This article first appeared in Law360.

After Two Losses, the FTC Looks to the Third Circuit's Decision in *FTC v. Penn State Hershey Medical Center* to Resurrect Its Hospital Merger Agenda

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Until very recently, most litigators would envy the enforcement record of the Federal Trade Commission (FTC) in hospital merger cases. But the Agency's losses in *Federal Trade Commission v. Penn State Hershey Medical Center et al*., No. 15-2362 (M.D. Pa. May 9, 2016) (*Penn State Hershey*), and *Federal Trade Commission v. Advocate Health Care et al*., No. 15-cv-11473 (N.D. Ill. June 14, 2016) (*Advocate Health Care*), if not overturned, likely will have a significant impact on the FTC's efforts to slow the record pace of health care provider consolidation.

Although the FTC had not litigated to victory a hospital merger case between 1991 and 2007 that changed in 2007 when—after spending years redeveloping its economic and legal enforcement framework—the FTC secured a victory in *In the Matter of Evanston Northwestern Healthcare Corp*. Since *Evanston*, the FTC has successfully challenged a number of hospital mergers and attained an enviable string of victories in the federal appellate courts and the U.S. Supreme Court. Following the passage in 2010 of the Patient Protection and Affordable Care Act (the Affordable Care Act), the number of health care provider mergers each year increased dramatically, with the FTC watching with skepticism.

At the end of 2015, over a six-week period, the FTC sought to block three hospital mergers in three different states. The FTC's winning streak ended when a federal district court denied the FTC and Pennsylvania Attorney General's request to enjoin a merger between Penn State Hershey Medical Center and PinnacleHealth System in *Federal Trade Commission v. Penn State Hershey Medical Center et al*., No. 15-2362 (M.D. Pa. May 9, 2016) (*Penn State Hershey*). The District Court's decision provided a major blow to the FTC's enforcement agenda. The court rejected the FTC's theory that a narrow geographic market should be the focus of the antitrust analysis and accepted the hospitals' evidence of post-merger efficiencies as countervailing reasons not to enjoin the merger. The court also strongly remarked that the FTC's enforcement agenda was inconsistent with the regulatory landscape, which encourages collaboration among providers.

If left to stand, the *Penn State Hershey* decision would threaten the FTC's litigating positions in pending and future cases; so it is no surprise that the FTC appealed the decision to the Third Circuit Court of Appeals. The Third Circuit's decision will have a significant impact on hospital merger enforcement going forward, as it will necessarily examine the FTC's approach to geographic market definition in hospital mergers (to which the FTC has credited its winning streak). The Third Circuit will also have an opportunity to clarify, for the first time, the preliminary injunction standard under § 13(b) of the Federal Trade Commission Act, and what weight, if any, the current health care climate should play in health care merger enforcement.

Just one month after its first defeat, on June 14, 2016, the FTC suffered another blow to its enforcement agenda when a federal court rejected the FTC's attempt to block a hospital merger in Chicago's North Shore area. *See Federal Trade Commission v. Advocate Health Care et al*., No. 1:15-cv-11473 (N.D. Ill.). The court filed its memorandum opinion under seal, but plans to issue a redacted version. Although the reasoning behind the decision is not yet known, the district court likely rejected the FTC's narrow geographic market definition (the northern suburbs of Chicago). It remains to be seen whether the FTC will appeal this decision to the Seventh Circuit. The healthcare community should follow this decision as well, as it too will likely impact future approaches to hospital mergers, in particular in urban areas where the case was a test of the agency's approach to geographic market definition in a densely populated area.

Penn State Hershey, in contrast, was a test of the FTC's market definition in a rural area. In that case, the FTC had alleged that the merger would create a dominant provider of general acute care inpatient services sold to commercial health plans in a relevant geographic market comprising the four-county area around Harrisburg, Pennsylvania (Harrisburg Area). Rejecting that definition, the court was persuaded by statistics showing, among other things, that in 2014, 43.5 percent of Hershey Medical Center's patients (or 11,260 people) traveled from outside of the FTC's designated Harrisburg Area, and several thousand of Pinnacle's patients resided outside of the Harrisburg Area. The court relied on qualitative factors, finding that "given the realities of living in Central Pennsylvania, which is largely rural and requires driving distances for specific goods or services," that the "19 other hospitals within a 65-minute drive of Harrisburg provide a realistic alternative that patients would utilize." In finding it unlikely that the merged entity could impose a profitable small but significant non-transitory increase in price (SSNIP) under the *Merger Guidelines*' hypothetical monopolist test relied upon by the FTC, the court found "it extremely compelling" that the hospitals have already entered into contracts with central Pennsylvania's two largest payors to ensure that post-merger rates do not increase, representing 75-80 percent of the hospitals' commercial patients.

Even though its rejection of the FTC's geographic market definition was dispositive, the court went further and rejected the FTC's position based on the "equities" of the merger, holding that enjoining the merger would not be in the best interests of the public. The court found that the merger was not likely to cause anticompetitive effects, but that it would in fact benefit consumers. The court explained that the merger would drive efficiencies, such as solving overcrowding problems at Hershey, save Hershey from straining resources to build a bed tower, and allowing patients greater access to more of Hershey's offerings. The court also credited the evidence indicating that other rivals have repositioned themselves as competitors to the two hospitals in order to draw patients away, and that increased "size of scale" will help the two hospitals move toward risk-based contracting.

The Third Circuit will decide several key issues that will impact the FTC's enforcement agenda and how health care providers approach mergers. The most significant questions that *Penn State Hershey* presents pertain to the FTC's approach to defining geographic markets. The Third Circuit's decision will only be the second time that a federal appellate court has evaluated the FTC's approach to defining geographic markets in hospital mergers under the 2010 Merger Guidelines. The Third Circuit will have to evaluate the FTC's claim that the district court adopted an outmoded and discredited methodology by focusing on the conduct of out-of-area

patients in defining the relevant geographic market, instead of taking an insurer, payor-focused approach that analyzed the leverage the merger hospitals would amass through the merger. The Third Circuit may also provide guidance on what role the perceived realities of living in a particular area should play in the analysis. If the Third Circuit approves of the district court's consumer-centric focus, it will make it more difficult for the FTC to challenge hospital mergers.

Hospitals considering mergers also will receive guidance on whether they can protect a merger through entering into price protection agreements with payors. In rejecting the FTC's market definition, the court in *Penn State Hershey* found that the price protection agreements with the largest payors in the area limited the hospitals' ability to impose price increases for at least five years, which the court found "extremely compelling." If the Third Circuit agrees with the district court, it could encourage merging hospitals to use similar arrangements to attempt to avoid or defeat merger challenges.

The Third Circuit likely will also provide guidance on the interpretation§ 13(b) of the FTC Act (which empowers the FTC to seek injunctions to block mergers); in particular, whether it requires, along with consideration of the FTC's likelihood of success on the merits, a weighing of the "equities" to determine whether enjoining the merger would be in the best interests of the public. The Third Circuit has not yet adopted the two-prong standard that several other circuit courts have.

Lastly, *Penn State Hershey* marks the first time that a court has reasoned that the evolving health care landscape, particularly the forces of the Affordable Care Act, should temper the FTC's enforcement agenda. The district court stated that its decision "further recognizes a growing need for all those involved to adapt to an evolving landscape of health care that includes, among other changes, the institution of the Affordable Care Act, fluctuations in Medicare and Medicaid reimbursement, and the adoption of risk-based contracting." This sentiment was expressed throughout its opinion. If the Third Circuit decides to tackle this issue, what it says could have seismic effects on the FTC's health care enforcement agenda. The health care community should be watching.
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