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FTC v. St. Luke's*: A Successful Challenge to a Hospital/Physician Group Merger—Vertical or Horizontal?*

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On January 24, 2014, the United States District Court for the District of Idaho ordered St. Luke's Health System to unwind a merger with the Saltzer Medical Group.[1] The outcome represented a significant victory for the various parties, including the Federal Trade Commission ("FTC") and the State of Idaho, that had challenged the merger under § 7 of the Clayton Act.[2] Because St. Luke's operates seven hospitals across Idaho and because Saltzer is the largest independent multi-specialty physician group in the state, the outcome has been likened to a warning shot across the bow of the many hospitals and physician groups that have been contemplating closer affiliations in the wake of the changes to the health care industry wrought by the Affordable Care Act.

Although the initial wave of reaction has focused on the "hospital" and "doctor" dimension of the planned affiliation,[3] the FTC did not challenge the merger on vertical grounds. That is, the FTC did not object to St. Luke's effort to combine with Saltzer on the theory that combining a hospital and a previously unaffiliated doctor group would foreclose competitors from access to an important input or distribution channel. Rather, the FTC challenged the merger and the district court struck it down on an entirely horizontal theory. The FTC based its theory of competitive harm on a reduction of competition between St. Luke's and Saltzer in a market for adult primary care in a single city, Nampa, Idaho.

Nampa is home to 80,000 people and sits about twenty miles due west of Boise, close to the Idaho-Oregon border. Prior to the proposed merger with Saltzer, St. Luke's employed eight primary care physicians in Nampa and Saltzer sixteen. According to the FTC's complaint, those twenty-four physicians gave St. Luke's nearly 80% of the Nampa market for adult primary care. On that basis, the FTC sought to block the merger. In the opinion ordering divestiture, the court agreed. It concluded that bringing together twenty-four physicians would allow the merged entity to command higher reimbursement rates from health insurance plans and increase costs to consumers.

The Merger and the FTC's Complaint

As the FTC's complaint explains, both St. Luke's and Saltzer had a significant presence in Nampa prior to the merger. Although St. Luke's operates seven hospitals throughout Idaho, none is located in Nampa. Rather, St. Luke's operates an emergency outpatient clinic in Nampa and, by virtue of a 2011 acquisition, employed eight primary care physicians ("PCPs").[4] Saltzer Medical Group ("Saltzer") was the largest independent, multi-specialty physician group in Idaho.[5] Before the merger, 41 physicians worked at Saltzer facilities, including16 adult PCPs in Nampa.[6]

Prior to joining St. Luke's, Saltzer had concluded that it would need to work more closely with other health care providers in order to meet the demands of consumers, the government, and other payers for better outcomes at lower cost.[7] To that end, Saltzer had attempted to coordinate care with the one hospital in Nampa proper, then named Mercy Medical Center and now Saint Alphonsus-Nampa. Those efforts, however, failed because "Mercy's out-of-state parent, Catholic Health Initiatives . . . , was unwilling to participate."[8]

Unable to find another willing partner, Saltzer began to work more closely with St. Luke's. Initially, the collaboration was informal, but the loose affiliation eventually gave way to a formal acquisition. Thus, on December 31, 2012, St. Luke's acquired the assets of Saltzer for $16,000,000; at the same time, Saltzer entered into a five-year professional services agreement ("PSA") with St. Luke's on behalf of its physicians.[9] The PSA prohibited Saltzer physicians from becoming employed by or financially affiliated with other health systems during the term of the PSA.[10]

Less than three months later, the FTC, together with the Idaho Attorney General, filed a complaint in federal district court seeking to block the merger, which was consolidated with a case initiated by Saint Alphonsus-Nampa (*i.e.*, the same hospital that had resisted Saltzer's advances and driven it into the arms of St. Luke's).[11] According to the joint complaint, the combined St. Luke's and Saltzer would have market power to demand higher rates for health care services provided by PCPs in Nampa, Idaho and surrounding areas, ultimately leading to higher costs for health care consumers.

The Court's Decision

As noted above, the district court agreed with the FTC, the Idaho Attorney General, and Saint Alphonsus-Nampa that the proposed merger would substantially lessen competition in the market for primary care services in Nampa, Idaho. Although the court's findings of fact and conclusions of law span fifty-two pages, the analysis is quite simple. It found a narrow market with substantial concentration flowing from the merger and no convincing proof of "extraordinary efficiencies" sufficient to overcome the higher prices that would be presumed to follow from the increased concentration.[12]

Because the parties apparently agreed that the relevant product market was Adult Primary Care Services sold to commercially insured patients ("Adult PCP services"), the market definition question reduced to a question of geography: to what extent could the product market accepted by the parties be confined to Nampa?[13] Using data from Blue Cross of Idaho, the largest insurer in Idaho, the court determined that a health plan could not successfully offer a network of Adult PCP services to Nampa residents without including Nampa doctors. Having concluded that offering commercial insurance services in Nampa requires a ready supply of primary care doctors in Nampa, the court concluded that the scope of the product market should also be limited to Nampa.[14]

The court then examined the potential anticompetitive effects of the merger. It noted that the merged entities' twenty-four physicians constituted 80% of the providers of Adult PCP services in Nampa.[15] Relying on the Herfindahl-Hirschman Index ("HHI"), the court found that the merger was presumptively anticompetitive.[16] It also noted that after St. Luke's had made acquisitions in other geographic markets, its reimbursement rates rose above average.[17] Based on these findings, the court concluded both that the combined entity would have the power to increase prices for Adult PCP services in Nampa and that payers such as Blue Cross would have no ability to resist those prices.[18]

The court rejected St. Luke's claim that the merger would yield efficiencies sufficient to outweigh any anticompetitive effects. St. Luke's argued that the merger was driven by its desire to reduce costs by moving toward value-based or risk-based care and away from fee-for-service care, including by using an integrated delivery system and employing physicians.[19] St. Luke's also argued that the merger would result in efficiencies because the entity could use a shared electronic medical record system.[20] The court concluded that neither of the defenses justified the transaction. According to the court, St. Luke's would not need to employ or affiliate with the Saltzer physicians in order to enter into value-based reimbursement contracts or to upgrade its medical record system.[21]

Impact of the Opinion

Although *St. Luke's* has been hailed as proof that the FTC intends to prevent hospitals from acquiring or affiliating with physician groups, the FTC's complaint and the decision ratifying it do not bear this out. The FTC challenged the acquisition based on concern about a product and geographic market—adult primary care services in Nampa, Idaho—in which St. Luke's had a presence prior to the merger. Viewed from that perspective, *St. Luke's* reflects garden-variety structure-conduct-performance analysis.

Now, there are reasons to be skeptical that twenty-four doctors in a city of eighty-thousand could succeed in driving up health care reimbursement rates and insurance premiums. For one thing, adult primary care services are not typically purchased in a vacuum. They are merely one element of a bundle of services that payers assemble, and although it is possible that an increase in the price of one element of the bundle would not be offset by decreases in other elements of the bundle, neither the FTC's complaint nor the court's decision attempts to explain why such a price increase would be inevitable. For another, payers across the country have been devising narrow networks in order to construct products to sell through the state and federal marketplaces created by the Affordable Care Act. Given the apparent success of those products, it is possible that even a small number of non-affiliated physicians would succeed in constraining the ability of the affiliated doctors to raise their prices.

But at least as reflected in the court's opinion, St. Luke's did not attempt to break out of the structure-conduct-performance vise. St. Luke's did not contest the narrow product market definition, and it did not appear to raise arguments trying to break the chain of inference linking higher concentration to higher prices. This left St. Luke's with essentially two arguments—the scope of the geographic market and efficiencies. And although both arguments were certainly plausible, the court concluded that they were not compelling. When St. Luke's failed to persuade the court to expand the market or credit its efficiencies, its defense of the transaction failed as well.

Placed in its proper context, *St. Luke's* has broad implications; just not the ones that have been highlighted by many of the initial commentators. *St. Luke's* arose in the health care industry and involved an entity that owned hospitals and an entity that operated a multi-specialty medical clinic, but the FTC did not challenge the merger between those entities on vertical grounds. It challenged them, as its complaint makes clear, because of concerns about horizontal overlap between those two entities in a narrow product and geographic market. The case is, thus, another reminder that whatever its many other concerns, the FTC is laser-focused on horizontal market overlaps. Companies contemplating a merger in any industry should concentrate on areas of horizontal overlap in the merged entity and be prepared to address them.

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1 *Federal Trade Commission v. St. Luke's Health System, Ltd.*, Findings of Fact and Conclusions of Law, Case No. 1:13-CV-00116-BLW (D. Idaho Jan. 24, 2014).

2 38 Stat. 731, 15 U.S.C. § 18.

3 *See, e.g.*, *FTC Wins Antitrust Challenge to Health System's Acquisition of Physician Practice* (Feb. 4, 2014), http://www.crowell.com/NewsEvents/All/FTC-Wins-Antitrust-Challenge-to-Health-Systems-Acquisition-of-Physician-Practice; Thomas Chandler, *Antitrust Decision Adverse to St. Luke's is Part of Nationwide Trend* (Jan. 31, 2014), http://www.hawleytroxell.com/2014/01/antitrust-decision-adverse-to-st-lukes-is-part-of-nationwide-trend/.

4 Findings of Fact and Conclusions of Law, Case No. 1:13-CV-00116-BLW at *6.

5 *Id.*

6 *Id.* at *7.

7 *Id.* at *8.

8 *Id.*

9 *Id.* at *9.

10 *Id.* at *10.

11 Complaint for Permanent Injunction, Case No. 1:13-CV-00116-BLW (D. Idaho Mar. 26, 2013).

12 *Id.* at *47-49.

13 Findings of Fact and Conclusions of Law, Case No. 1:13-CV-00116-BLW, at *12.

14 *Id.* at *16.

15 *Id.*

16 *Id.*

17 *Id.* at *18-19.

18 *Id.*

19 *Id.* at *29-33.

20 *Id.* at *34-38.

21 *Id.* at *34, 38.