

FTC v. Pinnacle: Antitrust Concerns vs. Reform-Based Consolidation

On May 9, 2016, the U.S. District Court for the Middle District of Pennsylvania denied the *Federal Trade Commission* (FTC) and Pennsylvania Attorney General's motion for a preliminary injunction to prevent the merger of *Penn State Hershey Medical Center* (Hershey) with *PinnacleHealth System* (Pinnacle).¹ The motion was filed in an effort to stop Hershey and Pinnacle "...from taking any steps toward[] consummating their proposed merger pending the completion of the FTC's administrative trial on the merits of the underlying antitrust claims."² In denying the FTC's motion, the court concluded that: (1) the FTC's "...relevant geographic market is unrealistically narrow and does not assume the commercial realities faced by consumers in the region";³ and, (2) the equitable factors stemming from the merger "weigh in the public interest."⁴ While the decision on the relevant geographic market provided the primary basis for denying the injunction, the opinion's discussion on equitable considerations provides a new example of the tension between antitrust enforcement and reform-based consolidation, stating, "[w]e find it no small irony that the same federal government under which the FTC operates has created a climate that virtually compels institutions to seek alliances such as the [h]ospitals intend here."⁵ This *Health Capital Topics* article will discuss the Hershey-Pinnacle litigation, as well as, the "efficiencies defenses" presented and the implications of these defenses in future hospital merger cases and antitrust enforcement in the evolving healthcare market.

Hershey, a 551-bed hospital located in Hershey, Pennsylvania,⁶ is a leading *academic medical center* (AMC), as well as the primary teaching hospital of the Penn State College of Medicine.⁷ Additionally, Hershey offers a broad array of high-acuity services and operates central Pennsylvania's only specialty children's hospital.⁸ Pinnacle, a 646-bed not-for-profit health system located in the Pennsylvania counties of Harrisburg and Cumberland,⁹ is comprised of three community hospitals that focus on cost-effective acute care with some higher-level services.¹⁰ Hershey and Pinnacle signed a letter of intent of their proposed merger in June of 2014 and received final board approval in March of 2015.¹¹ The hospitals notified the FTC of their proposed merger in April of 2015 and executed a "Strategic Affiliation Agreement" in May of 2015.¹²

In December 2015, the FTC issued an administrative complaint alleging that Hershey and Pinnacle's proposed merger violates Section 7 of the Clayton Act, which prohibits mergers whose effect "*may be substantially to lessen competition, or to tend to create a monopoly*,"¹³ and Section 5 of the FTC Act, which prohibits "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce."¹⁴ When the FTC believes that "any person, partnership, or corporation" is violating, or has violated, a law enforced by the FTC, Section 13(b) of the FTC Act authorizes the commission to "bring suit in a district court of the United States to enjoin any such act or practice."¹⁵ When deciding whether to grant a preliminary injunction under Section 13(b), the court must: "...*(1) determine the likelihood that the FTC will ultimately succeed on the merits and, (2) balance the equities.*"¹⁶ In the Hershey-Pinnacle case, in order for the FTC to succeed on the merits of its case, the commission had to demonstrate likely success under its stated cause of action: Section 7 of the Clayton Act.¹⁷ The burden-shifting framework for deciding actions under Section 7 of the Clayton Act requires the FTC to establish a *prima facie* case that the merger is unlawful.¹⁸ In order to establish a *prima facie* case, the FTC first must determine the relevant market at issue in the case, which analysis consists of two components: (1) the product market; and, (2) the geographic market.¹⁹ Upon defining the relevant market, the FTC must show that the merger will substantially increase concentration in the established relevant market, "...thereby creating a presumption that the transaction is likely to substantially lessen competition."²⁰ Once the FTC establishes the *prima facie* case, the burden shifts to the merging parties, who may "...rebut it by producing evidence to cast doubt on the accuracy of the FTC's evidence as predictive of future anti-competitive effects."²¹

In the Hershey-Pinnacle litigation, the court found that the FTC would not likely succeed on the merits of its Clayton Act case due to an overly narrow definition of the relevant geographic market.²² The parties agreed that the product market in this case is *general acuity services* (GAC) sold to commercial payors.²³ Regarding the definition of the geographic market, the FTC contended that the "Harrisburg Area" constituted the proper market, which is an area "roughly equivalent to the Harrisburg Metropolitan Statistical Area (Dauphin,

Cumberland and Perry Counties) and Lebanon County.”²⁴ Hershey and Pinnacle disagreed, arguing that this geographic market was too narrowly drawn.²⁵ The court agreed with Hershey and Pinnacle, concluding that the FTC had not properly accounted for the business that comes to the two hospitals, especially Hershey, from outside of the Harrisburg Area.²⁶ The court noted that 43.5% of Hershey’s patients traveled from outside the FTC’s proposed geographic market, while “...several thousand of Pinnacle’s patients reside outside of the Harrisburg Area.”²⁷ The court opined that facts related to patient flow volumes “...strongly indicate that the FTC has created a geographic market that is too narrow because it does not appropriately account for where the hospitals, particularly Hershey, draw their business.”²⁸ Additionally, the court found it “extremely compelling” that the hospitals had taken steps to prevent increases in the price of healthcare services post-merger for patients and payors in the market for each hospital.²⁹ Specifically, both Hershey and Pinnacle entered into contracts with central Pennsylvania’s two largest insurers, Capital Blue Cross and Highmark, that “...maintain existing rate structures for fee-for-service contracts and preserve the existing rate-differential between the hospitals.”³⁰ These agreements prevent payment rate increases for patients and payors in the market for each hospital for at least five years.³¹ In light of these facts, the court held that the FTC “...failed to set forth a relevant geographic market” and denied the motion for preliminary injunction.³²

While the court’s decision on the relevant geographic market disposed of the case, the court stated that, “...there are several important equitable considerations that merit further elucidation.”³³ Specifically, the court discussed four equitable considerations in the Hershey-Pinnacle case: (1) “Hershey’s Capacity Constraints”; (2) “Repositioning by Competitors Will Constrain Hershey and Pinnacle”; (3) “Risk-Based Contracting”; and, (4) “Public Interest in Effective Enforcement of Antitrust Laws.”³⁴ The court noted that “[t]he Supreme Court has not sanctioned the use of an efficiencies defense in a case brought under Section 7 of the Clayton Act,”³⁵ however, after considering the equities listed above, the court found “...that the majority of these factors weigh in the public interest.”³⁶ In particular, the court found that Hershey and Pinnacle presented a “...compelling efficiencies argument in support of the merger, in that the merger would alleviate some of Hershey’s capacity constraints.”³⁷ [Emphasis Added] At the time of the merger, the court held that Hershey had overcrowding and capacity problems that “...routinely climbed to as high as 112-115% occupancy during midday.”³⁸ In finding that the merger would solve the overcrowding problem at Hershey, the court noted that, “...the merger would immediately make additional capacity available to Hershey, causing near instantaneous benefits to Hershey’s patients.”³⁹

In addition to concerns regarding Hershey’s capacity to effectively treat its patients, the court also weighed Hershey and Pinnacle’s ability to adapt to risk-based

contracting as a reason against enjoining the merger.⁴⁰ The court defined risk-based contracting as “...new concepts and terms that begin to transfer the risk for the cost of care for the individual to the provider,”⁴¹ and noted that the government intends to shift 50% to 80% of payments into risk-based contracts by 2018.⁴² In order to perform optimally under risk-based contracting, the court found that hospitals need to offer a “total continuum of care.”⁴³ While acknowledging that Hershey and Pinnacle could independently operate under risk-based contracting, the court found persuasive the testimony of Hershey CEO, Dr. Craig Hillemeier, who stated that “there will be some advantages in terms of size of scale, in terms of being able to spread of costs [sic] of the infrastructure of population health over a larger healthcare system.”⁴⁴ The court opined that the merger could have a beneficial impact on the hospital’s ability to “adapt [] to risk-based contracting,” holding that “...as the payment models continue to shift, the local populace has a continued interest in seeing its most closely situated medical center remain competitive.”⁴⁵

The merger is currently on hold pending an appeal of the district court’s judgment.⁴⁶ The court’s holding in the Hershey-Pinnacle case may influence other courts adjudicating similar preliminary injunction cases under Section 13(b) of the FTC Act, as well as, the relevant market analysis under Section 7 of the Clayton Act. Currently, few courts have addressed the dispute regarding the proper definition of relevant geographic market under Section 7 of the Clayton Act.⁴⁷ In light of the court’s opinion in the Hershey-Pinnacle litigation, if the district court ruling is upheld on appeal, hospitals may more frequently argue that their relevant geographic market is broader than that proposed by the FTC, by using patient flow volumes in and out of the FTC’s proposed geographic market.⁴⁸ A broader geographic market may provide hospitals with a more persuasive argument that market competition will constrain them from engaging in future anticompetitive conduct, such as increasing prices.⁴⁹

Additionally, the court’s decision on the subject of equitable considerations provides an additional judicial opinion on the tension between antitrust enforcement and provider consolidation. In *St. Alphonsus Medical Center et al. v. St. Luke’s Health System et al.*, the Ninth Circuit Court of Appeals acknowledged St. Luke’s efficiencies defense that the merger would allow them to better serve patients, but held that this rationale was an insufficient defense to an antitrust scrutiny, stating, “...the Clayton Act does not excuse mergers that lessen competition or create monopolies simply because the merged entity can improve its operations.”⁵⁰ In contrast, the court in the Hershey-Pinnacle litigation opined on the importance of healthcare providers to be able to “...adapt to an evolving landscape of healthcare that includes, among other changes, the ACA, fluctuations in Medicare and Medicaid reimbursement, and the adoption of risk-based contracting.”⁵¹ While the Hershey-Pinnacle court discussed “several important equitable considerations,” it did so after finding that the

FTC did not establish a *prima facie* case under the Clayton Act.⁵²

Accordingly, it is yet unclear whether similar efficiency defenses and equitable considerations presented in a different hospital merger case, where the FTC successfully established a *prima facie* case under the Clayton Act, would be enough to overcome that merger's potential anti-competitive effects.⁵³ Further, although the decision denied the FTC's request to enjoin the merger, the case is not yet resolved, as the FTC is appealing the ruling of the district court.⁵⁴ It remains to be seen whether the decision regarding the Hershey-Pinnacle merger will provide added guidance on the role of the FTC and antitrust enforcement in a healthcare market increasingly moving toward provider consolidation.⁵⁵

- 1 "Federal Trade Commission, et al. v. Penn State Hershey Medical Center and PinnacleHealth System" Case No. 1:15-cv-2362 (M.D. Pa., May 9, 2016), Memorandum Opinion and Order, p. 1-2.
- 2 *Ibid.*
- 3 *Ibid.*, p. 11.
- 4 *Ibid.*, p. 25.
- 5 *Ibid.*
- 6 *Ibid.*, p. 2.
- 7 *Ibid.*
- 8 *Ibid.*
- 9 *Ibid.*, p. 2-3.
- 10 *Ibid.*, p. 3.
- 11 *Ibid.*
- 12 *Ibid.*
- 13 15 U.S.C. § 18 (2014); No. 1:15-cv-2362, p. 5.
- 14 "Unfair Methods of Competition Unlawful; Prevention by Commission" 15 U.S.C. § 45(a) (2014).
- 15 *Ibid.*, p. 4; "False advertisements; injunctions and restraining orders" 15 U.S.C. § 53(b).
- 16 *Ibid.*
- 17 "Acquisition by one corporation of stock of another" 15 U.S.C. § 18 (2014); No. 1:15-cv-2362, p. 5.
- 18 "Chicago Bridge & Iron Company v. Federal Trade Commission" 534 F.3d 410, 423 (5th Cir. 2008).
- 19 No. 1:15-cv-2362, p. 5.
- 20 534 F.3d 410, 423.
- 21 *Ibid.*
- 22 No. 1:15-cv-2362, p. 11.
- 23 *Ibid.*, p. 6.
- 24 *Ibid.*, p. 8.
- 25 *Ibid.*
- 26 *Ibid.*, p. 9-10.

- 27 *Ibid.*, p. 9.
- 28 *Ibid.*, p. 9-10.
- 29 *Ibid.*, p. 10-11.
- 30 *Ibid.*, p. 11.
- 31 *Ibid.*
- 32 *Ibid.*, p. 11-12.
- 33 *Ibid.*, p. 11-12, 14.
- 34 *Ibid.*, p. 14-24.
- 35 *Ibid.*, p. 14.
- 36 *Ibid.*, p. 25.
- 37 *Ibid.*, p. 14.
- 38 *Ibid.*, p. 15.
- 39 *Ibid.*, p. 17.
- 40 *Ibid.*, p. 22-24.
- 41 *Ibid.*, p. 22-23.
- 42 *Ibid.*, p. 23; "Better, Smarter, Healthier: In Historic Announcement, HHS Sets Clear Goals and Timeline For Shifting Medicare Reimbursements From Volume to Value" U.S. Department of Health & Human Services, HHS.gov, January 26, 2015, <http://www.hhs.gov/about/news/2015/01/26/better-smarter-healthier-in-historic-announcement-hhs-sets-clear-goals-and-timeline-for-shifting-medicare-reimbursements-from-volume-to-value.html> (Accessed 6/2/2016).
- 43 No. 1:15-cv-2362, p. 23.
- 44 *Ibid.*
- 45 *Ibid.*, p. 23-24.
- 46 "Federal Trade Commission, et al. v. Penn State Hershey Medical Center and PinnacleHealth System" Case No. 16-2364 (3rd Cir. 2016), Order.
- 47 "District Court Blocks FTC and PA AG Challenge to Hershey-Pinnacle Merger" By Jeffrey W. Brennan et al., McDermott Will & Emory, May 17, 2016, <https://www.mwe.com/en/thought-leadership/publications/2016/05/district-court-blocks-ftc-and-pa-ag-challenge> (Accessed 5/27/2016).
- 48 *Ibid.*
- 49 *Ibid.*
- 50 "St. Alphonsus Medical Center et al. v. St. Luke's Health System et al." Case No. 14-35173 (9th Cir., February 10, 2015), Opinion, p. 28-29.
- 51 No. 1:15-cv-2362, p. 25.
- 52 *Ibid.*, p. 12.
- 53 Brennan et al., May 17, 2016.
- 54 "Federal Trade Commission, et al. v. Penn State Hershey Medical Center and PinnacleHealth System" Case No. 1:15-cv-2362 (M.D. Pa., May 11, 2016), Memorandum of Law in Support of Plaintiffs' Motion for Injunction Pending Appeal. p. 1-2.
- 55 No. 1:15-cv-2362, p. 25; Brennan et al., May 17, 2016; "Speedbump or Roadblock for FTC's Hospital Merger Winning Streak" By Peter J. Levitas and Bryan M. Marra, Arnold & Porter, May 17, 2016, <http://www.arnoldporter.com/en/perspectives/publications/2016/05/ftc-v-penn-state-hershey> (Accessed 5/27/2016).



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