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FTC Prevails on Appeal in Chicago Health System Merger Challenge

On October 31, 2016, the U.S. Court of Appeals for the Seventh Circuit issued a decision halting the merger of two large Illinois hospital systems, Advocate Health Care and NorthShore University HealthSystem.

This decision marks a second victory in recent months for the Federal Trade Commission following the decision of the U.S. Court of Appeals for the Third Circuit in FTC v. Penn State Hershey in September, in which the Third Circuit criticized the district court's failure to properly apply the "hypothetical monopolist" test and emphasized consideration of the impact on health insurance payers, not just patients, in assessing competitive effects of a merger under federal antitrust law.[1]

The District Court Decision

Advocate and NorthShore each operate acute care hospitals in Chicago's northern suburbs. The health systems announced their proposed merger in September 2014, after which the FTC and the Illinois Attorney General sued in federal court seeking a preliminary injunction to halt the merger pending an administrative hearing challenging the merger under federal antitrust law. Advocate and NorthShore defended the merger, claiming that patients had plenty of choices for hospital services, including academic medical centers in Chicago. The FTC defined the relevant market much more narrowly. In June 2016, the U.S. District Court for the Northern District of Illinois denied the FTC's request, but agreed to continue the hold on the merger pending appeal. The district court found that the FTC failed to properly define the relevant geographic market as required by antitrust law.[2]

The Seventh Circuit Court of Appeals Decision

The Seventh Circuit disagreed, holding that the FTC had a sound basis for its market definition, and for distinguishing local hospitals and destination hospitals, which are primarily academic medical centers that attract patients from throughout the Chicago metropolitan area.[3] The court noted there was strong evidence that patients preferred local providers for hospital services, and that even if some patients were willing to travel for care, the district court overlooked

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the leverage created by the "silent majority" that would not travel. The Seventh Circuit's decision was influenced by testimony that insurers could not successfully market health plans to employers in Chicago's northern suburbs without including some of the merging hospitals in their network, which could result in increased prices. The Seventh Circuit reversed the district court's decision and remanded the case for reconsideration. In a joint statement issued on November 16, 2016, the hospitals announced that they will continue their efforts to merge despite the decision by the Seventh Circuit.

Takeaways

FTC Enforcement Efforts Will Continue. In light of the recent appellate court decisions, courts will likely review hospital mergers using the hypothetical monopolist test as the FTC advocated, which often leads to a narrow definition of the relevant geographic market. At least in the near term, the FTC is likely to continue stepping up its merger review and antitrust law enforcement in light of the favorable decisions. However, President-elect Donald Trump's antitrust enforcement agenda has not been defined in significant detail and could impact the FTC's efforts moving forward.

Need to Obtain "Buy-in" from Commercial Insurers and Other Stakeholders. Both the Seventh Circuit and the Third Circuit in Hershey make clear that the first layer of customers in hospital merger transactions is the insurance payer. The FTC routinely contacts payers to obtain information regarding network composition and other information related to current and future negotiations with the merging parties. Obtaining buy-in from payers is critical to avoiding damaging testimony by payer executives during the course of litigation.

Conclusions and Additional Questions

The appellate court decisions, though not favorable to health care providers considering similar transactions, provide some clarity on the criteria that courts and the FTC will apply moving forward. Both decisions make clear that a key focus will be on a transaction's impact on payers rather than just patient flow data.

Health systems should involve legal counsel and a health care economist in the early stages of the strategic planning process to analyze the legal and competitive issues associated with any considered merger or similar joint venture. Given the FTC's current enforcement strategy, it is critical to plan and document the procompetitive benefits of the transaction and consider likely challenges on the

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front-end.

If you have any questions about a potential transaction or about these recent developments, please contact Larri Broomfield, Guy Temple, Laura Brenner or your Reinhart attorney.

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[1] Federal Trade Commission v. Penn State Hershey Med. Ctr., 838 F3d. 327 (3d Cir. 2016).

[2] Federal Trade Commission v. Advocate Health Care, No. 15 C 11473, 2016 WL 3387163 (N.D. Ill. June 20, 2016). For further discussion of the lower court's initial decision, see Guy R. Temple, FTC Attempt to Block Chicago Hospital Merger Rejected by Federal Court.

[3] Federal Trade Commission v. Advocate Health Care Network, No. 16-2492 (7th Cir. Oct. 31, 2016).

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