FORUM

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FTC affirms ALJ's decision

Merger by Chicago-area hospitals violated antitrust laws

On Aug. 6, 2007, the FTC unanimously affirmed an earlier ALJ decision concluding that the merger by Evanston Hospital and Glenbrook Hospital with Highland Park Hospital substantially lessened competition in violation of Section 7 of the Clayton Act. Although the FTC's decision affirmed the ALJ's ruling, the FTC did not adopt the divestiture remedy ordered by the ALJ and, instead, ordered that the merged hospital system establish separate managed care negotiating teams for the member hospitals.

THE EVANSTON NORTHWESTERN MERGER

In 2000, Evanston Hospital and Glenbrook Hospital merged with Highland Park Hospital and merged the combined entity into Evanston Northwestern Healthcare Corporation ("ENH"). The total value of the merger was in excess of $200 million.

Almost four years after the ENH merger, in February 2004, the FTC staff commenced an antitrust enforcement action, alleging that the merger had substantially lessened competition, and, therefore, caused the price of health care services to rise. The FTC alleged that the merger had substantially lessened competition by aggregating the hospitals' market power and resulted in increased prices for health care services.

THE ALJ'S DECISION

The ALJ's decision may be viewed as validating the FTC's shift in focus in the field of hospital mergers from prospectively attempting to prevent mergers to its retroactive review of consummated mergers, a move that was first announced in 2002. After suffering a string of defeats in prospective challenges to hospital mergers, the FTC changed its focus to review consummated mergers, to determine whether: (a) the promised efficiencies had actually come to fruition, and (b) consumers ultimately benefited, as the merging parties represented they would.

By focusing on a completed merger, the FTC obtains the benefit of post-acquisition evidence, which arguably allows for a better empirical evaluation of the merger's actual competitive effects. In the case of the ENH merger, post-acquisition evidence played a significant role in the ALJ's decision. Based on the extensive economic analysis offered by both parties' economist experts and statistical analyses of price increases (which revealed significantly higher rates of increase for ENH than for comparable hospital systems), the ALJ found that ENH exercised its enhanced post-merger market power to obtain price increases significantly above its pre-merger prices and substantially larger than the price increases obtained by other comparison hospitals.

The ALJ concluded that, for purposes of defining the geographic market in a hospital merger case, the real question is not competition for patients, but rather, competition to be included in managed care or other health insurance plans. Pursuant to that analysis, the ALJ accepted the FTC's position that managed care organizations could not practicably turn outside the ENH geographic triangle for substitute hospitals and that, as a result, ENH had the ability to raise prices after the merger.

The ALJ's opinion also relied heavily on evidence of anticompetitive intent. Specifically, the record contained significant evidence of pre-merger communications suggesting that one of the purposes of the merger was to increase market power in order to obtain the ability to negotiate higher prices from payors. Evidence of post-merger actions and comments by ENH management reinforced this view.

As a remedy for the violation of Section 7, the ALJ ordered the divestiture of Highland Park hospital. The ALJ noted that the burden rested with ENH to show that some remedy other than divestiture was appropriate and would adequately redress the violation.

THE DECISION AND ORDER BY THE FTC

After an appeal by ENH, on Aug, 6, 2007, the full panel of the FTC Commissioners (the "Commission") unanimously affirmed the ALJ's decision. As was the case with the ALJ's decision, the Commission relied heavily on the statements by hospital executives and consultants about the reasons for the merger, and economic analysis of the price increases by ENH after the merger.

As a preliminary matter, although the Commission agreed with the ALJ that the relevant product market in the case included hospital services sold to managed care organizations, it departed somewhat from the ALJ's approach to defining the geographic market. Specifically, the Commission relied on post-merger pricing evidence, in conjunction with pre-and post-merger documents, to determine that the significant post-merger price increases were attributable to market power.

Addressing the evidence of anticompetitive intent and effect, the Commission noted that the record demonstrated that senior officials at Evanston and Highland Park hospitals anticipated that the merger would give them increased leverage to raise prices. In addition, the Commission cited to the post-merger evidence of senior officials attributing the price increases to bargaining leverage produced by the merger.

The Commission also found that the econometric analysis supported the conclusion that the merger gave the combined entity the ability to raise prices through the exercise of market power. Specifically, the Commission explained that the economic analysis demonstrated substantial merger-coincident price increases and ruled out competitively benign explanations for those increases.

Finally, the Commission rejected ENH's justifications for the price increases. For example, the Commission rejected ENH's position that the price increases reflected attempts to correct a historical failure by Evanston Hospital to charge market rates, or that they marked a response to an increased demand for Highland Park's services due to post-merger improvements.

While the Commission agreed with the ALJ that ENH's acquisition of Highland Park violated Section 7 of the Clayton Act, it did not agree that a divestiture was warranted as a remedy. The Commission acknowledged the potentially high costs associated with the separation of hospitals that had functioned as a merged entity for seven years. In place of divestiture, the Commission ordered ENH to establish separate and independent managed care negotiating teams — one for Evanston and Glenbrook Hospitals, and another for Highland Park. According to the Commission, the separate teams would allow managed care organizations to negotiate separately again for those hospitals so as to stimulate competition between them.

LESSONS FROM THE EVANSTON NORTHWESTERN PROCEEDINGS

The Commission's decision makes it more likely that the FTC's focus on the retrospective review of mergers and acquisitions will continue. Thus, hospitals and hospital systems should bear in mind that an affiliation could be subject to a retrospective review and/or challenge if the FTC determines after the fact that the affiliation resulted in a substantial deleterious effect on competition.

The Evanston Northwestern decision highlights the importance of sensitivity to antitrust issues in pre-merger planning. In this respect, the following guidelines should be observed:

■ Parties to a merger should be prepared to analyze prospective affiliations based on the competitive impact on managed care contracting, and not just in terms of patient flow data.

■ In any affiliation, the merging parties should accurately articulate how the transaction will benefit competition. Such benefits may include improvements in quality, the creation of new services and products, or cost savings.

■ The combining entities must avoid using language that suggests that the affiliation is motivated by, or will have, anticompetitive effects.

■ Care should be taken to avoid gun-jumping. Specifically, the merging entities should not coordinate their activities prior to the closing of the merger nor should they exchange competitively-sensitive information unless there are good, pro-competitive reasons for doing so.

Finally, as illustrated by the post-merger review in the Evanston Northwestern matter, it also will be important for hospitals and hospital systems to monitor transactions after the fact, to ensure that they do not result in price increases that are out of sync with the market and cannot be explained by factors other than enhanced market power. In addition, affiliations should make sure they are delivering on any pro-competitive promises made in justifying the transaction, such as integration efficiencies, quality improvements, and the like.

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