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## Ninth Circuit Court of Appeals Nixes Hospital System Acquisition of Physician Practice Group: Preserving Competition Trumps Better Patient Care in This Case

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On February 10, 2015, the United States Court of Appeals for the Ninth Circuit (which covers Idaho, Montana, Oregon, Washington, California, Nevada, Alaska, Hawaii and Arizona) ordered St. Luke's Health System, Ltd. ("St. Luke's") to unwind its 2012 purchase of the Saltzer Medical Group ("Saltzer"). The case was closely watched because the merging parties relied heavily on the argument that the merger would improve patient outcomes by allowing better-managed care, and that this overcame the presumption that the high market share resulting from the merger would lead to reduced competition.

As is typical in merger cases, the reviewing courts were chiefly concerned with two issues:

1. How would consumers respond to hypothetical price increases (i.e., would patients abandon their local physicians and travel to a neighboring city), and
2. Could sellers raise prices because they have market power?

The Court found that patients in Nampa, Idaho, would not abandon their doctors if faced with a price increase, and that the plaintiffs would likely raise prices. The Court also underscored the need for merging parties to advance efficiencies closely tied to the merger itself if they hope to use those efficiencies to rebut a *prima facie* showing of harm to competition. The Court left open the question of what the nature of such efficiencies must be in order to rebut the presumption. Ultimately, the case serves as a useful reminder that parties should think through the expected benefits of a transaction and how those benefits, if cited later, could be used to justify the merger, as well as how parties should keep firmly focused on the burden they will shoulder when attempting to do so.

### FACTUAL BACKGROUND

St. Luke's is a not-for-profit health care system that operates an emergency clinic in Nampa, Idaho. Saltzer was the largest independent multi-specialty physicians group in Idaho. In 2012, St. Luke's acquired Saltzer's assets and entered to a five-year professional services agreement with Saltzer's physicians. Prior to acquisition, Saltzer had 16 primary-care physicians in the Nampa market, St. Luke's eight, the local hospital nine, and there were several other solo or small primary-care physician practices. The merged entity had 24, giving it a market share of over 60 percent. St. Luke's argued that the merger would benefit patients by creating a team of physicians using its electronic medical records system, and would allow this group to adopt risk-based reimbursement methods that would lower costs and improve patient care.

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### DISTRICT COURT LITIGATION

The Federal Trade Commission (“FTC”) and the Idaho Attorney General, among others, challenged the acquisition in federal court after its consummation. They alleged that the acquisition would allow St. Luke’s to demand higher insurance reimbursement rates for health care services provided by primary-care physicians in the Nampa area, resulting in higher costs for health care consumers and employers.

After hearing extensive testimony, the trial court concluded that the over 60 percent market share of the post-transaction entity created a substantial risk of anticompetitive price increases in the Nampa adult primary-care physician market and, thus, violated federal and state antitrust laws. The trial court ordered St. Luke’s to unwind the transaction and fully divest itself of Saltzer’s physicians and assets. St. Luke’s and Saltzer appealed to the Ninth Circuit.

### NINTH CIRCUIT DECISION

The Ninth Circuit panel relied heavily on the trial court’s findings as to the merger’s likely effects on the Nampa market for primary-care physician services. The Court declined to find a geographic market broader than Nampa in light of the District Court’s finding that insurance providers need to provide local primary care physician options to Nampa residents. The very high market share the parties would enjoy after the acquisition established a *prima facie* case of harm to competition in this market.

The bulk of the Court’s opinion—and the most interesting part—focused on St. Luke’s and Saltzer’s attempted rebuttal of this presumption of harm. St. Luke’s and Saltzer chose modernization as their battleground, challenging the traditional fee-for-service payment model as discouraging cost savings and encouraging unnecessary procedures and waste. By giving Saltzer physicians access to the electronic records of St. Luke’s patients, health care delivery and quality would improve patient care, with all caregivers collaborating to provide care under a more holistic plan and incorporating one fee per patient based on various degrees of risk.

Both the trial and the appellate courts accepted that fee-for-service was an inferior model for health care delivery, citing many sources as to the relative merits of a risk-based, integrated care model. The appeals court, however, noted that there was a substantial and unsettled issue surrounding whether claims of efficiencies enabled by an acquisition can ever be used to rebut an established *prima facie* case of harm to competition. Efficiencies lower the costs of the merging parties and may enable them to lower prices, but in mergers that increase market concentration, efficiencies may only increase the merging parties’ profits at the expense of consumers.

The court ultimately found it unnecessary to resolve this dispute, however. It affirmed the District Court’s conclusion that the parties failed to show that the efficiencies—if achieved—were enabled by the acquisition. A better patient experience and a lower-cost means of coordinating care may well improve the quality of health care delivery and lower the costs of providing it, but the parties could not demonstrate that the acquisition was necessary to achieve these benefits. The court noted, for example that independent physicians had adopted risk-based reimbursement, transitioned to integrated care, or made use of analytical

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tools, such as centralized medical records systems, without being employed by a major health system. In the end,

... St. Luke's might provide better service to patients after the merger. That is a laudable goal, but the Clayton Act does not excuse mergers that lessen competition or create monopolies simply because the merged entity can improve its operations.

The court also pointed to evidence that the parties would not pass along any savings to insurance plans or, ultimately, to consumers. Communications in the parties' files anticipated an ability to demand higher reimbursement rates from health plans post-acquisition. For example, an e-mail between St. Luke's administrators discussed pressuring payors for new agreements. Similarly, Saltzer executives wrote "the clout of the entire network" after the transaction could be used to negotiate favorable terms with insurers. There was also evidence that in an unrelated acquisition in Twin Falls, Idaho, St. Luke's used its leverage to force insurers to accept St. Luke's pricing proposals.

### CONSIDERATIONS

The Ninth Circuit's opinion breaks no new ground in antitrust law, but it serves as a useful reminder for merging companies to keep a few principles firmly in mind when evaluating a merger or acquisition:

- The Clayton Act focuses on price effects, not ideals. There is often a better way to do things, and these days, no one argues otherwise with respect to health care, even though opinions differ on the approach. Likewise, structuring deals to improve costs or to improve the customer experience is a worthy aim. If the result will be higher prices to consumers, however, an acquisition can expect to face a significant antitrust challenge, and arguments appealing to the long-term improvement of quality will likely not save an otherwise anticompetitive transaction unless the efficiencies relate to the issue of whether the acquisition would substantially lessen competition.
- Always ask, "Do we really need to do this to achieve what we want to achieve?" Available alternative arrangements that would accomplish what the parties claimed they wanted to do doomed the acquisition of Saltzer. In the case of the affiliations between a hospital and a physicians group with market presence, the parties should consider alternatives to a hospital acquisition of the physician practice and employment of physicians. These alternatives could include affiliations with co-management of the post-transaction entity or a professional services agreement.
- Loose lips sink ships. This has been proven time and again in merger reviews: e-mails and memos that predict the ability to charge higher prices post-acquisition were key to the judicial condemnation of the acquisition. If the parties themselves predict that a merger will lead to higher prices, it will set a difficult tone for agency or court review, and put the parties in the unenviable position of having to prove a negative or, at the very least, to disavow their own prior statements.

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