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Appeals Court Upholds FTC Merger Challenge

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On April 22, 2014, the U.S. Court of Appeals for the Sixth Circuit affirmed a decision of the Federal Trade Commission (FTC) finding that the merger of two hospital systems in Ohio violated the antitrust laws. ***ProMedica Health System, Inc. v. FTC***, No. 12-3583 (6th Cir. Apr. 22, 2014). This ruling provides a number of useful reminders for companies considering mergers and acquisitions.

The case involved a 2010 merger between two of the four hospital systems in Lucas County, Ohio, ProMedica and St. Luke's. After the parties merged, the FTC filed an administrative complaint challenging the merger. Following extensive hearings, an Administrative Law Judge (ALJ) found that the merger likely would substantially lessen competition in violation of Section 7 of the Clayton Act. The FTC affirmed the ALJ's decision and ordered ProMedica to divest St. Luke's. ProMedica appealed, arguing that the FTC was wrong on both the law and the facts in its analysis of the merger's competitive effects. A three-judge panel of the Sixth Circuit disagreed.

The first issue addressed by the Sixth Circuit involved the relevant product markets. The Court accepted the FTC's view that there is no need to perform separate antitrust analyses for separate product markets when competitive conditions are similar for each. Applying this methodology, the Court held that it was appropriate to cluster primary (excluding obstetrics) and secondary hospital inpatient services for purposes of the competitive analysis, because the four competing hospital systems in the area had similar market shares for those services and the barriers to entry and geographic markets were similar. The Court also upheld the FTC's conclusion that obstetrics constituted a distinct relevant market deserving of separate analysis. The Court rejected ProMedica's contrary argument that the relevant market constituted all hospital services, including obstetrics and tertiary services, because customers preferred to receive a package deal. While it is true that managed care organizations must offer patients a network that provides a complete package of hospital services, the factual record showed that they do not need to obtain that complete package from a single provider.

The next issue was whether the FTC relied too heavily on market concentration data, involving Herfindahl-Hirschman Index (HHI) calculations (which are based on market shares), to establish a presumption that the merger would harm competition. ProMedica argued that measuring market shares and HHIs to apply a presumption of illegality is appropriate only in a "coordinated-effects" antitrust case (which considers whether firms will be able to better coordinate prices post-merger), while the FTC had challenged the ProMedica-St. Luke's

transaction on a "unilateral-effects" theory (claiming that the deal would allow ProMedica to unilaterally increase prices). According to ProMedica, the FTC should have focused instead on the extent to which consumers regard ProMedica and St. Luke's as next-best substitutes. The Sixth Circuit acknowledged that it took this argument seriously, but ultimately sided with the FTC, finding that this case was exceptional in two respects. First, the evidence showed a strong correlation between ProMedica's prices and its market share that could not be explained by better quality care or lower costs but rather by ProMedica's bargaining leverage over managed care organizations. Therefore, market shares were directly relevant to the competitive analysis. Second, the Court found the market shares and HHI numbers to be so high that it was extremely likely, "as a matter of simple mathematics," that a significant fraction of St. Luke's patients viewed ProMedica as a close substitute, hence the FTC was entitled to place significant weight upon the market-concentration data standing alone (for example, ProMedica and St. Luke's had a combined market share above 50% in the market for primary and secondary services and above 80% in the market for obstetrics services). The FTC was therefore "correct to presume the merger substantially anticompetitive."

The Sixth Circuit then considered whether ProMedica had rebutted that presumption, noting it was "remarkable" that ProMedica did not attempt to argue that the merger would generate efficiencies that would benefit consumers, and citing to an admission by St. Luke's CEO that a merger with ProMedica might "[h]arm the community by forcing higher rates on them." The Court went on to reference additional statements by representatives from both merging parties which reinforced the view that they were direct and close competitors and that the merger would lead to higher prices, noting that "[t]he parties' own statements, therefore, tend to confirm the presumption rather than rebut it."

Finally, the Court dismissed ProMedica's argument that St. Luke's was a weakened competitor as "the Hail-Mary pass of presumptively doomed mergers," pointing out that St. Luke's was doing better financially and had increased its market share before the merger.

In a statement following the Sixth Circuit's ruling, ProMedica said it was "extremely disappointed by the decision" and that it intends to appeal.

This decision is the latest in a series of successfully litigated merger challenges by the FTC and the Department of Justice in industries as diverse as health care, technology, and airlines. The *ProMedica* case is instructive in several respects:

- It provides useful insight into when different product markets, involving products that are not substitutes for each other, can be clustered together for purposes of analyzing a merger's competitive effects.

- Despite a trend at the agencies and in the private bar towards a more sophisticated and nuanced antitrust review of mergers and acquisitions, transactions between companies with high market shares in concentrated industries will continue to face an uphill battle.

- The case reaffirms that damaging statements made by the merging parties themselves in business documents or in oral testimony are given substantial weight by antitrust agencies and courts. Companies therefore should take basic precautions, including educating business personnel, to avoid creating unhelpful documents and making statements that would increase the likelihood of an antitrust investigation or challenge.

- The “weakened competitor” or “flailing firm” defense will usually be a losing argument and will not save an otherwise anticompetitive merger.