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# Merger Remedies: Lessons from the *Evanston* *Northwestern Healthcare* Decision

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## Merger Remedies:

### Lessons from the *Evanston Northwestern Healthcare* Decision

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On August 6, 2007, the Federal Trade Commission (“FTC” or “Commission”) issued an order in the *Evanston Northwestern Healthcare* hospital merger case,<sup>1</sup> creating a unique remedy for a consummated hospital merger that the Commission had concluded in an adjudicative proceeding had violated the Clayton Act. Finding that the traditional remedy in a merger case—divestiture—would do more harm than good in this case, the FTC decided to permit the merged hospitals (Highland Park Hospital and Evanston Northwestern Healthcare’s two hospitals) to continue to operate as a single entity, but to require them to conduct managed care negotiations separately at the option of managed care payers. The Commission’s theory was that the competitive harm from the transaction was the added leverage over these customers from the merger and that the leverage could be eliminated through this remedy. The Commission warned, however, that this was a highly unusual case, and that divestiture is the preferred remedy for unlawful mergers. Even in the case of consummated mergers, “where it is relatively clear

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<sup>1</sup> Opinion of the Commission (by D. Majoras), In the matter of Evanston Nw. Healthcare Corp., FTC Docket No. 9315 (Aug. 6, 2007), available at <http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf>.

that the unwinding of a hospital merger would be unlikely to involve substantial costs, all else being equal, the Commission likely would select divestiture as the remedy.”<sup>2</sup>

### **Proposal and Response**

The FTC order required Evanston to submit a proposed order that would accomplish the goals of the remedy articulated in the FTC opinion. Evanston’s proposed order contained the following provisions:

- Evanston would be required to establish distinct hospital contracting structures to allow payers to negotiate separately with Highland Park and Evanston Northwestern hospitals;
- Evanston would be required to establish separate negotiating teams for Highland Park on the one hand and the Evanston Northwestern hospitals on the other;
- Payers would have the choice of negotiating with each team separately or jointly with a team representing both Highland Park and Evanston Northwestern hospitals; the payers would have to affirmatively request separate negotiations;
- The joint team would be the same as the separate Evanston Northwestern team;
- Payers would be permitted to reopen and negotiate current contracts if the payer seeks separate contracting;
- Evanston would be required to refrain from making price or contract terms contingent upon a payer contracting with both hospitals; and
- Evanston would be required to institute firewalls to protect competitively-sensitive information.

Although the proposed order would require separate contracting teams, Evanston also proposed that it be permitted to have one corporate-level managed care department that would provide contract administration services for both contracting teams. Firewalls would protect against dissemination of information about the separate contracts for one

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<sup>2</sup> *Id.* at 91.

hospital to the other contracting team. And significantly, the separate contracting requirement would only be for inpatient services; the hospitals would be permitted to negotiate jointly for outpatient services.

Following the Evanston filing, the FTC staff (known as complaint counsel in FTC administrative proceedings) submitted comments on Evanston's proposed order. Complaint counsel—clearly unhappy about the Commission remedy, but with no alternative but to keep within the Commission's framework—observed that divestiture is typically the preferred remedy in a merger case. They also articulated a concern about imposing additional costs on the hospitals by adding to the complexity of the remedy, because those costs would only end up being passed on to consumers. Nevertheless, complaint counsel objected to several aspects of the order proposed by Evanston.

The most substantive area of disagreement was on the question of whether the order should cover outpatient services. Although complaint counsel had strenuously asserted in the litigation that outpatient services were not in the relevant product market at issue in the case, they objected to limiting the relief to inpatient services. Their point was that contracts with health plans typically cover both inpatient and outpatient services, so separating those negotiations would not comport with “contracting reality.”

Not surprisingly, Evanston argued in response that complaint counsel could not have it both ways—if outpatient services are not in the relevant market within which the FTC had found a violation of the Clayton Act, then the remedy should not apply to those services.

On April 28, 2008, the Commission issued its final opinion and order, which resolved the disputes between Evanston and the FTC staff with respect to the Evanston proposal. With respect to Evanston’s argument that outpatient services should not be subject to separate contracting, the Commission concluded that the separate contracting provisions contained in the order should apply to all hospital services (i.e., both inpatient and outpatient services), recognizing, as acknowledged by both parties, that payers typically include both types of services in one contract. In addition, the Commission rejected Evanston’s proposal that the joint team be the same as the separate Evanston Northwestern team, and made separate negotiations the “default” process, so that payers would not need to affirmatively request separate contract negotiations. The final FTC order modifies Evanston’s proposal accordingly.

### **Commentary**

The FTC’s refusal to order divestiture is of course of great interest to antitrust lawyers and parties to transactions. The natural question is whether that sets a precedent for future merger cases. The Commission was very clear that the remedy in the *Evanston* case should not be viewed as relief that would be suitable in other cases. But it is not clear from the Commission’s opinion what distinguishes *Evanston* from other post-merger challenges. The FTC’s stated concern was that divestiture of Highland Park by Evanston would eliminate the significant improvements that had occurred at Highland Park, and that divestiture would involve substantial costs. But these are factors that are likely to be present in any post-merger challenge—what is so different about this one?

On the other hand, there is precedent for merger remedies that do not involve divestiture. For example, the GM-Toyota joint venture was believed by the FTC to have the potential for anticompetitive effects, but the remedy imposed was a system of firewalls and separate selling teams, similar in concept at least to the *Evanston* remedy.<sup>3</sup> Similarly, several vertical merger cases have required firewalls rather than divestiture.<sup>4</sup>

Perhaps the most analogous matter is the *Morton Plant* case, another challenge to a hospital merger, brought by the U.S. Department of Justice Antitrust Division (DOJ) and the State of Florida.<sup>5</sup> In *Morton Plant*, the parties settled the DOJ/Florida challenge with a partial merger. The parties were permitted to merge their outpatient, ancillary, and tertiary-level services, but all other services were to be provided independently. Most significantly, managed care contracting was required to be done separately. Some would say that this approach was not successful. A few years after the case was settled, the DOJ charged that the parties had violated the consent decree by, for example, giving identical instructions to the separate managed care contracting teams, thereby coordinating managed care contracting. The parties again settled.<sup>6</sup>

Even if *Evanston* does manage to navigate the complex system set up by this remedy without violating the order, there are several practical and legal issues raised by the Commission's order. On the practical side, how will the merged entity manage its finances, including budgets? Legal issues include whether even with separate negotiating

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<sup>3</sup> General Motors Corp. et al., 103 F.T.C. 374 (1984).

<sup>4</sup> See, e.g., Boeing Co., 123 F.T.C. 812 (1997); and Eli Lilly & Co., 120 F.T.C. 243 (1995).

<sup>5</sup> United States v. Morton Plant Health Sys., 1994-2 Trade Cas. (CCH) ¶ 70,759 (M.D. Fla. 1994).

<sup>6</sup> United States v. Morton Plant Health Sys., 2000-2 Trade Cas. (CCH) ¶ 73,034 (M.D. Fla. 2000).

teams, tacit coordination will occur, and whether conducting separate negotiations will in fact minimize the likelihood of a unilateral exercise of market power.

With respect to budgeting, how will the hospital system's financial team obtain information about the separately negotiated contracts? How will the hospitals have input into the budgeting process? Will the firewalls interfere with the system's ability to predict revenues and therefore create uncertainty about future its financial situation?

The structure Evanston plans to implement could allow system management to learn enough about the hospitals' contracting to permit the hospitals tacitly to coordinate their competitive conduct. For example, management will presumably need to engage in a dialogue with both hospitals about what revenues to expect for purposes of budgeting. This dialogue could provide input into what contract terms and prices are acceptable, even without specific instructions about the pricing contained in the independent contracts. It may be that the insights will affect the hospitals' negotiating strategies.

It is also not clear that the remedy will entirely diminish Evanston's ability to exercise market power unilaterally. The FTC's theory of the case was that Highland Park was the primary (if not the only) constraint on Evanston's ability to charge high prices to managed care plans. If that is the case, Evanston could theoretically seek high prices from managed care plans, knowing that if the plans did not accept those prices, their patients would go to Highland Park instead and the revenues would remain in the system.

There is certainly room in merger enforcement for remedies that are short of divestiture. For example, there are numerous state attorney general consent decrees in

hospital merger cases that govern post-merger conduct without requiring divestiture.<sup>7</sup> It remains to be seen whether the FTC's novel remedy in the *Evanston* case will work.

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<sup>7</sup> See, e.g., *State of Wisconsin v. Kenosha Hospital and Medical Center*, 1997-1 Trade Cas. (CCH) ¶ 71,669 (E.D. Wisc. 1997); *Commonwealth of Pennsylvania v. Capital Health System Services*, 1995-2 Trade Cas. (CCH) ¶ 71,205 (M.D. Pa. 1995).