OCTOBER
2005

WWW.EBGLAW.COM

Resurgens Plaza
945 East Paces Ferry Road
Suite 2700
ATLANTA, GA 30326
(404) 923-9000

150 North Michigan Avenue
Suite 420
CHICAGO, IL 60601-7553
(312) 499-1400

Lincoln Plaza
500 N. Akard
Suite 2700
DALLAS, TX 75201-3320
(214) 397-4300

Wells Fargo Plaza
1000 Louisiana, Suite 5400
HOUSTON, TX 77002-5013
(713) 750-3100

1875 Century Park East
Suite 500
LOS ANGELES, CA 90067-2506
(310) 556-8861

Miami Center
201 South Biscayne Boulevard
10th Floor
MIAMI, FL 33131
(305) 373-4088

250 Park Avenue
NEW YORK, NY 10177-1211
(212) 351-4500

Two Gateway Center
12th Floor
NEWARK, NJ 07102-5003
(201) 642-1900

One California Street
26th Floor
SAN FRANCISCO, CA 94111-5427
(415) 398-3500

One Landmark Square
Suite 1800
STAMFORD, CT 06901-2681
(203) 348-3737

1227 25TH Street, N.W.
Suite 700
WASHINGTON, D.C. 20037
(202) 861-0900

The Epstein Becker & Green, P.C., ***Special Alert*** is published by the National Health Care & Life Sciences Practice to inform health care organizations and providers of new legal developments which may affect the delivery and financing of their health care services.

Information published in the ***Special Alert*** is not intended to be, nor should it be considered, legal advice. Readers should consult an attorney to discuss specific situations in further detail.

Lynn Shapiro Snyder, Esq.
Editor

Published by
Health Care & Life Sciences Practice
of

EPSTEIN BECKER & GREEN, P.C.

THOUGHT LEADERS IN HEALTH LAW®
WWW.EBGLAW.COM

SPECIAL ALERT

Hospitals at Risk for Post Merger Conduct: FTC ALJ Orders Dissolution of Evanston, IL Hospital Merger

Last week, the Federal Trade Commission's ("FTC") Chief Administrative Law Judge, Stephen J. McGuire ("ALJ"), issued an Initial Decision that the Evanston Northwestern Healthcare Corporation's ("Evanston") acquisition of Highland Park Hospital ("Highland") violated § 7 of the Clayton Act. The ALJ's Order specified that Evanston divest Highland within 180 days of the Order becoming final. Within a day, the defendants noted an appeal from the ALJ's decision to the FTC itself. For more information about the FTC's announcement and the appeals process click here.

This case should serve as a potent reminder that post-transaction, unilateral conduct can violate the antitrust laws, and that on-going antitrust counsel and continuing compliance should be an integral part of every health care company's efforts. Clearly, any assumption that the antitrust laws are only relevant until Hart-Scott-Rodino clearance is obtained is not only erroneous, but very risky.

Although some aspects of the Initial Decision are similar to other hospital merger cases, the ALJ's ruling (and the FTC's strategy) are quite different from earlier cases in other important respects. Traditionally, the FTC and the U.S. Department of Justice, have challenged hospital mergers prospectively, based on the anticipated effects of the merger. Unlike previous FTC challenges to hospital mergers, this case involved a retrospective review of a completed hospital merger and, importantly, the actual competitive effects of the merger. As explained in more detail below, the ALJ found that Evanston and Highland entered into the transaction with the purpose and intent of raising prices to managed care organizations. Because of the greater market power that Evanston obtained as a result of the transaction, the ALJ found that the merged entity was able to raise prices significantly to managed care organizations.

The ALJ found that the relevant product market was primary, secondary, and tertiary general acute care inpatient hospital services sold to managed care organizations. The relevant geographic market was determined to be a relatively small geographic area encompassing only seven (7) hospitals in a highly populated urban area: Evanston, Glenbrook, Highland Park, Lake Forest, Advocate Lutheran General, Rush North Shore, and St. Francis hospitals.

The Epstein Becker & Green, P.C., ***Special Alert*** is published by the National Health Care & Life Sciences Practice to inform health care organizations and providers of new legal developments which may affect the delivery and financing of their health care services.

Information published in the ***Special Alert*** is not intended to be, nor should it be considered, legal advice. Readers should consult an attorney to discuss specific situations in further detail.

Lynn Shapiro Snyder, Esq.
Editor

Published by
Health Care & Life Sciences Practice
of

EPSTEIN BECKER & GREEN, P.C.

THOUGHT LEADERS IN HEALTH LAW®
WWW.EBGLAW.COM

SPECIAL ALERT

Intent to Raise Prices

According to the ALJ, Evanston consciously and intentionally entered into the transaction with the primary purpose of obtaining negotiating leverage to extract higher reimbursement from managed care organizations. Immediately following consummation of the transaction, the ALJ found that Evanston embarked upon a conscious, aggressive strategy of raising prices to managed care organizations. In fact, the ALJ identified six specific mechanisms that Evanston employed to raise prices:

> "(1) utilizing the higher Evanston or Highland Park rate until new contracts were negotiated; (2) moving managed care organizations to one contract for all three hospitals; (3) in renegotiating contracts, demanding the higher of Evanston or Highland Park rates plus a premium and discount off rates; (4) increasing discount off charges arrangements; (5) adopting the higher of the Evanston or Highland Park chargemaster prices; and (6) increasing ENH's [Evanston Northwestern Healthcare's] chargemaster prices four times in 2002 and 2003."

The ALJ also found that Evanston tracked the revenue value of the price increases, and highlighted the increased revenue as an accomplishment of the transaction. Internal hospital documents stated that Evanston's price increases provided an annualized economic value of $18 million, and noted that Evanston "had never achieved" a price increase as high as $18 million before the merger. All plausible non-merger explanations for the price increases were ruled out, and the ALJ determined that the price increases, which were significantly higher (in relative terms) than any price increases at other hospitals, were only possible because of the transaction. Therefore, the ALJ found, the successful price increases demonstrated that the transaction had reduced competition and was likely to substantially reduce competition in the relevant market in the future, in violation of §7 of the Clayton Act.

Redefinition of the Product Market

There are several aspects of ALJ's decision that merit particular attention. First, the relevant product market was confined to general acute care inpatient hospital services *sold to managed care organizations*. Although hospital merger cases have routinely focused on managed care as the area of greatest potential competitive effect, in the past the product market typically has included all of the hospital's inpatient acute care hospital services. By identifying hospital services sold to managed care organizations as a separate and relevant submarket, the FTC rendered the effect on managed care the only relevant issue, and provided support for what is likely one of the most significant and far-reaching departures from traditional hospital merger analysis—the use of pricing data to establish directly the anticompetitive effects of the merger.

The Epstein Becker & Green, P.C., ***Special Alert*** is published by the National Health Care & Life Sciences Practice to inform health care organizations and providers of new legal developments which may affect the delivery and financing of their health care services.

Information published in the ***Special Alert*** is not intended to be, nor should it be considered, legal advice. Readers should consult an attorney to discuss specific situations in further detail.

Lynn Shapiro Snyder, Esq.
Editor

Published by
Health Care & Life Sciences Practice
of

EPSTEIN BECKER & GREEN, P.C.

THOUGHT LEADERS IN HEALTH LAW®
WWW.EBGLAW.COM

SPECIAL ALERT

Rejection of Elzinga-Hogarty and Patient Flow Analysis

Second, the ALJ ruled that the Elzinga-Hogarty test and patient origin analysis are not appropriate for defining geographic markets in hospital merger cases, and perhaps other hospital antitrust cases. As the ALJ explained:

> "[P]atient flow data and service areas are not reliable in determining substitutability in first stage (price) competition for managed care contracts and are not considered in determining the geographic market…. Therefore, factors such as market participant views, geographic proximity, travel times and physician admitting patterns are considered in making the geographic market determination."

The ALJ noted that "[b]oth parties acknowledge the string of government losses in hospital merger cases over the last decade. In many of those cases, the government's failure to prove a relevant geographic market within which a hospital merger would have anticompetitive effects was determinative." The ALJ went on to state that "[p]rior cases have traditionally relied on the Elzinga-Hogarty test and patient flow data to establish the geographic market for hospital services."

The ALJ's rejection of the Elzinga-Hogarty test and patient flow analysis is likely to affect future hospital merger and other hospital antitrust cases irrespective of the final outcome of this particular case. This is because Complaint Counsel (the FTC Staff), in what was likely its most clever tactical move, presented Dr. Kenneth G. Elzinga (the co-originator of the Elzinga-Hogarty test) as its expert witness. Dr. Elzinga testified that the Elzinga-Hogarty test in particular, and patient flow analysis generally, were not appropriate in hospital cases where the product is highly differentiated. In view of this testimony, it seems highly unlikely that the Elzinga-Hogarty test, which has been the primary tool used by many hospitals to support broad geographic markets, can be confidently relied upon in future hospital antitrust cases. Moreover, without the Elzinga-Hogarty test, any other use of patient flow data may have limited persuasive value.

Direct Effects and Market Definition

Third, the ALJ also dismissed as moot Count II of the Commission's Complaint – which asserted that, based on the direct price effects, the transaction violated § 7 of the Clayton Act even without identification of a market. Nevertheless, the ALJ criticized Complaint Counsel's theory, citing several cases from the 7th Circuit. According to the ALJ, even with proof of actual direct effects, the plaintiff in a § 7 case is still required to establish the "rough contours" of the affected market in order to inform the trier of fact where competition is restrained.

On appeal, the Commission may reinstate Count II, because the ability to establish antitrust violations without proving a relevant market has potentially far-reaching implications for the FTC's antitrust enforcement mission. Whatever the market definition requirements of § 7, it is likely that the Commission will rule that

The Epstein Becker & Green, P.C., ***Special Alert*** is published by the National Health Care & Life Sciences Practice to inform health care organizations and providers of new legal developments which may affect the delivery and financing of their health care services.

Information published in the ***Special Alert*** is not intended to be, nor should it be considered, legal advice. Readers should consult an attorney to discuss specific situations in further detail.

Lynn Shapiro Snyder, Esq.
Editor

Published by
Health Care & Life Sciences Practice
of

EPSTEIN BECKER & GREEN, P.C.

THOUGHT LEADERS IN HEALTH LAW®
WWW.EBGLAW.COM

SPECIAL ALERT

they are satisfied by the proof of direct effects evidence in the present case—that managed care plans seeking to operate in the area were required to pay significantly higher prices.

As the Supreme Court has explained in a non-merger context, "[s]ince the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, 'proof of actual detrimental effect, such as a reduction of output,' can obviate the need for an inquiry into market power, which is but a 'surrogate for detrimental effects.'" *F.T.C. v. Ind. Fed'n of Dentists*, 476 U.S. 447, 460-61 (1986) (citation omitted).

Judge Posner of the Seventh Circuit has himself addressed the significance of effects evidence in the hospital merger context. "It is regrettable that antitrust cases are decided on the basis of theoretical guesses as to what particular market structure characteristics portend for competition.... We would like to see more effort put into studying the actual effect of concentration on price in the hospital industry as in other industries." *U.S. v. Rockford Memorial Corporation*, 898 F.2d 1278, 1284 (7th Cir. 1990).

Divestiture Ordered

The relief requested by FTC Staff, and granted by the ALJ—divestiture of the hospital assets acquired through the transaction—is perhaps the single most significant aspect of the opinion. The message delivered by the ALJ's decision could not be clearer: without clinical integration—and in a number of hospital transactions there has been no significant clinical integration—the fact that the transaction has been consummated, by itself, provides no guarantee that it cannot not be undone if it is found to have produced anticompetitive effects. In other words, future price increases (or other anticompetitive conduct) made possible by acquired market power, put the merged organization's future at risk so long as the facilities remain essentially separate.

While the case is not likely to be concluded any time soon, it is nevertheless historic and far-reaching in its implications. Assuming the FTC upholds the ALJ's ruling, as seems likely, the defendants are almost certain to appeal to the Seventh Circuit Court of Appeals. If ultimately upheld by the Seventh Circuit, the case would represent a significant shift in hospital merger analysis.

* * *

If you would like additional information regarding this topic, please contact Michael Bissegger at 202/861-1888, email mbissegger@ebglaw.com or William Kopit at 202/861-1803, email wkopit@ebglaw.com, both in the firm's Washington, D.C. office or the Epstein Becker & Green attorney who regularly handles your legal matters. For further information about Epstein Becker & Green's Health Care & Life Sciences Practice, or to see back issues of Special Alerts, please visit our website at www.ebglaw.com.

The Epstein Becker & Green, P.C., ***Special Alert*** is published by the National Health Care & Life Sciences Practice to inform health care organizations and providers of new legal developments which may affect the delivery and financing of their health care services.

Information published in the ***Special Alert*** is not intended to be, nor should it be considered, legal advice. Readers should consult an attorney to discuss specific situations in further detail.

Lynn Shapiro Snyder, Esq.
Editor

Published by
Health Care & Life Sciences Practice
of

EPSTEIN BECKER & GREEN, P.C.

THOUGHT LEADERS IN HEALTH LAW®
WWW.EBGLAW.COM

SPECIAL ALERT

If you would like to be added to our mailing list, please complete the form below and return it to:

Amy Simmons
Marketing & Recruitment Manager
Health Care & Life Sciences Practice
Epstein Becker & Green, P.C.
1227 25th St., NW, Suite 700
Washington, D.C. 20037
phone (202) 861-1811 -- fax (202) 296-2882
asimmons@ebglaw.com

Name: ____________________ Title: ____________________

Company/Firm/Organization: ____________________

Street address: ____________________

City: ____________________ State: ________ Zip Code: __________

Phone number: ____________________ Fax number: ____________________

Internet E-mail address: ____________________

HEALTH CARE & LIFE SCIENCES PRACTICE ATTORNEYS OF THE FIRM

ATLANTA
Michael Barry, Robert Berg, Christy Durden
Amy Haywood, Rebekah Plowman, Kristen Pollock
Carol Saul, Kristin O'Connell Upton and Alan Wynne

CHICAGO
Amy Dow, Steve Drake, Heather Fesko
Catherine Katilius and Diane Romza-Kutz

DALLAS
Gayla Crain and Elise Healy

HOUSTON
Steve Cochell
Michelle Moore and Marty Wickliff

LOS ANGELES
Dale Bonner and Susan Graham

NEW YORK
Jeffrey Becker, Jerrold Ehrlich, Philip Gassel
Jay Gerzog, John Gleason, Wendy Goldstein
Robert Groban, Carrie Kissick, Purvi Maniar
Ari Markenson, Mark Moskovitz, Christopher Panczner
Brian Platton, Leigh Rubinstein, David Simon
Steven Swirsky, Mithran Tiruchelvam and Jonathan Trafimow

NEWARK
Richard Davis, Joan Disler, Lynne DeLisi
Mathew Farkas, James Flynn, Hervé Gouraige
Sucharita Iyengar, Philip Mitchell, Maxine Neuhauser
Kerry Parker and Jana Taylor

SAN FRANCISCO
William Helvestine, Michael Horan
Tim O'Connor, Jamie Platto and Lawrence Rose

WASHINGTON, D.C.
Daniel Abrahams, Jill Alvarez, Gianna Arnold
Kirsten Backstrom, Clifford Barnes, Uri Bilek
Michael Bissegger, George Breen, Teresa Brooks
Lee Calligaro, Jason Caron, Jason Christ
John Eriksen, Steven Epstein
James Falk, Jr., James Falk, Sr., Rebecca Fayed
Gregory Fortsch, Jackie Frazer, Stuart Gerson
Alexis Gilroy, Julianna Gonen, Daniel Gospin
Leah Guidry, Niteesha Gupte, Marci Handler
Douglas Hastings, Robert Hudock, Taylor Jones
Teresa Kelton, Jana Kolarik, William Kopit
Jennifer Luong, Mark Lutes, David Matyas
John Murdock, Elizabeth Murphy, Clayton Nix
Sarah Oliker, Sandra Park, Corey Perman
Kathleen Peterson, Corinne Pouliquen, Helen Quick
John Rah, Lauren Ranone, Robert Reif
Christopher Robinson, Tisha Schestopol, Anuj Shah
Lynn Shapiro Snyder, Rachel Spitz, Jessica Swartz
David Tatge, Daly Temchine
Linda Tomaselli (admitted in MA & NH only)
Carrie Valiant, Dale Van Demark, Patricia Wagner
Robert Wanerman, Connie Wilkinson and
Hilary Weckstein