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I. INTRODUCTION

A recent Ninth Circuit ruling holding that the merger of St. Luke's Health System, a not-for-profit health care system operating seven hospitals throughout Idaho, and Saltzer Medical Group, the largest independent multi-specialty physician group in Idaho, violated Section 7 of the Clayton Act has garnered much attention in the health care industry. Two main areas of debate have emerged since the ruling came down in February 2015: (i) the role of efficiencies arguments in merger analyses and (ii) the compatibility of the Affordable Care Act with classic antitrust laws.

II. THE TRIAL

The case, *St. Alphonsus Medical Center, et al. v. St. Luke's Health System, et al.*, concerns St. Luke's 2012 acquisition of Saltzer. The District Court initially denied a preliminary injunction to block the $16 million deal brought by two rival hospitals, St. Alphonsus Medical Center and Treasure Valley Hospital. After the Federal Trade Commission ("FTC") and the Idaho attorney general joined the suit in March 2013, however, the Court concluded that the acquisition violated the Clayton Act and the Idaho Competition Act, and ordered divestiture.

The FTC maintained that the joining of St. Luke's eight adult primary care physicians ("PCPs") in Nampa, Idaho, with Saltzer's 16 Nampa PCPs would result in a reduction of competition between St. Luke's and Saltzer in the market for adult primary care in a single city, Nampa, Idaho. According to the FTC's complaint, those 24 PCPs gave St. Luke's nearly 80 percent of the Nampa market for adult primary care, which would allow the merged entity to command higher reimbursement rates from health insurance plans and increase costs to consumers. The FTC also alleged that the merged entity could charge higher prices for ancillary services, such as x-rays and diagnostic tests.

St. Luke's and Saltzer, in contrast, argued that the merger would benefit patients by creating a team of employed physicians with access to the electronic medical records system used by St. Luke's. Moreover, they argued that the transaction was in line with the federal policy articulated in the Patient Protection and Affordable Care Act ("ACA"), which encourages creating large, integrated physician-hospital networks to reduce the cost of health care.

After a 19-day bench trial, Judge B. Lynn Winmill of the U.S. District Court in Idaho ruled in favor of the FTC and the State of Idaho. Defining the relevant market as adult primary care and the geographic market as Nampa, Idaho, Judge Winmill agreed with the plaintiffs that the merged entity would control 80 percent of services in that market and, consequently, would

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have the ability to increase prices for health insurance plans and ancillary services. The judge also rejected defendants' proposal that the Court require St. Luke's and Saltzer to negotiate separately with third-party payers to alleviate concerns over bargaining power. Instead, the Court ordered divestiture.

Although the District Court found that the merger would eventually "improve the delivery of health care" in the Nampa market, it found that St. Luke's anticipated efficiencies were insufficient to carry its burden of rebutting the plaintiffs' *prima facie* case. Indeed, the District Court found that the efficiencies touted by St. Luke's were not "merger specific." The Court found that the same positive outcomes could be realized through other means—though not identified by the Court—that "do not run afoul of the antitrust laws and do not run such a risk of increased costs."

III. THE APPEAL

St. Luke's and Saltzer appealed the District Court's order to the U.S. Court of Appeals for the Ninth Circuit, reiterating that the merger would allow for improvement in "the quality of healthcare and [a] move to a value-based rather than volume-based system of payment for services—in accord with federal policy as reflected in the Affordable Care Act." They identified several errors:

1. A lack of evidence of anticompetitive effects.
2. That the lower court should have been required to assess whether the anticompetitive effects were outweighed by the pro-competitive benefits that it acknowledged the transaction would produce.
3. The District Court wrongly imposed a burden on St. Luke's to prove that the merger's efficiencies could not have been accomplished in a less restrictive way.
4. There was an issue with the framing of the geographic market.
5. The divestiture was too extreme a remedy.

The Ninth Circuit affirmed the District Court's opinion. It saw no reason to disturb the lower court's conclusion that "St. Luke's would likely use its post-merger power to negotiate higher reimbursement rates from insurers for primary care services." It also agreed with the District court's framing of the geographic market, and disagreed with St. Luke's assertion that the District court erred in ordering divestiture.

Notably, the Ninth Circuit found insufficient evidence in the record to support the District Court's finding that the merger could lead to higher rates for ancillary services. Nonetheless, the Ninth Circuit affirmed the District Court's ruling that the FTC had established a *prima facie* case with respect to the merged entity's increase in market power in the PCP market and likely anticompetitive effects of higher reimbursement rates and costs to consumers.

The Ninth Circuit's rejection of St. Luke's efficiencies defense has resulted in vigorous debate among antitrust counsel, health care practitioners, and academics. On appeal, St. Luke's repeated the argument that the merger would benefit patients by, for example, creating a team of physicians with access to St. Luke's electronic medical records system. The panel agreed with the District Court that these efficiencies were not specific to the merger; such tools are also available

to independent physicians. It asserted that "[i]t is not enough to show that the merger would allow St. Luke's to better serve patients," noting that the District Court "did not find that the merger would increase competition or decrease prices."

Even if the claimed efficiencies had been merger-specific, the Ninth Circuit concluded that the defense would fail nonetheless. The panel said appellants would have to prove that the acquisition would not hurt competition, which they did not do. According to the Court, an anticompetitive merger cannot be excused "simply because the merged entity can improve its operations."

IV. PETITION FOR *EN BANC* REHEARING

St. Luke's and Saltzar asked the Court to rehear the case *en banc*, pointing to three main errors in the Ninth Circuit's opinion. First, they argued that the panel did not give appropriate weight to the merger's positive effects on the quality of health care. Second, they contended that the panel adopted an improper methodology for determining the relevant geographic market. Lastly, they maintained that portions of the opinion were internally inconsistent and suggested that the panel misunderstood the District Court's decision. The Ninth Circuit denied the petition for rehearing *en banc* on April 21, 2015.

Notably, St. Luke's and Saltzer's petition for rehearing *en banc* was backed by 17 antitrust professors and the International Center for Law and Economics, which filed an *amicus brief* in support of the *en banc* petition. The professors argued that many of the panel's positions were at odds with the Horizontal Merger Guidelines and rulings in other circuit courts. They noted that the Ninth Circuit's opinion would ultimately make consumers worse off by preventing beneficial mergers.

The *amicus brief* took particular aim at the panel's treatment of the efficiencies defense. The professors argued that the decision "will signal to market participants that the efficiencies defense is essentially unavailable in the Ninth Circuit, especially if those efficiencies go towards improving quality." They expressed concerns that companies contemplating an efficient merger might choose to abandon the transaction—even if it promotes consumer welfare—for fear that an efficiencies defense would be rejected.

The professors further argued that the Ninth Circuit incorrectly assumed that price effects are the only cognizable efficiencies. Rather, the professors said that courts assessing efficiencies must consider the quality of the products in question. The "relevant concept is *quality-adjusted price*, and a showing that a merger would result in higher product quality at the same price would certainly establish cognizable efficiencies."

In addition to criticizing the panel's position on the efficiencies defense, the professors argued that the ruling discourages health care integration—which the District Court specifically recognized is necessary to improve health care in this country. Indeed, the District Court noted that the merger would have improved and shifted health care in Idaho to a model focused on population health rather than fee-for-service. The professors argued that, as a result of the opinion, "both patients and payors will suffer in the form of higher costs and lower quality of care." "This can't be—and isn't—the outcome to which appropriate antitrust law and policy aspires," the professors declared.

V. CAN AN EFFICIENCIES DEFENSE EVER SUCCEED?

As the *amicus brief* demonstrated, there is a great deal of debate surrounding the efficiencies defense. The ruling in this case shows that merging parties relying on an efficiencies defense—not just hospitals and physician groups in the health care industry—face high hurdles. There is even uncertainty as to whether such a defense is available at all.

The Merger Guidelines were revised in 1997 to strengthen the role of efficiencies. The Guidelines were expanded to specify that, in addition to lower price, other efficiencies to consider when analyzing a merger include "improved quality, enhanced service, or new products." However, no antitrust defendant to date has successfully used an efficiencies defense to rebut a *prima facie* case of anticompetitiveness.

The St. Luke's case presented ideal circumstances for increasing the weight given to efficiencies. The current health care climate following the passage of the ACA encourages reform and integration by health care practitioners. Even the district judge acknowledged that the merger was an attempt "to assemble a team committed to practicing integrated medicine in a system where compensation depended on patient outcomes." Moreover, many commentators have observed that the merger here may have been the best way to achieve integration. After all, Saltzer had repeatedly attempted and failed to integrate through less-formal affiliations.

The Ninth Circuit's rejection of the efficiencies defense in the context of this merger challenge has led some observers to proclaim the ruling as a sign that the efficiencies defense is dead. The Court noted at the outset of its efficiencies analysis that the U.S. Supreme Court has never expressly recognized the efficiencies defense for Clayton Act §7 claims. Citing Judges Robert Bork and Richard Posner, the panel said it was "skeptical about the efficiencies defense in general and about its scope in particular." It said it would be difficult for any defendant to rebut a *prima facie* case of anticompetitive effects with an efficiencies defense.

Although the ruling shows that success based on an efficiencies defense is an uphill battle, there are a few takeaways for litigants relying on this argument. First, it is important to identify efficiencies that can only be achieved through the merger in question. Recall that here the centralized electronic records system was not enough, because independent physicians not subject to the merger could also access such tools. Second, antitrust defendants should explain how and why the merger will benefit consumers, with a particular focus on the increased competitive benefits and cost savings the deal would generate. The Ninth Circuit gave the example of a merger between two small companies in order to match the prices of a large rival or combine complementary assets to compete more effectively. Third, litigants must be prepared to show the court why a merger is the least restrictive method for achieving any touted benefits.

Perhaps, however, the place for efficiency arguments after the *St. Luke's* ruling is at the agency level. As University of Michigan antitrust professor Daniel Crane wrote in his 2011 article *Rethinking Merger Efficiencies*, although "efficiencies arguments are seldom dispositive" for antitrust agencies, the agencies are "significantly more receptive to efficiencies claims than they were a decade ago." Moreover, in June 2014, Director of the Bureau of Competition Deborah Feinstein wrote that the FTC will "carefully consider evidence that [a] transaction will benefit consumers through improved quality, new services and/or decreased costs" in "every investigation of healthcare provider transactions." Thus, merging entities are likely to have better

luck winning approval through efficiencies at the agency level rather than battling it out in court after the FTC has already made a *prima facie* case of anticompetitive effects.

VI. CONFLICT BETWEEN ANTITRUST LAW AND THE ACA

In addition to testing the strength of the efficiencies defense in general, this case highlights the tension between health care reform and antitrust enforcement. One of the core goals of the ACA is a health care system that provides better care at a lower cost. To meet this goal, many health care systems across the country have acquired medical groups. This case is the first FTC challenge to such a merger since the passage of the ACA. As it made its way through the courts, observers watched closely to see whether courts would allow greater consolidation in health care to achieve the integrated care mandated by the ACA.

There is little dispute that large, integrated physician-hospital networks can reduce the cost of health care and improve care, leading to a value-based rather than volume-based system. This is precisely what St. Luke's and Saltzer argued in defense of their merger. Indeed, St. Luke's president and CEO Dr. David C. Pate said in a company statement that what was at stake in the appeal was the ability to create integrated health systems in small and midsize markets,

> in order to improve the quality of health care and move to a value-based system of payment for services that will improve health, allow for new and better models of care, expand access to patients on Medicare and Medicaid, and lower the overall costs of care—a move that is encouraged and promoted by the Affordable Care Act.

FTC commissioner Julie Brill countered that there are many ways to achieve integration and that the ACA is not a "free pass" to a merger challenge. The Ninth Circuit apparently agreed and stated that its role was simply "to determine whether this particular merger violates the Clayton Act"—"not to determine the optimal future shape of the country's health care system."

The bottom line? Health care providers considering mergers to meet the ACA's goals of integration must still play by classic antitrust rules.