HEALTHCARE MERGERS: FOUR KEY PIECES OF EVIDENCE USED TO PREDICT THE FUTURE

BY DAVID DAHLQUIST, LAURA GREENSPAN, LEIGH OLIVER & KIMBERLY RANCOUR [1]




"It's tough to make predictions, especially about the future." - Yogi Berra

I. INTRODUCTION

Most merger challenges are an effort to predict the future.[2] Both sides put forward their vision of the future, and then argue why their predictions are more likely to be accurate than their opponents' predictions. Parties in litigation use a variety of evidence in an attempt to persuade courts that their vision of the future is correct. This paper will focus on the types of evidence that have played a critical role in recent healthcare merger challenges: (1) customer testimony; (2) internal party documents, (3) economic evidence, and (4) third party testimonial or documentary evidence. However, history has shown that not all evidence is created equal. Evidence that was routinely used and highly valued over the past decade — internal company documents — was all but absent from the most recent merger decisions. The recent decisions largely focused on customer and competitor testimony. Before discussing the different types of evidence, we lay out an overview of the merger review process to set out the context for how evidence is developed during government investigations before litigation, and then during the discovery process leading up to a preliminary injunction hearing or merits trial.

II. MERGER CHALLENGES BACKGROUND

Federal government challenges to proposed mergers are brought under Section 7 of the Clayton Act, 15 U.S.C. § 18, which states: "No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share . . . where . . . the effect of such acquisition may be *substantially to lessen competition*, or to *tend to create a monopoly*." (emphasis added). Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), states that whenever the Federal Trade Commission ("FTC") has reason to believe that any entity is violating, or is about

1 David Dahlquist is a partner and Laura Greenspan is an associate at Winston & Strawn LLP in Chicago, Illinois. Leigh Oliver is a partner and Kimberly Rancour is a senior associate at Hogan Lovells in Washington, D.C. All four represented defendants in *FTC v. Advocate Health Care Network*, 841 F.3d 460, 475 (7th Cir. 2016).

2 However, most merger challenges occur prior to consummation of the transaction or prior to the consolidation of merging parties' businesses. More rarely, challenges are brought to mergers retrospectively in which case actual evidence of the effects of the merger may be available.

to violate, any provision of any law enforced by the FTC, and that enjoining the proposed merger "would be in the interest of the public," the FTC may bring suit in a federal district court to enjoin the proposed merger.

In addition to the FTC, the U.S. Department of Justice ("DoJ") has authority to challenge these mergers. Although there is no written rule on who has jurisdiction over hospital mergers and health plan mergers, the recent hospital merger challenges have been brought by the FTC, whereas the recent health insurance merger challenges have been brought by the DoJ. State attorneys general often join the federal government in these actions pursuant to Section 16 of the Clayton Act, 15 U.S.C. § 26, though typically the FTC or DoJ has greater resources and experience to lead these investigations and litigation.

When the government challenges proposed mergers in federal court, it seeks a preliminary injunction ("PI") to temporarily block the parties from consummating the merger — though, practically, if the PI is granted, that typically causes the parties to abandon the merger (perhaps after an appeal). To obtain a PI, the government must meet the standard set forth in Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), which provides that a proposed merger may be enjoined "upon a proper showing that, *weighing the equities* and *considering the Commission's likelihood of ultimate success*, such action would be in the public interest." (emphasis added).

Courts assess Section 7 claims under a burden-shifting framework. First, the government must establish a *prima facie* case that the merger will be anticompetitive. If it does so, the burden shifts to the merging parties to rebut it. If they can do so, the burden of production shifts back to the government and merges with the ultimate burden of persuasion, which is incumbent on the government at all times.

III. PRE-LITIGATION SOURCES OF EVIDENCE

Much of the evidence relied on in merger challenges is developed long before the parties appear in court for a PI hearing. In accordance with the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18(a), merging parties must make an "HSR" filing if they meet certain thresholds regarding the value of the transaction or the size of the merging parties. If the HSR filing causes the FTC or DoJ to be concerned about possible anticompetitive effects of the merger, it will serve a "Second Request" on the parties. A Second Request is a lengthy, extremely burdensome request for the production of (often hundreds of thousands of) documents, data and interrogatory responses. Once a Second Request is issued, the parties must substantially comply with the request in order to trigger the FTC or DoJ timing parameters to conclude the investigation.

During the FTC's investigation of the 2015 proposed merger between Advocate Health Care Network and NorthShore University HealthSystem in the Chicago area, for example, NorthShore and Advocate produced over 500,000 documents in response to the Second Request. The FTC also takes "Investigational Hearings" ("IHs" — which are similar to depositions) of the parties' executives in order to gather even more information. In the *Advocate/NorthShore* merger investigation, for example, 14 of the parties' executives sat for IHs in the FTC's Washington, D.C. offices over the course of approximately a one month period. As the FTC or DoJ staff gathers evidence from the transaction parties during the investigation process, they also seek information from third-parties, including customers, competitors and others. This evidence gathering may include procuring declarations in support of the government's position or taking IHs of these third-parties. In the *Advocate/NorthShore* investigation, the FTC procured 17 declarations from payers, competitor hospitals and Chicago-area employers. Additionally, during an investigation, the parties may offer advocacy work in the form of presentations, white papers and letters or declarations procured from third-parties that are supportive of the proposed transaction.

The FTC's and DoJ's evidence-gathering ability during the HSR investigation period is very one-sided because they have the ability to compel evidence and testimony from the parties and third-parties, whereas the transaction parties do not. The FTC staff, taking into account the evidence gathered from all of these sources, makes a recommendation to the Bureau Directors, who then make recommendations to the Commission itself. A vote of the majority of the Commission (typically a panel of five) is required to challenge a proposed merger in federal court and/or through administrative proceedings before an FTC administrative law judge ("ALJ"). At the DoJ, a recommendation from the investigating staff is made to their management

and the ultimate decision to challenge is made by the Assistant Attorney General for the Antitrust Division.

IV. LITIGATION SOURCES OF EVIDENCE

If the government files a lawsuit seeking a PI and the parties intend to pursue a defense, a fast and furious discovery process immediately kicks off, with both sides requesting and producing documents and taking depositions in a very short timeframe. The district court cases involving the proposed mergers between *Anthem/Cigna* and *Aetna/Humana* were completed in about six months. In the FTC's challenge to the proposed merger of Penn State Hershey Medical Center and PinnacleHealth, the parties likewise conducted expedited discovery, had a five-day evidentiary hearing with 16 witnesses, and thousands of pages of exhibits admitted into evidence. In the *Advocate/NorthShore* challenge, the FTC filed its complaint in late December 2015; fact discovery closed at the end of February 2016; expert discovery closed at the end of March; PI motion briefing was also completed by the end of March; and a nine-day trial began in mid-April 2016. During this less-than-five-month process, Advocate and NorthShore produced another 10,000-plus documents beyond the hundreds of thousands produced during the investigation; third-parties produced almost 100,000 documents; the FTC itself produced almost 3,000 documents; 40 party and third-party depositions were conducted over the course of about two months; nine expert depositions took place over a one-week period; and the court heard live testimony from nine fact and six expert witnesses. As is apparent from the timelines detailed above, the discovery process in merger challenges is fast paced and intense.

As alluded to above, the FTC has a separate venue in which, concurrent with the federal court proceedings, the FTC can file a complaint with the FTC itself, setting off an administrative litigation process pursuant to Sections 7 and 11 of the Clayton Act, Section 5 of the FTC Act, and the Commission's Rules of Practice. This "Part III" administrative litigation provides a forum for all parties to conduct discovery (which is largely duplicative of the federal district court discovery), followed by a merits trial with up to 210 hours of live testimony. The decision of the ALJ is subject to review by the full Commission and the Commission's decision is appealable to a federal Court of Appeals. In most cases, the ALJ will stay the Part III litigation for some period of time to allow the PI case to be heard in federal court.

Several different types of evidence are gathered from various sources during discovery and can be used during the PI hearing. Section 2 of the DoJ's and FTC's Horizontal Merger Guidelines discusses economic evidence, as well as evidence from the merging parties and customers in the pertinent industry. The following section addresses the value placed on each of the different types of evidence used in recent health care merger-related PI hearing.

V. TYPES OF EVIDENCE

A. Customer Testimony

The importance of customer testimony originates in Section 2.2 of the DoJ's and FTC's Horizontal Merger Guidelines: "The Agencies consider many sources of evidence in their merger analysis. The most common sources of reasonably available and reliable evidence are the merging parties, *customers*, other industry participants, and industry observers." (emphasis added). In the most recent merger challenges, customer testimony has been put toward the top of the list of evidence that ultimately was relied on by courts.

In hospital merger cases, the FTC and the courts have long considered insurers to be "customers" of healthcare services. The Seventh Circuit recently affirmed that view, holding that "insurers [not patients] are the most relevant buyers" of hospital services.[3] The Seventh Circuit cited a range of insurer testimony in its opinion reversing the district court's denial of a PI against Advocate and NorthShore. For example, when addressing the contours of the relevant geographic market, it noted that insurers "unanimously" testified "an insurer's network must include either Advocate or NorthShore to offer a

3 *FTC v. Advocate Health Care Network*, 841 F.3d 460, 475 (7th Cir. 2016).

product marketable to employers."[4] Even so, four of the six largest Chicago area payers testified that they supported the merger between Advocate and NorthShore. However, on remand, the court found that support "was equivocal, unenthusiastic, and without a factual basis."[5] Throughout the litigation, the hospitals argued that some insurers saw their proposed merger as a threat to their own business and, therefore, to the extent insurers opposed the merger, they had their own competitive reasons for doing so. On remand, the Northern District of Illinois acknowledged these arguments, but ultimately found them unpersuasive: "The [c]ourt shares some of defendants' concerns about the credibility of the insurers' testimony, which may indeed be self-serving, but even taking their testimony with a grain of salt, the record as a whole supports the view that insurers genuinely believe that a plan that excludes Advocate and NorthShore is not viable in the" FTC's proposed geographic market.[6]

Payer testimony likewise played a role in the *Hershey/Pinnacle* litigation, as acknowledged by the Third Circuit: "The payors repeatedly said that they could not successfully market a plan in the Harrisburg area [the FTC's proposed geographic market] without Hershey and Pinnacle. In fact, one payor that attempted to do just that . . . lost half of its membership."[7]

Though not as significant as in the recent hospital merger cases, customer testimony was addressed in the litigation involving the proposed health plan merger between Anthem and Cigna. In that litigation, the DoJ and several states sought a preliminary injunction to block what would have been the industry's largest-ever, $54 billion combination. The DoJ alleged, and the district court found, that the relevant product market was the sale of health insurance to national accounts.[8] Large, national employers were cited for evidence supporting the alleged product market by showing that they "have a unique set of characteristics and needs that drive their purchasing processes and decisions."[9] There was also evidence that "the larger a company gets, and the more geographically dispersed its employees become, the fewer solutions are available to meet its network and administrative needs" — i.e. there is little room for other insurers to enter the national account market and alleviate the anticompetitive effects that would have resulted from the merger.[10] The district court granted the PI in February 2017, the D.C. Circuit upheld that decision in April 2017, and by May 2017, the parties had abandoned the deal.

B. Internal Party Documents

Under the Merger Guidelines, internal documents are one among "many sources" used by the government to evaluate a proposed merger. "Documents created in the normal course are more probative than documents created as advocacy materials in merger review."[11] Additionally, documents reflecting certain types of competitive effects are considered "highly informative in evaluating the likely effects of a merger."[12] For example, documents showing "that the merging parties intend to raise prices, reduce output or capacity, reduce product quality or variety, withdraw products or delay their introduction, or curtail research and development efforts after the merger" are considered especially probative.[13] Documents showing that "the ability to engage in such conduct motivated the merger" are also considered "highly informative."[14]

4 Id. at 474.

5 *FTC v. Advocate Health Care Network*, No. 15 C 11473, 2017 WL 1022015, at *11 (N.D. Ill. Mar. 16, 2017).

6 Id. at *5.

7 *FTC v. Penn St. Hershey Med. Ctr.*, 838 F.3d 327, 343 (3d Cir. 2016).

8 *United States v. Anthem, Inc.*, No. 16–1493, 2017 WL 685563, at *19 (D.D.C. Feb. 21, 2017).

9 Id. at *1.

10 Id. at *2.

11 Id. at § 2.2.1.

12 Id.

13 Id.

14 Id.

The same types of documents are considered significant in the litigation context, particularly in earlier cases involving hospital merger challenges. And it is not uncommon for the litigation record to include thousands of internal documents from the parties.[15] For example, in *In re Evanston Northwestern Healthcare Corp.*, a case challenging the consummated merger of Evanston Northwestern Healthcare Corporation and Highland Park Hospital, the Commission pointed to the parties' internal documents as corroborating evidence that the merger had led to higher prices.[16] In concluding that the merger violated Section 7 of the Clayton Act, the Commission found that "the merging parties' documents reflect that a primary motivation of the senior officials in agreeing to merge the hospitals was to increase their bargaining leverage with MCOs in order to raise prices."[17] In finding as such, the Commission pointed to board meeting minutes in which one of the merging hospitals stated that the merger was an opportunity to "strengthen negotiation capability with managed care companies through merged entities" and not to "'compete with self' in covered zip codes."[18] In another document, a hospital executive told his board that the merger would "[i]ncrease our leverage, limited as it might be, with the managed care players and help our negotiating posture."[19]

In 2012, the Commission blocked another hospital merger in which the merging parties' internal documents corroborated evidence of anticompetitive effects.[20] The Commission found documents that not only undercut defendants' failing competitor defense, they showed that the merger was motivated by greater bargaining leverage and higher rates.[21] By way of example, a presentation regarding the potential merger stated: "An SLH affiliation with ProMedica has the greatest potential for higher hospital rates. A ProMedica-SLH partnership would have a lot of negotiating clout."[22] The same presentation also expressed concern that the merger would "harm the community by forcing higher hospital rates on them."[23]

These types of documents speculating about anticompetitive effects are noticeably absent from more recent cases enjoining proposed hospital mergers. For example, in *St. Alphonsus Medical Center-Nampa, Inc. v. St. Luke's Health System, Ltd.*, only one document is cited as evidence that the merged hospitals would use increased bargaining leverage to increase prices.[24] That document involved discussions about "pressur[ing] payors for new direct agreements" and using "the clout of the entire network" to negotiate favorable reimbursement rates.[25]

Documents played an even smaller role in *Advocate*. On remand, the district court makes only one reference to internal documents that contained maps, which the court said: "show[ed] that Advocate and NorthShore are close competitors who dominate the North Shore Area."[26] Unlike earlier hospital mergers that had been enjoined, the court's anticompetitive effects analysis did not depend, even in part, on documents showing the intent or potential for increased bargaining leverage or higher prices. Instead, the document cited by the district court contained information that could have been measured by economic data, and thus they arguably did not add anything to the government's case.

---

15 See, e.g. *In re Evanston Nw. Healthcare Corp.*, 2007 WL 2286195, at *3 (more than 1,600 exhibits); *FTC v. OSF Healthcare Sys.*, 852 F. Supp. 2d 1069, 1072 (N.D. Ill. 2012) (more than 2,000 exhibits). While not all of these documents are internal to the parties, and not all critical to the ultimate decision, the volume of exhibits entered into evidence highlights the significance of documentary proof in merger cases.

16 2007 WL 2286195, at *54 (F.T.C. Aug. 6, 2007).

17 Id.

18 Id. at *10.

19 Id.

20 See *In re ProMedica Health System, Inc.*, 2012-1 Trade Cases P 77840 (F.T.C.), 2012 WL 1155392, at *30-*31 (Mar. 28, 2012).

21 Id. at *39.

22 Id. at *11.

23 Id.

24 778 F.3d 775, 787 (9th Cir. 2015).

25 Id.

26 *Advocate Health Care Network*, 2017 WL 1022015, at *6-*9.

Similarly, in *Hershey*, the Third Circuit decided to block the merger of two hospital systems without citing to a single contemporaneous business document from the parties.[27] The recent decisions in *Advocate* and *Hershey* suggest that the government can prevail even in the absence of documents from the parties' that support the competitive effects theory of the case.

C. Economic Evidence

Under the Merger Guidelines, economic evidence also plays an important role in evaluating the legality of a proposed merger. As the Guidelines state: their "unifying theme" is that "mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise."[28] "A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives."[29] Accordingly, in evaluating anticompetitive effects, the Merger Guidelines call for looking at different types of evidence, including among other things, market share, market concentration, ease of market entry, market expansion and whether the merger will eliminate head-to-head competition.[30]

In particular, the hypothetical monopolist test is used to define the relevant product market and the relevant geographic market. Under this test, a region forms a relevant geographic market if a hypothetical monopolist is able to profitably impose a Small But Significant and Non-Transitory Increase in Price ("SSNIP"). That is, if a hypothetical monopolist can raise prices without losing customers to sellers outside of the proposed region, then that area is a relevant geographic market.[31]

The economic theory underlying the hypothetical monopolist test was addressed in two recent hospital merger cases, *Hershey* and *Advocate*. In both cases, the relevant product market was not in dispute, but the relevant geographic market was.

In *Hershey*, the district court denied the government's motion for preliminary injunction after finding that it had alleged a geographic market that was too narrow to be viable. On appeal, the Third Circuit reversed after finding that the district court had failed to apply the appropriate economic theory.[32] While the district court identified the appropriate test — the hypothetical monopolist test — the Third Circuit found the district court's application of the test to be incomplete and erroneous because it more closely resembled the Elzinga-Hogarty test.[33] Though Elzinga-Hogarty, which focuses on patient flow data, was once considered the appropriate method by which to define the relevant geographic market in hospital cases, the Third Circuit found the test to be "unreliable" because of its analytical shortcomings, including (1) "the silent majority fallacy" and (2) its failure to account for the payer as the customer, i.e. the "payer problem."[34]

As the Third Circuit explained in *Hershey*: "'The silent majority fallacy is the false assumption that patients who travel to a distant hospital to obtain care significantly constrain the prices that the closer hospital charges to patients who will not travel to other hospitals.'"[35] The payer problem, on the other hand, refers to the perceived disconnect between patient flow data and the hypothetical monopolist test in hospital merger cases.[36] Because healthcare is sold in a two-stage process (the first step being competition among hospitals to be included in a payer's network), the appropriate question under the hypothetical

27 See generally 838 F.3d 327.

28 Id. at 2.

29 Id.

30 Id. at 3-4.

31 Id. at 14-15.

32 838 F.3d at 336.

33 Id.

34 Id. at 340-341.

35 Id. at 340 (quoting *In re Evanston Nw. Healthcare Corp.*, 2007 WL 2286195, at *64).

36 Id. at 342-43.

monopolist test is how a *payer*, not a patient, would respond in the face of a SSNIP.[37] This is because insurers negotiate directly with providers for the price of services and then, once those rates are set for the payers' membership, those prices do not adjust depending on whether fewer or substantially more patients utilize the provider's services.

In *Advocate*, the Seventh Circuit similarly reversed and remanded on the district court's determination that the government had failed to properly define the relevant geographic market. In doing so, the Seventh Circuit criticized the district court's opinion in several respects. For example, the Seventh Circuit rejected the district court's conclusion that there was "no economic basis" for distinguishing between academic medical centers and community hospitals.[38] The Seventh Circuit also rejected the district court's determination that the evidence was "equivocal" with respect to whether patients generally choose hospitals close to home.[39] The Seventh Circuit also sharply criticized the district court for focusing on patients as the relevant buyers, instead of insurers.[40] In this regard, the Seventh Circuit took issue with the district court's reliance on diversion ratios, which measure patient choice among hospitals, not the hospitals' market power over insurers or the testimony of insurers as discussed above. Economic evidence has always been important in merger challenges, but has taken an even more significant role in the most recent challenges.

With respect to the proposed merger between Aetna and Humana, the DoJ and several states sought a preliminary injunction to block the health insurers from consummating their $37 billion deal. This was the first time the DoJ had sought to block a health insurance merger. The district court enjoined the transaction in January 2017, resulting in the parties abandoning the deal. In that litigation, the main source of evidence regarding the nature and extent of the parties' competition was economic evidence and party documents, rather than evidence from the perspective of consumers.[41]

D. Other Evidence

Other third-party witness testimony: Both the government and the transacting parties have recently used other third-party witness testimony in PI hearings, as well, including evidence from competitor hospitals and area employers. In the challenge to a 2012 merger between a healthcare system and a multi-specialty physician group in Nampa, Idaho, by the FTC, Idaho Attorney General and local competitor hospitals, the merging parties relied on evidence from a local employer in an attempt to show the plaintiffs' proposed geographic market was improperly narrow and should include areas outside just the city of Nampa. Specifically, the merging parties offered extensive evidence that a Boise employer, Micron, created a healthcare plan with cost differentials that caused a substantial portion of Micron's employees, who reside in Nampa, to switch to non-Nampa providers. The merging parties argued this evidence proved that Nampa residents would travel beyond Nampa if the transaction resulted in higher prices — disproving that Nampa was the relevant geographic market. The district court did not find this argument persuasive because the employees' cost-differentials were much higher than are needed for the SSNIP test and because, although Micron employees traveled to non-Nampa providers, this did not mean that other Nampa residents would travel beyond Nampa for primary care services. The Ninth Circuit did not find clear error in the district court's findings on this point.[42]

Other non-economic experts: In addition to economic experts, both the government and the merging parties have increasingly relied on "quality" or "efficiencies" experts, whose expertise has been particularly useful during the government investigations into the mergers. In recent litigated cases, however, the utility of quality and efficiencies experts has been limited: once the presumption shifts to the parties to rebut the *prima facie* case of anticompetitive effects, courts have been reluctant to find that the proposed efficiencies overcome that presumption. For instance, the Ninth Circuit in *St. Luke's*, the

37 Id.

38 *Advocate Healthcare Network*, 841 F.3d at 467.

39 Id. at 474.

40 Id. at 475-77.

41 See *United States v. Aetna Inc.*, No. 16-1494, 2017 WL 325189, at *12-13 (D.D.C. Jan 23, 2017).

42 *St. Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775, 785 n.11 (9th Cir. 2015).

Northern District in *Advocate* and the Third Circuit in *Hershey* found the alleged efficiencies were insufficient to overcome the presumption in favor of the FTC that the merger would have anticompetitive effects.[43]

VI. CONCLUSION

Recent cases confirm that not all evidence is created equal in merger challenges. Nor are the merging parties on equal footing with the government when a challenge is lodged. One could argue that the government has an advantage during the investigation process particularly because it is able to use compulsory process not only with the parties, but with third-party customers and competitors. Accordingly, the merging parties should consider building evidence during the investigation with these same types of third parties if possible, but also must be ready to move quickly to develop the facts and strategy of their defense if they anticipate that a complaint may be filed. In doing so, the parties should be mindful of the range of evidence that will be persuasive to the court, including testimony given during the investigation phase, customer testimony and economic analysis. In most cases, no one piece of evidence or category of evidence is determinative of the outcome of the case, but when taken together should provide the best predictor of the impact of a merger on future competition.

43 See St. *Luke's Health Sys., Ltd.*, 778 F.3d at 785; *Advocate Healthcare Network*, 2017 WL 1022015, at *14-16; *Penn St. Hershey Med. Ctr.*, 838 F.3d at 349-51.