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# A History of *Evanston* and Analysis of the Merger Remedy

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## **A History of *Evanston* and Analysis of the Merger Remedy**

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**T**he *Evanston* case is a result of the Federal Trade Commission’s (“FTC” or “Commission”) retrospective review of hospital mergers that was announced by then-FTC Chairman Tim Muris in 2002. The retrospective review was initiated by the FTC after both federal antitrust agencies—the U.S. Department of Justice (“DOJ”) Antitrust Division and the FTC Bureau of Competition—lost numerous cases when challenging hospital mergers pre-consummation in federal court.<sup>1</sup> In an effort to reinvigorate the Commission’s hospital merger program, the FTC announced that it intended to analyze the effects of hospital mergers in several cities across the country with an eye towards potentially challenging the consummated transactions that resulted in anticompetitive price increases. According to Chairman Muris, the effort provided the FTC with an opportunity to utilize “real-world empirical evidence, instead of hunches, guesswork, and theoretical predictions” to assess the competitive effects of hospital

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<sup>1</sup> See Timothy J. Muris, *Everything Old is New Again: Health Care and Competition in the 21<sup>st</sup> Century*, Speech at the 7<sup>th</sup> Annual Competition in Health Care Forum, Chicago, Illinois (Nov. 7, 2002), available at <http://www.ftc.gov/speeches/muris/murishealthcarespeech0211.pdf>.

mergers.<sup>2</sup> At the outset, Chairman Muris indicated that the Commission would “carefully consider” whether administrative litigation was appropriate, noting that whether or not there was an appropriate remedy would influence the Commission’s decision of whether to pursue litigation.<sup>3</sup>

### **Evanston’s Acquisition of Highland Park Emerges as the Apparent Test Case**

Evanston’s acquisition of Highland Park Hospital (“Highland Park”) emerged as the apparent test case for the FTC’s new approach. Evanston Northwestern Healthcare (“ENH” or “Respondent”) acquired Highland Park Hospital in January 2000. The transaction combined ENH’s 400-bed and 125-bed facilities in Cook County, Illinois with Highland Park’s 150- to 200-bed facility (located just over 13.5 miles north of Evanston). Evanston Hospital offered a broad range of primary and secondary medical services, but was also a tertiary care teaching hospital that offered high-level, complex medical and surgical services. Highland Park offered a broad range of primary and secondary medical and surgical services, but was not considered a tertiary care facility.

Two years after the retrospective review was initiated and four years after the transaction closed, the FTC issued a three count administrative complaint alleging that Evanston’s acquisition of Highland Park violated the antitrust laws:

- In Count I, the FTC charged ENH with violating Section 7 of the Clayton Act, alleging that the merger substantially lessened competition for acute care inpatient

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<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

- hospital services sold to private payors in the geographic area directly proximate to the merging facilities.<sup>4</sup>
- In Count II, the FTC alleged a Section 7 violation, but interestingly enough, did not define a relevant product or geographic market. Complaint counsel subsequently argued that it was not necessary to allege a relevant product or geographic market given the direct evidence of post-merger anticompetitive effects.
  - In Count III, the FTC charged ENH with price-fixing for physician services in violation of Section 5 of the FTC Act through its ENH Medical Group by collectively negotiating prices with managed care organizations on behalf of its independent, non-salaried physicians. This was later resolved via a consent order that was finalized in May 2005.

According to the complaint, following the merger, ENH imposed system-wide pricing on payors and significantly increased prices at all locations, effectively forcing payors to accept price increases that were significantly higher than the price increases of other comparable hospitals, or face the loss of all three hospitals from their networks.<sup>5</sup>

### **Complaint Counsel's Proposed Remedy**

Complaint Counsel sought to have ENH divest Highland Park Hospital in a manner that would restore Highland Park as a viable, independent competitor in the relevant market. Complaint Counsel also sought to prevent future combinations between the parties for a period of time and to require ENH to give prior notice of any future

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<sup>4</sup> The complaint defined the relevant product market as “general acute care inpatient hospital services sold to private payors.” The relevant geographic market was defined as the geographic area “directly proximate to the three ENH hospitals and contiguous areas in northeast Cook County and southeast Lake County, Illinois,” which was essentially the geographic triangle formed by the three ENH facilities.

<sup>5</sup> Complaint, In the matter of Evanston Nw. Healthcare Corp., FTC Docket No. 9315 (Feb. 10, 2004), available at <http://www.ftc.gov/os/caselist/0110234/040210emhcomplaint.pdf>. The complaint alleged that all but one payor accepted the price increases.

transactions with other facilities in the relevant market. ENH denied the allegations of the Complaint asserting, among other things, that the merger resulted in several significant efficiencies and improvements in the quality of patient care that outweighed any alleged anticompetitive effects.<sup>6</sup> According to the parties, the post-merger price increases were justified, in part, by the increased demand for Highland Park's services resulting from the quality improvements ENH added to the facility. The parties also argued that a significant portion of the price increases were due to efforts to bring Evanston Hospital's prices in line with competitive levels, which ENH says it learned were below competitive levels after it obtained access to Highland Park's prices.

### **The ALJ's Initial Decision**

The case was tried before Administrative Law Judge ("ALJ") Stephen McGuire. Following an eight week trial, the ALJ upheld Count I of the Complaint and found that the acquisition "substantially lessened competition" and resulted in substantial price increases to managed care organizations.<sup>7</sup> On finding a violation of Count I, the ALJ dismissed Count II as moot. The ALJ agreed with complaint counsel's definition of the relevant product market, but not its definition of the relevant geographic market. The ALJ defined the relevant geographic market as a slightly broader area encompassing the parties' three facilities as well as four other area hospitals. According to the ALJ, ENH's improvements to Highland Park did not justify the price increases implemented following

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<sup>6</sup> Respondents' Answer to Complaint, In the matter of Evanston Nw. Healthcare Corp., FTC Docket No. 9315 (Mar. 17, 2004), *available at* <http://www.ftc.gov/os/caselist/0110234/040317enhanswertocmplt.pdf>.

<sup>7</sup> Initial Decision of Stephen J. McGuire, In the matter of Evanston Nw. Healthcare Corp., FTC Docket No. 9315 (Oct. 20, 2005) [hereinafter "ALJ Decision"], *available at* <http://www.ftc.gov/os/adjpro/d9315/051021idtextversion.pdf>.

the merger (which were deemed to be substantially higher than price increases obtained by other comparable hospitals).<sup>8</sup> Rather, the only explanation for increased prices was the elimination of a competitor, which enhanced ENH's market power.

The parties argued for alternative remedies short of divestiture, including:

1. a prior notice order that would require ENH to give the FTC advanced notice of future transactions; and
2. a conduct remedy regarding establishing separate contract negotiating teams.

The ALJ was not persuaded that the alternative remedies to divestiture would effectively resolve the competitive problem, noting that it failed to undo the competitive effects of the unlawful merger and to "make the markets whole again."<sup>9</sup> The ALJ also concluded that a conduct remedy calling for separate negotiating teams would not adequately restore competition to the pre-merger landscape given the geographic dynamics of the market. In short, the parties did not demonstrate to the ALJ's satisfaction how non-structural relief would effectively redress the violations at issue. The ALJ found that the appropriate remedy to restore competition as it would have existed without the merger was a full divestiture of Highland Park from ENH. The ALJ concluded that the quality of care improvements that would be lost through divestiture were "insubstantial in relation to the anticompetitive harm from the merger."<sup>10</sup>

### **The Commission's Opinion and Initial Order**

ENH appealed the ALJ's decision to the full Commission. On August 6, 2007, the Commission issued its unanimous decision affirming the ALJ's determination that the

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

merger violated Section 7 of the Clayton Act by enabling the merged firm to unilaterally increase price through the exercise of market power. Citing the testimony of two economic experts, the Commission found that the prices increased by either 9 to 10 percent or 11 to 18 percent.<sup>11</sup> The Commission reached its conclusion by relying significantly on econometric analyses, party documents, as well as managed care plan testimony. The econometric analyses performed by both complaint counsel's and ENH's economists "strongly supported" the Commission's conclusion that the merger gave ENH the ability to raise price through the exercise of market power. These analyses, the Commission believed, ruled out the most likely competitively benign explanations for significant portions of the price increases.

The Commission was not convinced, for example, that the price increases reflected an attempt by ENH to correct a multi-year failure by Evanston to charge market rates for increased demand for Highland Park's services due to post-merger improvements. The parties' documents also revealed an anticompetitive intent. The Commission pointed to language in pre-merger documents that revealed that the parties' true intent for the merger was to increase bargaining leverage with payors. The Commission also considered the testimony of managed care plans, who testified, among other things, that they were reluctant to drop ENH from their networks. The Commissioners also rejected ENH's efficiency claims and quality improvement justifications, finding instead that the quality improvements asserted by ENH were not merger-specific and were benefits that could have been made by Highland Park on its

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<sup>11</sup> Opinion of the Commission (by D. Majoras), In the matter of Evanston Nw. Healthcare Corp., FTC Docket No. 9315 (Aug. 6, 2007) [hereinafter "Commission Opinion"], *available at* <http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf>.

own. For example, the Commissioners found that Highland Park had plans in place to improve and expand services, including developing a cardiac surgery program in affiliation with Evanston or another hospital. The medical staff integration and the affiliation with a teaching hospital were the only improvements the Commission deemed merger-specific.

There were, however, some significant departures from the ALJ's decision. First, the Commission differed in approach and substantively with the ALJ's geographic market definition. Largely rejecting the use of patient origin data, the Commission concluded (based significantly on post-merger pricing evidence), that the triangle formed by the three ENH facilities properly defined the boundaries of the market. Second, and perhaps most significantly, the Commission rejected the ALJ's divestiture order, finding instead that the costs associated with separating hospitals that had functioned as one entity for more than seven years would be too high and determining that certain quality improvements that had been made at Highland Park (namely the cardiac surgery program and the EPIC electronic medical records system) would make divestiture more difficult and carry a greater risk of unforeseen costs and failure.<sup>12</sup> The Commission explained that divestiture could jeopardize Highland Park's ability to maintain a cardiac surgery program and ultimately could diminish the quality of patient care. The Commission also believed that it would take a significant amount of time and money for Highland Park to install a comparable medical records system and noted that glitches in changing systems could negatively impact patient care.<sup>13</sup>

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<sup>12</sup> *Id.* at 89.

<sup>13</sup> *Id.* at 90.



The Commission determined, therefore, that competition could best be restored through injunctive relief. It issued an Order requiring the hospitals to establish separate and independent contract negotiating teams for the hospitals.<sup>14</sup> It also required the parties to permit payors to renegotiate their contracts, to establish firewalls to prevent the flow of competitively sensitive information between the hospital teams, and to refrain from making managed care contracts with one facility contingent on the payor also contracting with other ENH facilities. The initial Order also required ENH to recommend mechanisms for dispute resolutions with payors with respect to ENH's compliance with the terms of the Order. The Commission gave ENH 30 days to submit a detailed proposal for implementing its injunctive relief.

In response to the Commission's Opinion, ENH filed its submission in explanation of its proposed Final Order on September 17, 2007.<sup>15</sup> In its submission, ENH proposed:

1. to establish distinct hospital contracting structures to allow payors to negotiate separately with Highland Park and the other ENH-owned hospitals;
2. to allow payors the opportunity to contract with one hospital but not the other;
3. to establish separate negotiating teams for Highland Park and other ENH-owned hospitals, which would be instituted at the request of the payor so that some payors might not elect to pursue separate contracting options;
4. that no price or contract terms are contingent on whether the payor contracts with Highland Park, other ENH-owned hospitals, or both, so that payors could exclude Highland Park or other-ENH owned hospitals to form an alternative network;

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<sup>14</sup> *Id.*

<sup>15</sup> Submission of Evanston Northwestern Healthcare in Explanation and Support of Its Proposed Final Order, In the matter of Evanston Nw. Healthcare Corp., FTC Docket No. 9315 (Sep. 17, 2007) [hereinafter "Submission in Explanation"], *available at* <http://www.ftc.gov/os/adjpro/d9315/070917submissioninexplanation.pdf>.

5. to allow all payors to reopen and renegotiate their current contracts if the payor seeks separate contracting for Highland Park inpatient services;
6. to institute a firewall type mechanism to protect all competitively sensitive information and enable competition between the hospitals; and
7. that ENH will submit annual compliance reports to the Commission that detail how ENH has complied with the terms of the Final Order.

In response, Complaint Counsel filed its comments to ENH's proposed Final Order.<sup>16</sup> Complaint Counsel noted that while ENH's proposed order generally followed the Commission's order, it did not think that establishing two negotiating teams with a firewall was sufficient to restore competition and limit information flowing between the two groups.<sup>17</sup>

ENH filed a response to Complaint Counsel's comments on November 8, 2007, noting that the three issues that needed to be resolved were whether:

1. outpatient services needed to be contracted separately for the hospitals;
2. the term "payor" includes government entities such as Medicare or Medicaid; and
3. "notification should be required of three representatives of each payor."<sup>18</sup>

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<sup>16</sup> Complaint Counsel's Comments on ENH's Proposal, In the matter of Evanston Nw. Healthcare Corp., FTC Docket No. 9315 (Oct. 29, 2007), available at <http://www.ftc.gov/os/adjpro/d9315/071029cccommentsonenhproposal.pdf>.

<sup>17</sup> *Id.* at 3. Complaint Counsel was, however, concerned that requiring ENH to make too many changes or institute too many procedures would cause it to increase prices due to the costs of instituting the procedures.

<sup>18</sup> Respondents' Response to Complaint Counsel's Comments on Proposed Final Order, In the matter of Evanston Nw. Healthcare Corp., FTC Docket No. 9315 (Nov. 8, 2007), available at <http://www.ftc.gov/os/adjpro/d9315/071108enhresponsetoccomments.pdf>. ENH and Complaint Counsel agreed to the prior notification provision that had been suggested by Complaint Counsel in its October 29, 2007 filing. *Id.* at 15.

## The Commission's Final Order on Remedy and Its Implications

On April 24, 2008, the Commission issued its Final Order.<sup>19</sup> The Final Order requires Respondent:

1. to negotiate managed care contracts for hospital services at Evanston separately from managed care contracts for hospital services for Highland Park, and vice versa;
2. to allow payors, at their request, to submit disputes as to prices or terms obtained by payor as a result of separate negotiations, first to mediation and then to binding arbitration;
3. to establish separate and independent negotiating teams for Highland Park and other ENH-owned hospitals and to negotiate managed care contracts in competition with each other and other hospitals;
4. to institute a firewall type mechanism to protect all competitively sensitive information and enable competition between the hospitals;<sup>20</sup>
5. to allow all payors to reopen and renegotiate their current contracts if the payor seeks separate contracting for Highland Park inpatient services; and
6. to give prior notice to the Commission for any future acquisitions of hospitals that ENH may make within the Chicago Metropolitan Statistical Area for the next ten years.<sup>21</sup>

The Commission cited *United States v. E.I. du Pont de Nemours & Co.*, noting that the appropriate remedy for a Section 7 violation is one that is “necessary and

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<sup>19</sup> Opinion of the Commission on Remedy (by T. Rosch), In the matter of Evanston Nw. Healthcare Corp., FTC Docket No. 9315 (Apr. 24, 2008), available at <http://www.ftc.gov/os/adjpro/d9315/080428commopiniononremedy.pdf>.

<sup>20</sup> The ENH Corporate Managed Care Department is permitted to receive managed care contracting information from both negotiating teams, but it is prohibited from sharing such information with the respective negotiating teams.

<sup>21</sup> The Order terminates after twenty years and contains other provisions (e.g., annual compliance report requirements, obligations on Respondent to notify affected parties, and so forth) that are standard in most consent decrees.

appropriate in the public interest to eliminate the effects of the acquisition offensive to the statute.”<sup>22</sup> It therefore concluded that it need not limit its remedy to the confines of its relevant product market definition and instead decided to broaden the remedy to require separate negotiations to include outpatient as well as inpatient services. According to the Commission, limiting the separate negotiations requirement to inpatient services would “not effectively re-inject competition between Highland Park and Evanston for the business of [managed care organizations] because it does not comport with the reality of how payors contract for hospital services.”<sup>23</sup>

Agreeing, in part, with Respondent’s desire to exclude “government payors” from the scope of the Order, the Commission concluded that the definition of “payor” should exclude government insurance programs such as Medicare and Medicaid, but not all governmental entities. The Commission recognized that certain government entities (e.g., municipalities) contract for health care services for their employees as self-insured entities much like private employers. Thus, the Order only excludes government payors for public health insurance programs.<sup>24</sup>

In a further departure from Respondent’s proposed Order, the Commission found that separate negotiations should be the “default setting” for contracting with managed care plans. The Commission sought to place the burden of restoring competition on ENH rather than payors. Thus, it required the hospitals to commence separate negotiations with payors and preferred to have payors affirmatively opt out by notifying the hospital that

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<sup>22</sup> *Id.* at 3.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 5.

they sought to contract jointly, rather than “putting the onus on payors” to seek separate negotiations. According to the Commission, the firewall mechanisms designed to protect competitively sensitive information would be more effective “if separate negotiations are understood to be the baseline for managed care contract negotiations.”<sup>25</sup>

The Commission also disagreed with ENH’s proposed firewalls. Respondent sought to use the same ENH negotiating team to handle the joint negotiations for all three ENH hospitals (Evanston, Glenbrook, and Highland Park) as well as the negotiations with Evanston (defined to encompass Glenbrook Hospital and Evanston Hospital) when payors sought to contract separately for the hospitals. This structure, the Commission asserted, could enable the ENH negotiating team to use competitively sensitive information obtained in its negotiations with payors for all three facilities when negotiating with payors for the services of Evanston Hospital independent of Highland Park, thus defeating the purpose of creating the separate negotiating teams. The Final Order, therefore, requires the two negotiating teams to remain separate and independent (i.e., “the two teams used to negotiate for Evanston and Highland Park separately shall not be involved in the joint negotiations” for all three facilities).<sup>26</sup>

Finally, the Commission’s Final Order requires ENH to submit disputes regarding price or other contractual issues (at the payor’s request), first to mediation and then to binding arbitration if mediation proves unsuccessful.<sup>27</sup> According to the Commission, the

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<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 10.

<sup>27</sup> The binding arbitration provision, which is not applicable when payors opt to negotiate jointly with all three hospitals, requires implementation in accordance with the AAA Commercial Arbitration Rules and that the parties hold the arbitration before a single arbitrator mutually agreed on by Respondent and payor.

binding arbitration provision is designed to overcome the “structural difficulties of an order requiring separate negotiations by teams which are part of a single corporate entity.”<sup>28</sup> As such, the Commission believed it was reasonably related to the remedial purposes of the Order and necessary to “promote the effectiveness of the Order.”<sup>29</sup>

As it did in its Initial Opinion and Order, the Commission took the opportunity in its Final Opinion on Remedy to reiterate that the *Evanston* remedy not be viewed as a sign that it is relaxing its preference for structural solutions (i.e., divestiture) as the more appropriate mechanism to remedy anticompetitive transactions. It specifically noted that a mere scrambling of the eggs by merging parties will “almost never justify a remedy short of divestiture,” yet explained that sufficient justification existed in this circumstance because:

1. a critical improvement (the development of the cardiac surgery program) was made to Highland Park after consummation of the transaction and there was evidence that a cardiac surgery program maintained by Highland Park alone might not have sufficient volume to maintain the service to enable it to compete effectively; and
2. this was not a case in which the parties consummated the merger (and made improvements) in the midst of an FTC investigation with full notice of a possible challenge to the transaction; instead, this case involved “a retrospective challenge that was made after the key improvement had already been made at Highland Park.”

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<sup>28</sup> *Id.* at 9.

<sup>29</sup> *Id.*

While the Commission states that the lack of notice of a potential challenge will not typically prevent the FTC from ordering divestiture, the Opinion clearly indicates that the retrospective posture of the case played a significant role in the merger remedy imposed.

The Final Order improves on and strengthens the Initial Order in some respects. For example, given that inpatient and outpatient services are typically negotiated together, the Final Order appears designed, in part, to address the practical realities of contract negotiations among payors and providers by including outpatient services in the Order. If conduct remedies are not properly crafted and fail to square with how the industry operates, they may, in fact, hinder competition and fail to accomplish the remedial purpose of the Order. The Commission may have fashioned the Final Order, in part, with this in mind. In addition, by defining the scope of the Order to include government entities that purchase health care services like self-insured private employers, the Commission appears to ensure that a potentially large category of payors that ENH sought to exclude are adequately covered by the remedy.

It is fairly clear that the Commission's mediation and binding arbitration provisions are designed to minimize what might otherwise have amounted to significant and costly government involvement in the marketplace (i.e., significant amounts of time and effort to closely monitor Respondent's compliance with the Order), which antitrust agencies generally assert they are ill-equipped to perform. In lieu of continuous government involvement in disputes over basic contractual terms and conditions, the Commission has empowered payors with the tools to hold the parties accountable. Time

will tell, however, whether and the extent to which such disputes (particularly those involving price), will morph into legitimate concerns about the parties' compliance with the Order, thus invoking the Commission's continuing jurisdiction regarding actual and potential violations of the Order.

However, as with the Initial Order, the Final Order also raises a number of interesting issues and questions in the minds of antitrust practitioners. Some would argue, as did certain economics professors,<sup>30</sup> that the Final Order is unlikely to curb anticompetitive behavior, in part, because it fails to properly provide an incentive for the hospitals to vigorously compete against each other (e.g., the parties may still have the ability to tacitly collude). Furthermore, the Final Order still leaves some unanswered questions regarding the extent to which the Commission considered permitting Evanston and Highland Park to develop a joint venture for cardiac surgery services, particularly in light of the fact that the parties had previously considered doing so prior to the merger. The Opinion makes reference to the DOJ's experience in *Morton Plant* (a case where a conduct remedy in a similar situation resulted in the hospitals' violation of the Order shortly after the Order was entered), yet the Commission did not take the opportunity to compare and contrast its Final Order in *Evanston* with the outcome in *Morton Plant*.<sup>31</sup>

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<sup>30</sup> See Brief *Amicus Curiae* of Economics Professors, In the matter of *Evanston Nw. Healthcare Corp.*, FTC Docket No. 9315 (Oct. 16, 2007), available at <http://www.ftc.gov/os/adjpro/d9315/071017econprofsamicusbrief.pdf>.

<sup>31</sup> In *Morton Plant*, the DOJ Antitrust Division and the State of Florida allowed the merging hospitals to combine administrative and other inpatient services while marketing certain other price and clinical services separately. See *United States and State of Florida v. Morton Plant Health System, Inc. and Trustees of Mease Hospital, Inc.*, Civ. No. 94-748-CIV-T-23E (M.D. Fla. 1994); see also *United States v. Morton Plant Health Sys.*, Civ. No. 94-748-CIV-T-23E, 2000 W.L. 33223244, at \*3 (M.D. Fla. July 14, 2000) (settling charges regarding violation of a consent order).



In its Initial Opinion, the Commission described its decision in *Evanston* as the “highly unusual” case in which a conduct remedy, rather than divestiture, was more appropriate.<sup>32</sup> It emphasized that its remedy should not be viewed as a sign that it is relaxing its preference for structural solutions, noting that its “rationale for not requiring a divestiture” would have “little applicability” to its consideration of the proper remedy in future (consummated or unconsummated) merger challenges.<sup>33</sup> The Commission’s recent May 9, 2008 challenge to the proposed acquisition of Prince William Health System, Inc. by Inova Health System Foundation is the Commission’s first challenge of an unconsummated hospital merger post-*Evanston*. Consistent with its previous statement, the FTC’s Complaint seeks a divestiture remedy in the event the Inova transaction is consummated. As with *Evanston*, the Inova litigation will undoubtedly provide antitrust practitioners with another useful forum in which to analyze and debate significant antitrust issues important to the health care industry.

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<sup>32</sup> See *Commission Opinion*, *supra* note 11, at 89.

<sup>33</sup> *Id.*