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Lessons from *Evanston*: FTC Orders Novel Remedy in Hospital Merger Case

On August 6, 2007, the Federal Trade Commission (FTC) ruled that a merger between Evanston Northwestern Healthcare (ENH) and Highland Park Hospital was anticompetitive and a violation of Section 7 of the Clayton Act. Despite this ruling, the FTC did not order the traditional remedy of divestiture. Instead, the FTC fashioned an extraordinary remedy and ordered ENH to establish two separate and independent contract negotiating teams—one to negotiate managed care contracts on behalf of hospitals that were part of ENH prior to the merger and one to negotiate contracts for Highland Park Hospital.

The novelty of the prescribed remedy has raised many questions, including: (1) whether ENH can practically comply with this order; and (2) whether, assuming that ENH can and does comply with the FTC order, the prescribed remedy can actually "undo" the anticompetitive harm that the FTC cited as its reason for issuing the order.

ENH has not indicated whether it will appeal the FTC ruling, but regardless of the filing or outcome of an appeal, the August 6 ruling offers important lessons to health care entities that are contemplating or undertaking a merger or other combination that may affect price or competition in health care markets.

The Merger and the FTC's Decision

ENH consummated its merger with Highland Park Hospital in 2000. Although the parties filed the requisite pre-merger notification under the Hart-Scott Rodino Act, the FTC did not seek to block consummation of the transaction.

In 2002, the FTC announced that it would begin retrospective review of consummated hospital mergers to assess their anticompetitive effects. As a result of a retrospective review of the ENH/Highland Park Hospital merger, the FTC filed an administrative complaint against ENH in 2004—four years after the ENH/Highland Park Hospital merger transaction had closed. The administrative complaint alleged that ENH's acquisition of Highland Park Hospital violated Section 7 of the Clayton Act because it enabled ENH to charge higher prices at all three member hospitals than those hospitals would have charged absent a merger. In particular, the administrative complaint noted that ENH had substantially raised its prices to managed care organizations (MCOs) shortly after consummating the merger transaction with Highland Park Hospital.

ENH did not dispute that it had increased its prices following the merger, but it alleged that these price increases were the combined result of: (1) a "price correction" resulting from the fact that one of the ENH hospitals was charging below-market prices prior to the merger; and (2) an increase in the demand for the services as a result of post-merger improvements in facilities and services.

In October 2005, Chief Administrative Law Judge ("ALJ") Stephen Maguire ruled that the ENH merger violated Section 7 of the Clayton Act. As part of the ruling, Maguire issued an order for ENH to divest Highland Park Hospital. Maguire's ruling highlighted documents showing that senior officers and consultants for the merging hospitals intended that their impending merger would give their hospitals greater bargaining power with MCOs,

and would thereby result in ENH having the needed "leverage" to raise prices. The evidence also included certain post-merger statements by ENH officials, including a statement by one ENH executive that:

> *the larger market share created by adding Highland Park Hospital has translated to better managed care contracts… [S]ome $24 million of revenue enhancements have been achieved, mostly via managed care renegotiations…[N]one of this could have been achieved by either Evanston or Highland Park alone. The 'fighting unit' of our three hospitals and 1600 physicians was instrumental in achieving these ends*.

ENH appealed the ALJ's ruling to the Commissioners of the FTC. They affirmed that the ENH/Highland Park Hospital merger was anticompetitive and illegal. Like the ALJ, the Commissioners cited to pre- and post-merger statements made by hospital officials and consultants regarding the merger's anticipated and actual effect on ENH's power to raise prices. They also relied on econometric analyses of the merged hospitals' pre-merger and post-merger prices, which demonstrated a substantial increase in average net price per case following the consummation of the merger, and, in the opinion of the Commissioners, effectively ruled out procompetitive and competitively neutral explanations for the price increases, such as improved efficiency, changes in patient mix or improvements in quality. The Commissioners' ruling explicitly notes the lack of any evidence that improvements in quality or services were communicated to patients or MCOs in the course of contract negotiations, suggesting that communication of improvements to the users and payors of services would be required to reasonably support the argument that ENH was able to raise its prices as a result of increased demand due to improvements in quality or services.

Although the Commissioners' ruling affirmed that the ENH/Highland Park Hospital merger was illegal, it did not affirm the ALJ's order for ENH to divest Highland Park Hospital. Instead, the FTC ordered a "conduct remedy," stating:

> *ENH has integrated the operations of [its merged hospitals] and has made substantial improvements at Highland Park since the merger. [Although] [t]he large majority of these improvements would have occurred without the merger, and therefore do not bear on whether the transaction violated Section 7…they are relevant to determining whether divestiture is appropriate because divestiture may reduce or eliminate the resulting benefits for a material period of time.*

The Commissioners acknowledged that a structural remedy such as divestiture is ordinarily preferred over a conduct remedy of the sort ordered for ENH, but stated that the costs, including the potential loss to the community if Highland Park Hospital had to forfeit its cardiac surgery program and state of the art electronic medical records system, warranted an alternative to a structural remedy.

The FTC analyzed the ENH/Highland Park Hospital merger through the "consumer protection" lens of antitrust law, and with careful consideration of the rather unique aspects of the marketplace for hospital services. For example, the ruling contains an interesting—if not new—argument that transactions and arrangements among health care providers warrant especially intense scrutiny because the injury that may result from anticompetitive conduct extends far beyond the individuals who personally use the health care services. When an entity such as ENH negotiates higher prices with MCOs, those MCOs spread the cost of the higher prices to all their enrollees, as well as to all employers who purchase the MCO's plans for their employees. The result is that all consumers in a region—which may be very large if certain MCOs serve employers and enrollees over a large geographic area—may be injured by the anticompetitive conduct.

Analysis and Lessons

The FTC May Bring a Merger Challenge Before or After Consummation of a Merger

This ruling serves as a reminder that the FTC can and may bring a merger challenge whenever it develops evidence that the merger is harmful to consumers. The fact that the FTC does not challenge a transaction prior to the expiration of the waiting period under the Hart-Scott-Rodino Act does not mean that the transaction cannot later be challenged. As the *Evanston* ruling demonstrates, this means that parties to a merger transaction need to be mindful of the antitrust implications of statements, conduct and pricing behavior before, during and after consummation of a merger.

Statements Concerning Competitive Effects Made by the Merging Parties in the Ordinary Course of Business Will Be Given Substantial Weight

A pivotal consideration in the ENH ruling was the trail of statements by ENH and Highland Park Hospital officials indicating their merger was intended to, and did, reduce competition, increase market power, generate "leverage" to negotiate with MCOs, and increase reimbursement rates. To withstand antitrust scrutiny, a merger transaction among competing hospitals with substantial market shares should be supported by clear evidence of procompetitive enhancements in quality and efficiency. Notwithstanding the post-merger increase in prices, the ENH merger may have survived antitrust scrutiny had there been well-documented evidence that the intent and effect of the transaction was to improve the quality, scope and efficient utilization of healthcare services in a manner that the pre-merger entities could not achieve independently.

The FTC Is Mindful of the Difficulty in "Unscrambling Eggs"

Since announcing its retrospective review of hospital mergers in 2002, the FTC has faced numerous questions about the potential public harm that may result if merged entities are suddenly ordered to "undo" their merger after many years of unified operation. By the *Evanston* ruling, the FTC clearly acknowledged that divestiture may be ill-advised and contrary to the public interest when many years have passed between the consummation of the transaction and the conclusion of antitrust litigation. However, although the ruling acknowledges that a consummated merger that is deemed illegal "after the fact" may not always warrant an order for divestiture, it also stresses that "it is the highly unusual case in which a conduct remedy, rather than divestiture, is more appropriate." In sum, the FTC's ruling in *Evanston* opens the door for alternative remedies to divestiture, but it is not known whether these alternative "conduct" remedies will become common, whether they will be practicable, or whether they can actually remedy the competitive harm.

In addition, there is no indication of whether ENH will appeal the FTC's ruling to a federal court, on what grounds ENH may appeal, or what the outcome of the appeal may be. Taken together, these questions suggest that it may be some time before we have full appreciation for what the *Evanston* decision means for entities that face post-merger challenges brought by the FTC. Consequently, there is considerable incentive for health care entities to be mindful of antitrust considerations in structuring and executing transactions, and in dealing with payors after the transaction, so as to avoid having to face the prospect of a post-merger challenge and the difficult questions of whether and how they may be required to "unscramble their eggs."

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