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CLIENT ALERT

FTC Finds Evanston Hospital Merger Unlawful, But Refuses to Order Spin-Off

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Overview

The Federal Trade Commission (the "Commission") has declared that Evanston Northwestern Healthcare Corp. ("ENH") substantially lessened competition in violation of Section 7 of the Clayton Act when it acquired Highland Park Hospital ("HPH") and subsequently, immediately, and substantially raised its prices for inpatient hospital services, but declined to order divestiture of the acquired hospital. See *Evanston Northwestern Healthcare Corporation*, FTC, No. 9315 (Aug. 2, 2007).

The Commission agreed with an October 20, 2005 previous ruling of an Administrative Law Judge that ENH violated Section 7, but declined to adopt the ALJ's proposed order that ENH divest HPH. Citing the "high costs inherent in the separation of hospitals that have functioned as a merged entity for seven years," the Commission instead ordered ENH to create two independent negotiating teams – one for Evanston Hospital and Glenbrook Hospital (which ENH owned prior to acquiring HPH), and one for HPH. Although ENH is required to propose the details of this framework, each team must negotiate separately and independently with purchasers of inpatient hospital services, i.e., managed care organizations. The Commission oddly stated that the remedy imposed on ENH will "re-inject[ ] competition …for the business of MCOs," even though the two teams will be working, ultimately, for a common parent entity with an interest in maintenance of prices as high as the market will bear. The post hoc posture the Commission was in was inevitable, of course, since its compliant was issued years after the merger had occurred. The Commission did state that that "[d]ivestiture is the preferred remedy for challenges to unlawful mergers, regardless of whether the challenge occurs before or after consummation…. [W]here it is relatively clear that the unwinding of a hospital merger would be unlikely to involve substantial costs, all else being equal, the Commission likely would select divestiture as the remedy."

Background

ENH purchased HPH in January, 2000. The Commission issued a complaint in February 2004, alleging that the acquisition resulted in less competition and higher prices of inpatient hospital services, for MCOs and patients alike, in a geographic market that comprised the geographic triangle that the three ENH hospitals formed. Documentation introduced by FTC Complaint Counsel and heavily cited by the Commission revealed that executives at both ENH and HPH had expected the merger to provide greater leverage to raise prices, that ENH did raise prices after the merger, and that the same executives later attributed the price rises to the leverage garnered by the merger.

Price Increases and Competitive Effects

ENH argued that the increase in prices was attributed to (1) ENH learning, after acquiring HPH, that it had for several years undervalued and thus under-priced its own services, relative to its previous competition, and (2) a post-merger increase in the quality of services provided by HPH. Both the ALJ and the Commission rather summarily rejected ENH's justifications for the rise in prices. The Commission specifically noted not only the executives' pre- and post-merger assertions (discussed above), but also

that both ENH's and Complaint Counsel's economists had determined that ENH's "supracompetitive" price increases were very unlikely to be attributed to anything other than the exercise of market power.

Product Market

Although ENH argued that the product market should include both hospital inpatient and outpatient services, the Commission determined – consistent with judicial precedent and Complaint Counsel's reasoning – that inpatient services and outpatient services are not substitutes for each other. Inpatient services include primary, secondary, and tertiary services but did not include quaternary services. However, the Commission's ruling posits that, for purposes of future antitrust analyses, the market for inpatient hospital services can be gauged by sales to MCOs, and is not dependent on patient origin patterns.

Geographic Market

ENH argued that the geographic market should have included the three ENH hospitals and six other hospitals located outside the triangle but within close proximity to at least one of the ENH hospitals. The ALJ determined that the geographic market included three of these six additional hospitals. However, the Commission stated that the contours of a geographic market can be determined by demonstrating the region over which a hypothetical monopolist can impose a "significant and non-transitory price increase." Applying this analysis to the case at hand, the Commission held that Complaint Counsel had successfully demonstrated that "significant higher-than-predicted post-merger price increases resulted from market power gained through the merger," and thus the ENH triangle was, indeed, the proper geographic market. Market participants should mind the potential ability of this analysis to arrive at limited geographic markets.

Analysis and Conclusion

Counsel for hospitals and MCOs alike should take great interest in the Commission's choice of remedy, particularly (1) whether the Commission's reticence to impose divestiture will have a dampening effect, generally, on both private and governmental challenges to completed mergers, and (2) whether the establishment of two separate negotiating teams – within ENH and within a declaredly non-competitive market – will truly "inject" competition, or whether the negotiating teams could preserve price levels without running afoul of either firewalls or antitrust laws. The notion of "competition" between two divisions of the same corporate parent, irrespective of firewalls, is problematic.

Regardless, future pre-merger and post-merger analyses and challenges will be affected by the Commission's treatment of the relevant product and geographic markets, particularly how evidence of certain price increases will be used by the Commission to identify a proper geographic market.

Finally, the Commission itself noted that "sticky and unsettled issues for merger analysis" remain open with respect to hospital mergers. The Commission specifically pointed to the fact that, in a market where MCOs are purchasers and hospitals are sellers, a merger of two hospitals may severely impact one MCO while hardly impacting another – and that the aggregate impact could lead to a violation of Section 7. Such commentary would indicate that market participants should analyze not only merging hospitals' product and geographic markets, but also the effects that a merger would have on each of the merging hospitals' purchasers.

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