

FTC's Attempt to Block Hershey-Pinnacle Merger Rejected by Federal Court in Pennsylvania

A Pennsylvania federal court denied a motion by the Federal Trade Commission and the Commonwealth of Pennsylvania (collectively, the "FTC") for a preliminary injunction last month which would have prohibited the merger of Penn State Hershey Medical Center ("Hershey") and PinnacleHealth System ("Pinnacle") (collectively, "Defendants"). Judge John E. Jones III of the United States District Court for the Middle District of Pennsylvania found that the FTC failed to set forth a relevant geographic market, and thus had not met its burden to show a likelihood of success on the merits of their antitrust claim. The court went even further in finding that the efficiencies created by the merger outweighed potential anticompetitive risks.

Tracey Klein, chair of Reinhart's Health Care Practice, believes this may be the beginning of a trend where "courts and the FTC begin to acknowledge the shifting landscape of the health care marketplace as a result of reforms brought on by the Affordable Care Act." However, the fight continues, as the United States Court of Appeals for the Third Circuit ("Third Circuit") subsequently granted the FTC's request for a stay to prevent Hershey and Pinnacle from moving forward on the merger while the appeal is pending.

Background

Hershey, a 551 bed hospital with 1 location in Hershey, Pennsylvania, and Pinnacle, a 3 campus, 646-bed system in Harrisburg and Cumberland Counties, signed an Affiliation Agreement in April 2015 and notified the FTC of the proposed merger. The FTC subsequently moved for a preliminary injunction to block the merger.

Issues

Definition of "Geographic Market"

The primary factor in the court's decision was the FTC's flawed construction of the relevant geographic market. The FTC argued that the geographic market should be limited to the four-county Harrisburg area, and claimed that the geographic market for general acuity services is inherently local because people want to be

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hospitalized near their family and homes. But the Defendants argued that the FTC's proposed geographic market was overly narrow, citing statistical evidence that in 2014, 43% of Hershey patients traveled to the hospital from outside of the 4 county Harrisburg area to receive services; 50% of Hershey patients traveled at least 30 minutes and 20% traveled at least 60 minutes.

Weighing the Equities

Although the court's decision on the geographic market was determinative, Judge Jones also found that the efficiencies created by the merger outweighed any potential risk of anticompetitive effects. The Defendants argued that Hershey's capacity constraints, repositioning by existing competitors and the increase in risk-based contracting all weighed in favor of allowing the Defendants to consummate the merger. Hershey's occupancy rate of 89% to 115% was consistently higher than the 85% optimal occupancy rate. The Defendants argued that they could shift lower acuity patients to Pinnacle and avoid Hershey needing to spend \$277 million to build a new bed tower—the cost of which would be passed along to consumers—to alleviate occupancy constraints. Additionally, other hospitals in the area already started repositioning in response to the merger. For example, Geisinger Health System acquired Holy Spirit Hospital and WellSpan Health acquired Good Samaritan Hospital. Hershey CEO Craig Hillemeier testified that larger organizations are better able to spread infrastructure costs in response to an increase in risk-based contracting. Over the next three years, the government and other payors intend to shift a significant percentage of payments towards risk-based arrangements.

Decision

Judge Jones ultimately determined that the FTC's proposed geographic market was unrealistically narrow because it did not reflect the commercial realities faced by consumers (*i.e.*, that many consumers traveled from outside the four-county Harrisburg area to receive care at Hershey).

Although the ruling by Judge Jones on the geographic market was determinative, Judge Jones was also persuaded by the Defendants' equitable arguments. Specifically, Judge Jones held that: (1) Hershey would be able to alleviate its capacity constraints by shifting lower acuity patients to Pinnacle hospitals; (2) competitors already started repositioning themselves in such a way that would limit the risk of anticompetitive effects; and (3) larger organizations that are "able to spread the costs of the infrastructure of population health over a larger health



care system" are more likely to succeed as risk-based contracting continues to increase.

Discussion

The Hershey-Pinnacle decision was one of *two* recent cases in which the Federal Trade Commission's effort to block a hospital merger was thwarted. Judge Jorge Alonso in the Northern District of Illinois reached a similar conclusion on June 20, 2016 in denying the Federal Trade Commission's request to enjoin the merger of Advocate Health Care Network ("Advocate") and NorthShore University HealthSystem ("NorthShore") in the northern Chicago suburbs.^[1] The court in *Advocate* also concluded that the Federal Trade Commission's had failed to prove a relevant geographic market, and thus had not shown a likelihood of success on their claim. But the *Advocate* decision—unlike the *Hershey* case—did not address the "balancing of the equities" or the competitive effects of the proposed merger. For more detail on the *Advocate* decision, see Guy Temple's article "[FTC Attempt to Block Chicago Hospital Merger Rejected by Federal Court.](#)"

The FTC has appealed in the *Hershey* case and the Third Circuit granted the FTC's request for a stay, which prevents Hershey and Pinnacle from moving forward on the merger while the appeal is pending. Likewise, the Federal Trade Commission has filed a notice of appeal of the *Advocate* decision to the Seventh Circuit Court of Appeals and the merger is temporarily enjoined pending that appeal. Both appellate court decisions will have to address how the Federal Trade Commission constructed the geographic market and whether the lower courts were correct in rejecting those constructions, and in doing so, they will provide a roadmap for both future merger challenges and defenses.

Additional Questions and Assistance

If your organization is considering a merger or other combination, it is critical that you consult with legal counsel early on to minimize the risk of a challenge from the Federal Trade Commission and to proactively develop defenses to a challenge. Without advanced planning, a challenge from the Federal Trade Commission can be the kiss of death for a transaction. If you would like to discuss these developments or a contemplated transaction, please contact [Larri Broomfield](#), or your Reinhart attorney.

^[1] See *FTC v. Advocate Health Care Network, et al.*, No. 1:15-cv-11473, 2016 WL



3387163 (N.D. Ill. Jun. 20, 2016).

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