



ACCESS TO CAPITAL

Managing the Antitrust Risks Associated With Mergers and Affiliations

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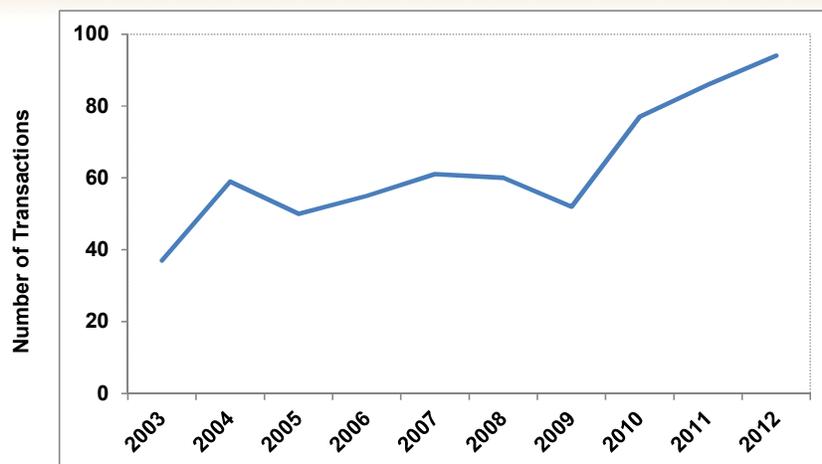


Agenda Overview

- Trends in hospital M&A
- Antitrust legal framework applicable to hospital mergers and affiliations
- Recent enforcement activity
- Key antitrust related points to consider early in the deal process
- Antitrust review process – what to expect, how to prepare for it, and how it may impact your deal



Hospital M&A Activity, 2003 - 2012



Source: Irving Levin Associates.



Hospital Mergers and Enforcement Activity Trending Up

- Health care mergers in 2012
 - Consolidation wave in reaction to PPACA
 - In survey, 75% of providers considering some form of affiliation
- Hospital mergers seen as important enforcement priority for FTC and DOJ
 - FTC says stance in 2013 is “appropriately aggressive” in challenging hospital consolidation
 - Providers have different perspective in light of changes required by PPACA



Why the Increase in M&A Activity?

- The need to obtain greater economies of scale and scope driven by:
 - An anticipated reduction in Medicare and Medicaid reimbursement
 - A shift from volume reimbursement to value-based reimbursement
 - Recognition that there are more cost-effective ways to deliver higher quality of care
- Greater access to capital, especially for stand-alone hospitals
- Increase in outpatient procedures, and inpatient overcapacity



Other Health Care Merger Activity

- Consolidation trend showing up in several areas of health care market
 - Vertical Merger of West Penn, Highmark
 - DOJ reviewed merger of health system and insurer and allowed to go forward in 2012.
 - Acquisition by St. Luke's of Saltzer Medical Group (Idaho)
 - Challenged by FTC (2013)
 - Express Scripts and Medco
 - Approved by FTC in April 2012
 - FTC v. Renown Health
 - FTC challenged acquisition of two cardiology groups by hospital system in August 2012
 - Allowed to go forward with structural remedy



Hospital Merger Analysis: Basic Legal Framework

- Rationale for the proposed transaction
- Section 7 of the Clayton Act
 - Prohibits transactions where “the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly”
- DOJ/FTC Horizontal Merger Guidelines
 - Competitive effects analysis
 - Relevant antitrust markets
 - Market share/concentration
 - Barriers to entry
 - Other competitive factors affecting pricing
 - Efficiencies
 - Failing company defense
- The basic elements still matter in the era of health care reform



Hospital Merger Analysis: Basic Legal Framework (cont.)

- Product market definition
 - In addition to general acute-care inpatient services, FTC has alleged markets for particular service lines (inpatient and outpatient) and primary care physician services
- Geographic market definition
 - Often hotly contested in hospital deals
 - Considers where health plans and patients turn to or would turn to for services
- Assessing the competitive effects
 - Are the hospitals close substitutes
 - Documents
 - Perspectives of third party payors
 - Economic evidence
- The potential for efficiencies
 - particularly if the target hospital lacks sufficient financial resources
 - Importance of being merger specific

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Hospital Affiliations Short of Mergers

- Hospitals have pursued a variety of arrangements, such as joint operating arrangements, to affiliate or coordinate with regard to certain business aspects while preserving important elements of independence or control
- Hospitals need to be mindful that without sufficient common control or integration that the parties may be subject to Section 1 of the Sherman Act such that certain activities like joint contracting may be challenged as alleged per se illegal price fixing
 - See *Medical Center at Elizabeth Place LLC v. Premier Health Partners*, No. 3:12-cv-26 (S.D. Ohio, Aug. 30, 2012)
 - See *Healthamerica Pa. Inc., v. Susquehanna Health Sys.*, 278 F. Supp. 2d 423 (M.D. Pa. 2003)

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Economic Perspectives on Hospital Merger Analysis

- Assessing the competitive overlap between the merging hospitals
 - The acquisition of a stand-alone hospital
 - Acquisitions involving hospital systems with multiple hospitals in the same metropolitan area
- Predicting the effect of a proposed acquisition
 - Modeling the proposed acquisition
 - Assessing the effect of prior events in the market

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Hospital Merger Enforcement

- FTC v. Phoebe Putney, Palmyra Park
 - Merger to monopoly (only hospitals in county)
 - FTC challenged hospital acquisition in Georgia
 - Allegation is that the transaction used county hospital authority to cloak transaction in “state action doctrine” to avoid antitrust scrutiny
 - State, municipal acts immune from federal antitrust laws only if pursuant to a clearly expressed state policy that had foreseeable anticompetitive effects
 - Eleventh Circuit affirmed application of state action doctrine
 - On February 19, 2013, the Supreme Court held that the merger was not immunized by the state action doctrine

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Hospital Merger Enforcement (cont.)

- **FTC v. OSF & Rockford**
 - 3-2 merger
 - FTC alleged that hospitals were “must haves” for payors
 - Alleged harm is that merged hospital would have exercised leverage with payors to raise rates
 - Hospitals argued that economies of scale, efficiencies would lead to lower costs
 - Merging parties offered to stipulate that they would not require MCOs to exclude non-merging hospital system
- District court granted FTC request for injunction in April 2012; parties abandoned merger

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Hospital Merger Enforcement (cont.)

- **FTC v. Reading Health System**
 - FTC challenged acquisition of 16-doctor surgical hospital by 970-doctor health system
 - Complaint quoted internal documents describing parties as head-to-head competitors on price, quality
 - Alleged relevant markets were narrowly drawn; 49-71% shares
 - FTC found that “more bureaucratic” approach of larger hospital system would mean less likelihood of efficiencies
- Parties abandoned deal hours after FTC, Pa. Attorney General challenges announced

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Hospital Merger Enforcement (cont.)

- **FTC v. ProMedica/St. Luke's**
 - 4 to 3 merger
 - FTC challenged consummated acquisition of low-cost hospital by larger system
 - Observed post-merger rise in rates in inpatient care
 - Merger resulted in market share increase from 47% to 58%
 - Alleged that merger made ProMedica "must have" provider
 - ProMedica cited increase in quality of care through collaboration
 - District court upheld FTC move to undo merger; now on appeal in Sixth Circuit
 - Amicus briefs demonstrate strong feelings on payor, provider side re effects of and need for consolidation

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Hospital Merger Enforcement (cont.)

- **But, compare: Yale-New Haven Hospital and Hospital of St. Raphael**
 - Consummated without challenge in 2012
 - Hospitals 6 blocks apart; nearest competing hospital 10 miles away
 - Yale-New Haven needed capacity; St. Raphael struggling
 - Concrete plans to consolidate services
 - \$160 million investment by Yale-New Haven in St. Raphael
 - Economic analysis showed neither hospital provided competitive restraint on the other

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Hospital Merger Review: Pre-Merger Filing Considerations

- Advisable to start thinking about the antitrust issues early in the process of identifying acquisition opportunities and strategies and during the bid process
- Identify potential HSR filing obligations
- Take steps early in the process to identify antitrust risk, if any, ways to reduce risk, and possible fixes to address concerns as necessary
- Seek appropriate protections in the purchase agreement
 - e.g., divestiture clauses, efforts clauses, conditions to closing and termination provisions

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Hospital Merger Review: Pre-Merger Filing Considerations (cont.)

- Counsel can assist in taking steps to avoid waiving protective privileges
- Need to conduct due diligence and integration planning without raising antitrust concerns
- Avoid creation of bad and inaccurate documents
- Prepare in advance to address potential agency questions and concerns, if there are potential substantive issues

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Pro-Merger Arguments – AHA Amicus Brief

No. 12-3583

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

PROMEDICA HEALTH SYSTEM, INC.,
Petitioner,

v.

FEDERAL TRADE COMMISSION,
Respondent.

ON PETITION FOR REVIEW FROM THE
FEDERAL TRADE COMMISSION

BRIEF OF *AMICUS CURIAE* AMERICAN HOSPITAL ASSOCIATION
IN SUPPORT OF PETITIONER

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- Mergers enable hospitals to become more competitive through economies of scale
- Mergers give hospitals access to capital to make necessary investments (IT etc.)
- Move toward systems – stand-alone hospitals in “downward spiral”



Documentation Creation Considerations

- Avoid creation of bad and inaccurate documents
 - HSR filings require submission of a broad array of transaction related documents (items 4(c) and 4(d))
 - Assume documents will be produced in a governmental investigation, court challenge or private litigation regardless of whether the deal requires regulatory clearance



Documentation Creation Considerations (cont.)

- Agencies and courts often give substantial weight to statements in the parties' documents
- Document creation guidelines can be provided for the business team
- Consider making certain documents, like board presentations or annual business plans, subject to review by counsel while in draft

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Documentation Creation Considerations (cont.)

- Avoid using words and phrases that could be read as guilt-laden (such as “destroy after reading”)
- Avoid exaggeration of market position (e.g., “will dominate the market”) or the impact on competition (“will create leverage over payors” or “deal will destroy other competitors”)
- Do not suggest that patients or payors will not have alternatives
- Examples of language **not** to use:
 - Dominate, control or corner the market
 - Crush or destroy the competition
 - Exploit, squeeze or punish payors
 - Eliminate a competitor or price-cutter
 - High barriers to entry
 - Monopolize
 - Gentleman's understanding with competitors
 - Truce with competitors
- Emphasize the procompetitive, and efficiency enhancing aspects of the transaction

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Hart-Scott-Rodino Reportability

- Prohibits closing of acquisitions of assets, non-corporate interests or voting securities that meet or exceed the HSR thresholds
- Requires filing of premerger notification form with waiting period (30 days or less for most deals; review can be much longer for deals that may raise competitive concern)
- *** Remember deals that are not HSR reportable may still raise antitrust concerns, and be investigated/challenged by FTC/DOJ and/or State AGs ***
 - There is a history of investigation of and challenges to non-reportable consummated hospital deals

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Hart-Scott-Rodino Reportability (cont.)

- \$70.9 million HSR “size of the transaction” test
 - A \$50 million statutory threshold annually indexed based on changes in GNP
- Acquisitions valued equal to or below \$70.9 million are not HSR reportable
- Valuation can be very complex (including aggregation obligations)
- Where there is no acquisition price, the value is based on a fair market valuation done in accordance with the HSR rules
- The acquisition of “control” over a non-stock, non-profit corporation is viewed as an asset acquisition for HSR purposes.
- Asset Value: greater of acquisition price (if determined) or fair market value - the acquisition price for assets includes the value of liabilities being assumed

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Hart-Scott-Rodino Reportability (cont.)

- Transactions valued at $\leq \$283.6$ million also have to meet the “size of the parties” test to be reportable
 - generally requires that the ultimate parent (including all controlled entities) on one side be at least a \$14.2 MM person and the ultimate parent (including all controlled entities) on the other side be at least a \$141.8 MM person
- An HSR exemption exists for certain non-profit formations that sometimes exempts the creation of new non-profit hospitals systems from HSR reportability (even though the basic thresholds are met)
 - Important to check with counsel before relying on an exemption given the applicability can be fact specific, the rules are highly technical, and substantial penalties exist for non-compliance

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Hospital Merger Review: Responding to the Antitrust Agencies

- What should you expect during the merger review process?
 - In the first 30 days, “voluntary” requests relatively common if competitive overlap exists – e.g. strategic plans, major payor contracts
 - Second request – in depth investigation; generally for deals FTC or DOJ believes potentially could raise substantial concern
 - Post second request compliance
- Documents the FTC is likely to request
 - Pre-merger documents
 - Data collection and analysis
- Data the FTC is likely to request
 - Detailed inpatient discharge data for several years



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Responding to a Second Request

- Typically burdensome set of interrogatories and document requests
- Extends the waiting period generally until 30 days after substantial compliance with Second Request, although the period often is longer in practice due to timing agreements
- Investigation is likely to last multiple months
- During the process, the parties' counsel and economists typically will make multiple presentations to agency staff (and as appropriate management)

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Responding to a Second Request (cont.)

- A substantial amount of client time and resources are needed to comply with a second request
- Depositions and interviews of company officials may be taken
- The agency also will collect information from payors, competitors and other industry participants

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Consent Decrees/Lawsuits/Preliminary Injunctions

- To the extent second request substantial compliance is required, FTC/DOJ staff will make a recommendation to either close an investigation, file a preliminary injunction to block a merger or seek divestitures or other relief
- Substantial negotiations with agency management and staff may be required
- If agreement can not be reached and a lawsuit is filed, the deal is frequently abandoned particularly if a preliminary injunction is granted
- Challenges can be brought post consummation (but rare for deals that go through the HSR process)

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Questions and Answers

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