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

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)
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

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
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

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
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

- **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
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

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
Pro-Merger Arguments – AHA Amicus Brief

- 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

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
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

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
Hart-Scott-Rodino Reportability (cont.)

- Transactions valued at <$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

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
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)

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
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)

Questions and Answers