

# The Street

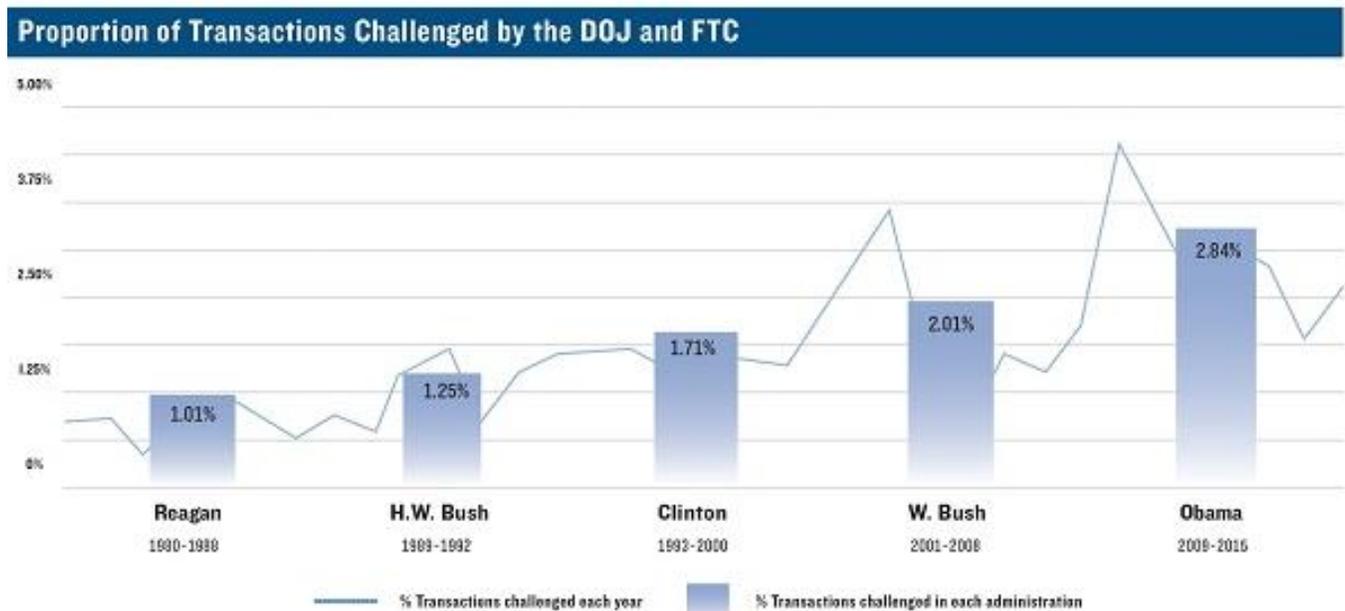
## Obamacare Has Big Government Fighting Itself Over Hospital Mergers -- And Winning April 26, 2016

The Affordable Care Act has meant a lot of changes for ordinary Americans. It's also meant a transformation of the business of health.

Since the law took effect in March 2010, the landscape for dealmaking among hospitals, physician groups and other care providers has shifted. Changes in the business of health care have incentivized hospitals and health systems in particular to merge. At the same time, antitrust regulators have stepped up their game, proving more victorious than previous years in their efforts to thwart industry consolidation.

The clash between the Affordable Care Act, also known as Obamacare, and the Federal Trade Commission has meant health systems and antitrust regulators are increasingly facing off in court over attempts to merge. It's one part of the government fighting another in an era of more complex merger activity and increased government efforts to police it.

Using data from the Federal Trade Commission and *The Deal*, a subsidiary of TheStreet.com, TheStreet has discovered a pattern of increased regulatory actions challenging mergers that dates back to the Reagan administration. Under President Obama, the FTC, Department of Justice and other regulatory bodies have challenged and blocked a higher proportion of U.S. deals than ever before. At the same time, deals are getting bigger and more complicated. Call it "Big Business vs. Big Government." In this instance, in a way, big government is battling forces that it created.



Each administration since Ronald Reagan has challenged a larger proportion of mergers, TheStreet has discovered. Source: Hart-Scott-Rodino Act filings with the FTC.

"It's a clear tension between what one intuits from the ACA, perfecting healthcare, and the market's natural response to the plan, versus the traditional approach that the antitrust enforcement agencies have chosen to take," said Mark Rust, who as a managing partner of Barnes & Thornburg LLP and the immediate past chair of the firm's health care department, concentrates on transactional, regulatory and medical-legal issues affecting healthcare entities.

A good example of this tension is an early trial win for the FTC in the post-Obamacare: the successful blockage of OSF Healthcare System's attempt to buy Rockford Health System in April 2012. The Commission charged that the merger would result in OSF controlling more than 64% of the market for general acute-care services in the Rockford, Ill. area, giving it greater leverage to boost rates. OSF, meanwhile, claimed the FTC was ignoring the "dramatic healthcare reform initiatives" that fueled a need for substantial merger-specific cost-savings and efficiencies.

In matters that ended up in trial, the FTC has since prevailed in another two instances in which health systems put up a fight on the merits of the ACA.

Yet, health care providers clearly believe that to effectively do what the ACA wants them to do, they need to achieve scale, Rust said. And that means mergers. Perhaps coincidentally, it has also reversed a long losing streak for the FTC in challenging them.

### **How the FTC Turned a 20-Year Losing Streak Around**

There has always been an incentive for hospitals to merge. But almost immediately after the passage of the ACA in March 2010, the markets saw a huge uptick in hospital and physician merger activity, Rust said. At that moment, the FTC had gone about 20 years without an ultimate victory in a court case attempting to block one of these mergers. After losing a slew of challenges in the 1990s, the FTC from about 2000 to 2010 seemingly had "their ears pinned back," Rust said.

In 2002, then-FTC Chairman Tim Muris, during a speech at the 7th Annual Competition in Health Care Forum in Chicago, asserted that something needed to be done to address the Commission's string of lost hospital cases. Muris noted that during the last eight years the Commission and Department of Justice was 0 for 7 in hospital merger cases.

"The template for trying hospital merger cases that was used with such great success in the 1980s and early 1990s no longer works," Muris told attendees. "Although some have suggested the Commission should just fold its tent and ignore hospital mergers, I do not believe that response is acceptable."

A Merger Litigation Task Force was created in 2002 to come up with new methods for challenging hospital mergers in light of the agencies' lack of success over the last several years, while a retrospective study of consummated hospital mergers was simultaneously carried out. The exact results of the task force are not apparent, but the move marked the beginning of a turnaround in enforcement efforts.

Fast-forward to Obamacare: Hospital M&A accelerated and antitrust regulators got tougher.

**"We've seen a much more aggressive stance by the Obama administration and the FTC," said Gregory Hagood, who as the head of the healthcare practice at SOLIC Capital LLC, recently advised the Board of Trustees to Jackson, Mich., health system Allegiance Health on its merger with Detroit hospital system Henry Ford Health System. "[The FTC] has really been emboldened in recent years."**

Thomas Greaney, former assistant chief in charge of health care antitrust enforcement at the Justice Department, said he believes the FTC is appropriately concerned with maintaining competitive markets in both the payor and provider settings.

"Consolidation is good, but problematic when we reduce ourselves to three, two or one participant in any market," said Greaney, who is now co-director for the Center for Health Law Studies at St. Louis University School of Law. "Even if you have operational synergies, there's not much incentive to pass those savings down to the consumer."

### **Advantage Regulators**

Perhaps the most high-profile win for the FTC followed a five-year battle against ProMedica Health System's August 2010 acquisition of St. Luke's Hospital in Toledo, Ohio. The Sixth Circuit, in May 2015, affirmed the FTC's initial 2011 ruling that ProMedica's proposed merger with St. Luke's violated Section 7 of the Clayton Act, requiring that the latter be divested.

The blow to ProMedica served as a warning to other mergers. Since 2008, the FTC has brought several enforcement actions and the two high profile cases that did go to court, including ProMedica, they won. Many are stopped before even making it to trial.

The FTC's outstanding hospital battles include the Cabell Huntington Hospital's proposed merger with St. Mary's Medical Center, two hospital systems located just three miles apart in Huntington, W.V.; The Penn State Hershey Medical Center's proposed merger with PinnacleHealth System in Harrisburg, Pa.; and the Advocate Health Care Network's proposed merger with NorthShore University Health System in the North Shore area of Chicago. In all three situations, the FTC is arguing the combinations hold greater than 50% market share.

That's not to say that hospital deals aren't going through, because most of them still do.

"We at [the] FTC see [lots] of hospital mergers," said Deborah Feinstein, director of the FTC's Bureau of Competition. "There's no question that all that's going on in the healthcare environment is driving those deals. But people are missing that we clear a significant number of those, but a handful raise real issues and those are the ones we challenge. Those tend to go to court at a disproportionate rate compared to other mergers because there's often not a good settlement."

**The FTC's objections have typically focused on mergers within secondary markets that encompass two to four healthcare providers, Hagood said.**

**As an increasing amount of volume shifts away from inpatient care and toward outpatient care, small- and mid- sized communities look at consolidation as a means to preserve resources and create larger, efficient health systems, he said. Meanwhile, more sizable hospitals in major markets are able to continue to buy health systems while staying below 50% market share.**

**"Right now, in market after market, the FTC is playing by these traditional antitrust rules," Hagood said. "Ultimately it hurts these communities."**

Beyond the publicly reported and formally challenged health system mergers, a number are squelched behind the scenes before ever making it to trial. Health systems often don't bother to move forward with a deal after filing forms in connection with Hart-Scott-Rodino Antitrust Improvements Act (HSR), which require antitrust clearance by the FTC and Department of Justice, experts said.

"A lot of times, the FTC will say 'we're going to challenge [a merger]', and many stop right there," Rust said.

With every healthcare transaction now, one of the first items advisors look at is antitrust considerations, and many prospective buyers and strategic partners are eliminated before process begin, Hagood said.

"Over the past couple of years, we have had three clients in particular substantially alter or abandon transactions after getting to a fully negotiated term sheet, when regulators raised substantial antitrust concerns," Hagood said.

### Hospitals Find Ways to Grow

While just about every hospital merger is scrutinized by the FTC, only a handful of proposed hospital-physician deals have required antitrust approval given that most fall below the HSR monetary threshold (in 2016, deals over \$78 million had to be reported to the FTC).

"The day after the ACA passed, cardiologist groups all around the country showed up in hospitals 'ready to talk turkey'," Rust said, explaining that provisions of the ACA meant that physician groups of this type were not going to be able to maintain current income levels as independent entities.

"If your rival hospital grabs all the cardiologists, what's going to happen to the other hospital cardiology practices?" Greaney added, describing hospitals rush to roll-up physician practices as a "reflex move".

Even so, the FTC has the right to take jurisdiction over a proposed deal if it hears about the transaction. In that case, it's extremely rare for the parties to challenge regulators' objections. The deal is likely to be quietly killed, Rust said. And the FTC is adapting.

In 2014, the FTC expanded its forces beyond hospital deals and successfully prevented a major hospital-physician merger in Nampa, a Boise, Id. suburb.

The Ninth Circuit in December affirmed a federal district court ruling which held that St. Luke's Health System's acquisition of Idaho's largest independent, multi-specialty physician practice group, Saltzer Medical Group PA, violated Section 7 of the Clayton Act and the Idaho Competition Act. The FTC and the Idaho attorney general claimed the combination would have the market power to hike costs for patients. St. Luke's was ultimately ordered to fully divest itself of Saltzer's physicians and assets.

### Future of Obamacare vs. FTC

Looking ahead, healthcare antitrust experts expect the FTC will continue to be a force in its attempts to block health system mergers.

"I think they will continue to be very violent and challenging," Greaney said of the FTC.

What's a good antidote for M&A?

It's not entirely clear that hospitals and physician groups need to merge to achieve the desired efficiencies, Greaney said. At the same time, it's also unclear if joint ventures and contracting agreements serve as adequate alternative forms to consolidation, he said.

One factor to keep in mind is the presidential election.

"It is really important to know that these things can really turn on a dime with a new administration," Rust said.

"The enforcement agencies don't take direction from act of Congress, really, but what they perceive the law to be [in connection with] cues from the executive branch," Rust added.

## **Beyond Hospitals, Beyond the ACA**

While the FTC is responsible for reviewing hospital mergers, it's the Department of Justice that typically challenges insurance deals.

Two proposed health insurance megadeals are now pending before the DOJ -- Anthem Inc.'s \$54 billion agreement to buy Cigna and Aetna's \$37 billion deal for Humana. If both deals successfully go through, the number of large health insurers would be reduced to three, from five.

In both situations the parties have indicated their willingness to spin-off overlapping plans in markets, but doing so is no easy task. The DOJ is likely to be skeptical when looking at possible buyers of divestitures.

"The DOJ really has to examine the capabilities and predict the ability of those substitute plans," Greaney said. "Historically that has not worked out so well."

As opposed to hospital mergers, insurers are looking to combine for reasons outside of the ACA.

"They are combining not because of the ACA, but because they see the potential for scale and [elimination] of cost," Rust said. "They see the potential for big profits."

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