company's management wanted to expand and improve its operations by combining with the only other significant hospital in the area, Palmyra Park Hospital. The FTC contended that this combination would give rise to a virtual monopoly. But believing the state action doctrine provided a silver bullet defense, the parties structured the transaction so that the Hospital Authority, not Phoebe-Putney, would acquire Palmyra (and thus be its nominal owner), with funds provided by the private company.

To the FTC, this was the perfect test case. Even if it were unsuccessful in challenging *Lee County*'s broader principle regarding government-owned hospital immunity, it still could prevail on the narrower ground that the arrangement was effectively a sham. The Supreme Court agreed to hear both issues. But as it turns out, the FTC did not need to rely on the narrower ground because the Court held that state legislatures must do more than merely authorize local governments to own and operate a hospital in order to exempt them from the federal antitrust laws.

The Court recognized that "when a local governmental entity acts pursuant to a clearly articulated and affirmatively expressed state policy to displace competition, it is exempt from the antitrust laws." It also acknowledged that, "to pass the 'clear articulation test,' a state legislature need not 'expressly state in a statute … that the legislature intends for the delegated action to have anticompetitive effects.'" Rather, according to prior precedent, "immunity applies if the anticompetitive effect was the '*foreseeable result*' of what the State authorized."

Taking a step back, however, the Court clarified that "foreseeability" in this context should not be construed "too loosely" and does not mean "*reasonably anticipated*" (as the Eleventh Circuit had held and as the term's dictionary definition would suggest). Instead, the Court held that state action immunity will only be *implied* in situations "where the displacement of competition was the *inherent, logical, or ordinary result* of the exercise of authority delegated by the state legislature." So, for example, in cases where a local government enacts a zoning ordinance or adopts a comprehensive regulatory scheme under a state authorizing statute, the legislature's intent to displace competition will be presumed.

But where a state merely grants the power for "substate governmental entities to participate in a competitive marketplace," the Court found that no such presumption applies. As it explained, "when a State grants some entity the general power to act," such as granting "simple permission to play in a market," the authorization should be construed "against the general backdrop of federal antitrust law." Thus, a law that "allows a [local government] to acquire hospitals" does not "clearly articulate and affirmatively express a state policy of empowering the [local government] to make acquisitions … that will substantially lessen competition." Any other ruling, the Court held, would set a "a trap for unwary state legislatures" who may want to provide a public option in addition to, but not in lieu of, private ones.

What are the practical effects of this ruling for the 1,000 public hospitals (and potential third parties who wish to collaborate with or acquire them)? *First*, for the parties to the *Phoebe* transaction, it means that the merger is likely to be unwound. *Second*, for other government-owned hospitals, the Court's decision means that they can no longer rely on the state's general grant of authority to do business and acquire property to avoid antitrust scrutiny. Instead, government-owned hospitals will need to defend the pro-competitive rationale for their transactions or, alternatively, amend enabling statutes and/or seek expressed state authorization – perhaps transaction-specific – to enter into anticompetitive transactions that may have other countervailing societal benefits. *Third,* government-owned hospitals should review their enabling statutes/ordinances and see if they meet the clear articulation test with specific activities, including a clear contemplation or authorization of anticompetitive activities. If, like many statutes and ordinances, the specific activities are too general or opaque, consider – subject to political realities – seeking legislative amendments to "fix" them. In this era of heightened hospital-hospital and hospital-physician-payor consolidation, government-owned hospitals (and third parties who want to collaborate with/acquire them) should take advantage of the immunity afforded them, but only if their statutes/ordinances permit.

In sum, the *Phoebe* decision changes the landscape for government-owed hospitals seeking to adapt, grow, and innovate through acquisition. Careful planning will increase the likelihood that such strategies will be successful.

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