CHAPTER I

INTRODUCTION TO HOSPITAL MERGERS

A. Introduction

This chapter provides a brief, non-technical introduction to hospital merger challenges in the United States. It includes a general description of certain trends in hospital merger litigation and introduces methods of analysis and arguments utilized in the antitrust assessment of hospital combinations. The main goal of the chapter is to offer readers a broad analytical overview; subsequent chapters provide an in-depth look at specific issues that have arisen in hospital merger review.

B. History of Hospital Merger Litigation

Over the past three decades, the hospital industry has seen substantial consolidation and a great deal of merger litigation. The 1990s marked a tumultuous period of restructuring among firms in the U.S. health care sector. In an effort to streamline operations, providers and payors reorganized both themselves and their relationships with patients. The growing presence of managed care placed enormous pressure on hospitals to reduce excess capacity and costs, while improving the quality of patient care. The result was a period of rapid and substantial consolidation. After a brief lull during the first decade of this century, the consolidation trend has continued as physician groups, health plans, and hospital systems, spurred in part by health care reform, have continued to seek ways to contain costs, shore up market positions, and achieve improvements in care.[1]

Over the years, hospital consolidation frequently has clashed with Section 7 of the Clayton Act's prohibition on mergers that result in a "substantial lessening of competition." Since the mid-1980s, enforcers have litigated against 17 hospital mergers under Section 7, with a number of other matters either settling or being abandoned after a complaint was

1. *See, e.g.*, Leemore Dafny, *Hospital Industry Consolidation – Still More To Come?*, 370 N. ENG. J. MED. 198 (2014); Rich Daly, *Hospital Consolidation Trend To Continue*, HEALTHCARE FIN. MGMT. ASS'N HEALTHCARE BUS. NEWS, June 16, 2014; Helen Adamopoulos, *10 Key Healthcare Transaction Trends*, BECKER'S HOSP. REVIEW, Feb. 7, 2014.

filed. Initial efforts at enjoining these transactions were moderately successful, with the government winning four of seven hospital merger challenges before 1995. However, a string of losses in the mid-1990s led enforcers to re-tool their approach, incorporating more advanced economic analysis in defining relevant markets and demonstrating competitive effects. The result has been several recent victories and a renewed vigor to agency enforcement.[2]

C. Applicability of Section 7 to Nonprofit Hospital Mergers

Mergers are typically challenged under Section 7 of the Clayton Act,[3] which prohibits transactions "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[4] Despite this broad language, the applicability of Section 7 to hospital mergers involving nonprofit institutions has sometimes been called into question. In *United States v. Carilion Health System*,[5] the district court reviewed such a challenge, noting that there are effectively two clauses of Section 7 relevant to this issue: the "stock clause" that governs acquisitions of shares and the "assets clause" that governs acquisitions of assets.[6] Because many nonprofit hospitals are not corporations, the stock clause of Section 7 often will be inapplicable to the analysis. The asset clause, on the other hand, is limited to persons

2. Appendix A contains a brief description of each of the hospital mergers that have been litigated to at least a preliminary conclusion challenged under Section 7 since 1985.
3. 15 U.S.C. § 18.
4. *Id*. Mergers may also be challenged under Sections 1 or 2 of the Sherman Act. 15 U.S.C. §§ 1, 2. In such cases, the merger is alleged to unreasonably restrain trade, create a monopoly, or suggest an attempt to create a monopoly.
5. 707 F. Supp. 840, 848 n.1 (W.D. Va.), *aff'd*, 892 F.2d 1042 (4th Cir. 1989).
6. 15 U.S.C. § 18 ("No person engaged in commerce . . . [1] shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and [2] no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person," where the acquisition will "substantially . . . lessen competition, or to tend to create a monopoly.").

"subject to the jurisdiction" of the Federal Trade Commission (FTC). In determining whether a nonprofit hospital is subject to the FTC's jurisdiction, the *Carilion* court looked to Section 4 of the FTC Act.[7] Because Section 4 limits jurisdiction to entities that are "organized to carry on business for its own profit or that of its members,"[8] the court concluded that the assets clause did not render Section 7 applicable to nonprofit hospital mergers.[9] Having ruled out a cause of action under Section 7, the court went on to consider an allegation that the parties violated Section 1 of the Sherman Act.[10]

This interpretation was questioned by Judge Posner in *United States v. Rockford Memorial Corp.*,[11] a case in which the district court had ruled that Section 7 did apply to nonprofit hospitals because it found that the acquisition of control of a nonprofit hospital amounted to an acquisition of the hospital's stock for purposes of Section 7. Before addressing the lower court's analysis, Judge Posner first noted in dicta that the reference in the assets clause to the jurisdiction of the FTC could refer to Section 11 of the Clayton Act,[12] which grants broad jurisdiction to the agency to regulate "all other character of commerce" not expressly delegated to another agency in the statute, thereby obviating the need to consult Section 4 of the FTC Act.[13] Because Section 11 would confer jurisdiction on the FTC, the court suggested that nonprofit hospital mergers should

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7. 15 U.S.C. § 44 ("'Corporation' shall be deemed to include any company, trust, so-called Massachusetts trust, or association, incorporated or unincorporated, which is organized to carry on business for its own profit or that of its members, and has shares of capital or capital stock or certificates of interest, and any company, trust, so-called Massachusetts trust, or association, incorporated or unincorporated, without shares of capital or capital stock or certificates of interest, except partnerships, which is organized to carry on business for its own profit or that of its members.").
8. *Id*.
9. *Carilion*, 707 F. Supp. at 841 n.1.
10. *Id*. at 841.
11. 898 F.2d 1278 (7th Cir. 1990).
12. 15 U.S.C. § 21. Section 11 confers jurisdiction on the Interstate Commerce Commission to regulate common carriers, the Federal Communications Commission and the Civil Aeronautics Board (now defunct) to regulate common carriers, and the Federal Reserve to regulate banks. "[A]ll other character of commerce" is subject to the jurisdiction of the FTC.
13. *See Rockford*, 898 F.2d at 1280 n.1.

be subject to Section 7. Nonetheless, because this argument had not been presented to the court, Judge Posner declined to resolve the issue on this basis.

The court then turned to the argument before it and concluded that it was inappropriate to stretch an interpretation of Section 7's stock clause to include acquisitions of nonprofit hospitals.[14] The court therefore proceeded to examine the merger under Section 1 of the Sherman Act, noting that "the standards under section 1 of the Sherman Act and section 7 of the Clayton Act have converged."[15]

Since *Rockford*, reviewing courts have adopted Judge Posner's suggested analysis to find that Section 7 reaches transactions involving nonprofit hospitals.[16] As a result, many defendants have elected not to raise the jurisdictional argument.[17] Nonetheless, the applicability of Section 7 to nonprofit entities, including nonprofit hospitals, remains a matter unresolved by the Supreme Court, and, therefore, arguably remains a threshold matter of note for attorneys facing hospital merger litigation.

As an additional matter of note, the premerger notification requirements of the Hart-Scott-Rodino Act generally are held to apply to acquisitions of nonprofit hospitals, presuming the Act's threshold requirements are met.[18] One exception occurs when the transaction involves the formation of a nonprofit joint venture.[19]

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14. *Id*. at 1281 ("We are especially reluctant to test the elasticity of our interpretive powers without good reason, the only reason here being that the government overlooked a solid argument, based on section 11. . . .").
15. *Id*. at 1283.
16. *See* FTC v. Freeman Hosp., 69 F.3d 260, 266-67 (8th Cir. 1995); FTC v. Univ. Health, 938 F.2d 1206, 1215 (11th Cir. 1991); FTC v. Freeman Hosp., 914 F. Supp. 331, 333-34 (W.D. Mo. 1995).
17. Where the merged entity operates as a nonprofit, however, defendants continue to assert that the entity will be less likely to raise price or reduce quality. *See infra* Chapter III.E.4 for a detailed discussion of this "nonprofit defense."
18. 15 U.S.C. § 7A.
19. Under the FTC's Hart-Scott-Rodino Premerger Notification Rules, 16 C.F.R. § 801 *et seq*., the acquisition of voting securities of a not-for-profit joint venture as part of the venture's formation is expressly exempt from the requirements of the Act. 16 C.F.R. § 802.40.

D. Merger Analysis

As a general matter the courts and the federal antitrust agencies review hospital mergers consistently with the government's *Horizontal Merger Guidelines*.[20] These *Merger Guidelines* outline the "principal analytical techniques, practices, and the enforcement policy" of the federal antitrust agencies "with respect to mergers and acquisitions involving actual or potential competitors."[21] Published in 2010, the *Merger Guidelines* replaced a prior version issued by the agencies in 1992.[22] Although similar in approach, there are some distinct differences between these two sets of Guidelines that are worth noting, particularly since many courts may be more familiar with the 1992 *Merger Guidelines*. The 1992 *Merger Guidelines* set out a step-wise approach to merger analysis that is reflected in numerous court decisions. Pursuant to this approach, a reviewing agency or court must first define the relevant market(s) and determine the effect of the merger on market concentration. The second step in the process is to assess whether an increase in concentration resulting from the merger gives cause for concern that the transaction would lead to anticompetitive effects. The third step calls for an assessment of the ease or difficulty of entry and the likelihood that any anticompetitive effects resulting from the merger would be alleviated by entry. The fourth step requires an analysis of merger efficiencies to determine whether they are sufficient to outweigh any merger-related concerns. And, finally, the fifth step calls for the reviewer to determine whether, but for the merger, either of the merging firms would fail, causing their assets to exit the market.[23]

The current version of the *Merger Guidelines* takes a less formalistic approach to merger review, recognizing that the analysis must center on the ultimate likelihood that a merger will result in anticompetitive effects. For example, section 4 of the *Merger Guidelines* states that: "The agencies' analysis need not start with market definition. Some of the

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20. U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (2010) [hereinafter MERGER GUIDELINES], *available at* http://www.ftc.gov/os/2010/08/100819hmg.pdf.
21. *Id.* § 1.
22. U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (1992) [hereinafter 1992 MERGER GUIDELINES], *available at* https://www.ftc.gov/sites/default/files/attachments/merger-review/hmg.pdf.
23. *Id.*

analytical tools used by the agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis."[24] The 2010 *Merger Guidelines* describe in more detail the various types of evidence the agencies rely upon to determine whether a merger may result in anticompetitive effects.[25] They also provide a more nuanced description of the frameworks used to assess the likelihood that a merger may result in unilateral or coordinated effects.[26]

Even with these differences, however, the current *Merger Guidelines* continue to reflect much of the basic analytical paradigm employed by the courts and the federal antitrust agencies over the past three decades in reviewing mergers. In the vast majority of cases the government still will delineate relevant product and geographic markets, assess market concentration, determine whether a particular transaction may raise anticompetitive concerns within the relevant market(s), and assess various factors such as entry, efficiencies, and the existence of power buyers that may potentially ameliorate such concerns.[27] These basic features of merger review and analysis are described in general terms below. Chapters II through IV provide substantial additional detail.

At the outset, it is also worth noting that the 1996 *Statements of Antitrust Enforcement Policy in Health Care*,[28] jointly issued by the FTC and U.S. Department of Justice (DOJ), identify a "safety zone" within which the agencies will not challenge a hospital merger on antitrust grounds. Within this safety zone, absent extraordinary circumstances, neither the FTC nor the DOJ will challenge a merger between "general acute care hospitals" where one of the hospitals (1) has an average of fewer than 100 licensed beds over the three most recent years, (2) has an average daily inpatient census of fewer than 40 patients over the three most recent years, and (3) has been in existence for at least five years.[29]

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24. MERGER GUIDELINES, *supra* note 20, § 4.
25. *Id.* § 2.
26. *Id.* §§ 6-7.
27. *Id.* §§ 4-10.
28. U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, STATEMENTS OF ANTITRUST ENFORCEMENT POLICY IN HEALTH CARE (1996) [hereinafter 1996 HEALTH CARE STATEMENTS], *available at* http://www.justice.gov/sites/default/files/atr/legacy/2007/08/14/0000.pdf.
29. *Id.*