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Court of Appeals Upholds Decision Unwinding Consummated Merger of Two Physician Groups Following FTC Suit

The United States Court of Appeals for the Ninth Circuit on February 10, 2015 issued an opinion in a closely-watched case in which it upheld a lower court decision requiring the unwinding of a consummated merger of two physician groups in Nampa, Idaho. The Court, in *Saint Alphonsus Medical Center – Nampa Inc., et al.* v. *St. Luke's Health System, Ltd., et al.*, No. 14-35173 (9th Cir. Feb. 10, 2015), agreed with the district court that the merger violated Section 7 of the Clayton Act, 15 U.S.C. § 18, which prohibits mergers the effect of which "may be substantially to lessen competition, or tend to create a monopoly," *id.*, and an analogous Idaho state law. Slip Op. at 7. The decision is notable because even though the district judge found that "the merger was intended to improve patient outcomes and might well do so," *id.* – a finding that the appeals court did not disturb – these claimed efficiencies were not sufficient to overcome the possibility that prices would increase as a result of the merger. *Id.* at 21, 29.

Background

In 2012, St. Luke's Health System, Ltd. acquired the Saltzer Medical Group. *Id.* at 7. Both firms provided adult primary care physician services in the city of Nampa, Idaho. *Id.* Prior to the closing of the transaction, two Idaho hospitals sought to enjoin the transaction, alleging that the then-proposed transaction would have anticompetitive effects in numerous alleged health-care-related markets. *Id.* The district court declined to issue a preliminary injunction, which would have blocked the acquisition from proceeding, see *Saint Alphonsus Med. Ctr.* v. *St. Luke's Health Sys.*, No. 12-cv-00560 (D. Idaho Dec. 20, 2012), and the transaction was consummated at the end of 2012. *See* Slip Op. at 8. In March 2013, the FTC and the State of Idaho filed a related suit seeking divestiture. *FTC* v. *St. Luke's Health System*, No. 13-cv-00116 (D. Idaho Jan. 24, 2014).

After a bench trial the district court found that even though "the [a]cquisition was intended by St. Luke's and Saltzer primarily to improve patient outcomes" and even though the court "believed that it would have that effect if left intact, and St. Luke's is to be applauded for its efforts to improve the delivery of health care," the acquisition violated Section 7 and Idaho antitrust law and ordered that it be unwound. *Saint Alphonsus Med. Ctr.* v. *St. Luke's Health Sys.,* No. 12-cv-00560 (D. Idaho Jan. 24, 2014), at 3. The district court reached its decision primarily on evidence that the combined firm employed eighty percent of Nampa's primary care physicians and thus would result in pricing power that would raise costs to health insurance plans; and on the lack of evidence supporting countervailing merger-related efficiencies. *See id.* at 3, 47. The defendants appealed.

The Ninth Circuit's Opinion

Horizontal merger analysis normally requires the definition of relevant product and geographic markets in order to measure effects on competition. Here, the parties contested the geographic market. The district court found, based on testimony demonstrating consumers' preference for local physicians as well as "testimony that consumers choose physicians on factors other than price," that a significant number of consumers would seek the services of local physicians rather than physicians outside of Nampa even when faced with increased prices for those services. Slip Op. at 15. The court thus determined that the City of Nampa was the relevant geographic market. Reviewing under a "clear error" standard, the Ninth Circuit affirmed this finding. *Id.* at 14-16.

The district court next determined that the combination of the two physicians' groups increased market concentration "far above the levels necessary to trigger the presumption that the combined entity will lessen competition," *Saint Alphonsus Med. Ctr.* v. *St. Luke's Health Sys.*, No. 12-cv-00560 (D. Idaho Jan. 24, 2014), at 44, a conclusion with which the Ninth Circuit also agreed. Slip Op. at 17. Similarly, the district court found that the market has high barriers to entry, and thus entry by a potential competitor "would not be timely to counteract the anticompetitive effects of the [a]cquisition"; this finding was not challenged on appeal. *Id.* Finally, the district court, citing internal communications and evidence from a prior acquisition St. Luke's had made, found that the combined firm would be able to extract higher reimbursement rates for physicians from health plans – a likely anticompetitive effect. Again, the appellate court agreed. *Id.* at 19, 21.

The Ninth Circuit then examined the lower court's finding that the defendants failed to prove the existence of countervailing efficiencies. Whether a transaction's efficiencies can serve as a "defense" to a prima facie demonstration that the transaction would have anticompetitive effects is a question that the Court treated as unsettled. The Court noted that other circuits "have suggested that proof of post-merger efficiencies could rebut" a prima facie anticompetitive effects finding.[1] *Id.* at 24. Here, the Court stated that it "remain[s] skeptical about the efficiencies defense in general and about its scope in particular." *Id.* at 25. Nevertheless, the Court assumed – without deciding – that "a defendant can rebut a prima facie case with evidence that the proposed merger will create a more efficient combined entity and thus increase competition." *Id.* at 26. "In other words," the Court observed, "a successful efficiencies defense requires proof that a merger is not, despite the existence of a prima facie case, anticompetitive." *Id.* at 27.

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1 When analyzing horizontal mergers, the FTC and Department of Justice may "credit" efficiencies. However, to figure into the agencies' analysis, those efficiencies must be merger-specific (*i.e.*, "likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects"); and must be "verify[able] by reasonable means" rather than being "vague [or] speculative." *Horizontal Merger Guidelines* § 10. These guidelines are not binding on the courts.

Here, the district court found – and the Ninth Circuit agreed – that the defendants failed to demonstrate that efficiencies flowing from the move toward so-called "integrated care" would ameliorate the predicted price increases. *Id.* at 28. The Ninth Circuit also agreed that the claimed efficiencies could be achieved without a team of physicians having to be employed by the same firm and thus were not dependent on the merger. *Id.* at 29. Notably, the Court reached these conclusions despite the district court's finding "that the merger would eventually 'improve the delivery of health care' in the Nampa market." *Id.* at 28.

Finally, the Ninth Circuit found that the district court did not abuse its discretion in ordering divestiture rather than the defendants' proposed conduct remedy "establish[ing] separate bargaining groups [of physicians] to negotiate with insurers," noting that "conduct remedies risk excessive government entanglement in the market." *Id.* at 31-32.

Implications for Future Merger Cases

The case is notable for the Court's skeptical treatment of the "efficiencies defense" to merger challenges. The Court strongly suggested that, in mergers with prima facie anticompetitive effects, firms should take care to identify efficiencies with precision, and these efficiencies should be significant enough to negate the predicted anticompetitive effects. The opinion further suggests that any claimed efficiencies must be seen to result in price effects, and that non-price effects may not be enough to support an efficiencies defense.

The case also serves as a reminder that asserted efficiencies must be specific to the merger, a point stressed in the reaction to the decision by the Chairwoman of the FTC. *See* Press Release, FTC, Statement by FTC Chairwoman Edith Ramirez on Appellate Ruling in the St. Luke's Hospital Matter (Feb. 10, 2015), *available at* http://www.ftc.gov/news-events/press-releases/2015/02/statement-ftc-chairwoman-edith-ramirez-appellate-ruling-st-lukes ("The acquisition would have delivered no benefit to consumers that could not be achieved in ways other than the anticompetitive merger.").

Finally, this case is another example of enforcement agencies' interest in policing health care mergers, and confirms that no transaction is too small or too localized to escape scrutiny.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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