Bloomberg BNA

BNA's
Health Law Reporter™

Antitrust

In Win for FTC, Unanimous High Court Finds No State Action Immunity in Hospital Merger

The acquisition of Palmyra Park Hospital in Albany, Ga., by Phoebe Putney Health System (PPHS) was not immune from antitrust scrutiny under the state action doctrine, the U.S. Supreme Court ruled Feb. 19 (*FTC v. Phoebe Putney Health System Inc.*, U.S., No. 11-1160, 2/19/13).

In what antitrust attorneys said is a significant victory for the Federal Trade Commission, the high court found the doctrine did not apply because the Georgia Legislature did not ''clearly articulate and affirmatively express a public policy to displace competition'' for hospital services when it adopted a law giving county hospital authorities the power to acquire area hospitals.

The Supreme Court ruled, in a unanimous decision authored by Justice Sonia Sotomayor, that the general grant of corporate power that allowed the authority to acquire hospitals was insufficient to confer antitrust immunity. The court reiterated its guiding principle that state-action immunity is disfavored and ruled that antitrust immunity is available only where the authority to displace competition ''was the inherent, logical, or ordinary result of the exercise of authority delegated by the state legislature.''

Robert F. Leibenluft, with Hogan Lovells, Washington, called the ruling ''a big victory'' for the FTC.

''The FTC will be pleased not only with the fact that this was a unanimous decision, but also with the Court's reaffirmation that state-action immunity should be disfavored in light of the 'essential national policies' underlying federal antitrust laws,'' Leibenluft added.

Arthur N. Lerner, with Crowell & Moring LLP, in Washington, said the high court went back to the roots of its state action jurisprudence in holding that there must be an affirmative policy for state action immunity to apply. ''It seems entirely logical—afterwards—that the decision to apply the doctrine narrowly would be unanimous given that this case involves *whether* antitrust laws apply rather than *how* they should be applied,'' he said.

Thomas Chambless, a Phoebe Putney Health System senior vice president and the system's general counsel, told BNA Feb. 20 that the system ''does not intend to fold its tent'' in the wake of the high court's decision. ''There is going to be an ongoing, adversarial process in which we intend to resist the FTC's attack on a merger that is working well to help the system meet the needs of the patients and communities it serves,'' he said.

Uphill Fight. In rejecting the appeals court's resolution of the state action immunity issue, the high court began by noting that immunity is disfavored because of ''the fundamental national values of free enterprise and economic competition that are embodied in the federal antitrust laws.'' It then noted that, although states are immune from federal antitrust scrutiny with respect to anticompetitive actions they take pursuant to regulatory schemes, state subdivisions or authorities must show that they are acting ''pursuant to a 'clearly articulated and affirmatively expressed' state policy to displace competition.''

In finding this ''clear articulation'' lacking, the high court focused on the acquisition and leasing powers given to hospital authorities under Georgia law and observed that those powers ''mirror general powers routinely conferred by state law upon private corporations.'' A state law authorizing a substate entity to act ''is insufficient to establish state-action immunity; the substate governmental entity must also show that it has been delegated authority to act or regulate anticompetitively,'' the court said.

''This is a very important antitrust decision that will have significant and long lasting implications.''

—J. Mark Waxman, Foley & Lardner LLP

Although the Georgia Legislature allowed the authority to acquire hospitals, it did not ''clearly articulate and affirmatively express a state policy empowering the Authority to make acquisitions of existing hospitals that will substantially lessen competition,'' the court said. The court rejected the appeals court's contrary conclusion, reasoning that it applied the concept of the foreseeability of anticompetitive actions ''too loosely.''

Saying it had historically adopted a practical approach to the clear-articulation inquiry, the court noted it has done so ''without diluting the ultimate requirement that the State must have affirmatively contemplated the displacement of competition such that the challenged anticompetitive effects can be attributed to the 'state itself.' '' In this case, there simply was insufficient evidence the state intended to allow anticompetitive conduct, the court concluded.

The court also turned aside the authority's claim that its activities should be viewed in the larger context of its obligation under state law to undertake those measures necessary to provide all of its residents with access to adequate and affordable health and hospital care. ''The

 ISSN 1064-2137

state legislature's objective of improving access to affordable health care does not logically suggest that the State intended that hospital authorities pursue that end through mergers that create monopolies,'' the court said.

''Nor do the restrictions imposed on hospital authorities, including the requirement that they operate on a nonprofit basis, reveal such a policy,'' the court added. ''Particularly in light of our national policy favoring competition, these restrictions should be read to reflect more modest aims.''

The decision reversed a December 2011 ruling of the U.S. Court of Appeals for the Eleventh Circuit. The appeals court found the merger of Phoebe Putney Memorial Hospital and HCA Inc.-owned Palmyra Park did not violate federal antitrust laws, even if the merged entity would result in a monopoly in the provision of hospital services in the area served by the former competitors, because the merger was consummated under the direction of the Hospital Authority of Albany-Dougherty County (20 HLR 1807, 12/15/11).

That decision affirmed a June 2011 trial court ruling that dismissed a complaint filed by the FTC and Georgia's attorney general and denied their motion for a preliminary injunction to stop the merger (20 HLR 1017, 7/7/11). Both courts found the anticompetitive conduct alleged by the FTC was a ''foreseeable'' result of the power to lease and acquire hospitals that was conferred on the authority by state law.

Oral arguments before the Supreme Court were held in November 2012 (21 HLR 1627, 11/29/12).

Significant Victory. Attorneys told BNA the Supreme Court's decision was a significant triumph for the FTC and, although not wholly surprising, was noteworthy because it was unanimous.

James M. Burns, with Dickinson Wright PLLC, in Washington, said that, ''while the ruling is not a big surprise, the fact that it was 9-0 is a surprise, and not what anyone likely would have anticipated based on the difficult questioning both counsel faced at oral argument.''

He said the decision likely will require state legislatures throughout the country to assess—or reassess—whether their intentions for subordinate governmental entities with respect to competition issues have been sufficiently expressed in their enabling statutes. ''Without clearly expressed intentions, many actions by such entities will now become subject to potential challenge,'' he said.

J. Mark Waxman, with Foley & Lardner LLP, Boston agreed. ''This is a very important antitrust decision that will have significant and long lasting implications,'' he said.

''By holding that state action immunity requires a 'clear articulation' of the desire to preempt, many actions by local governmental authorities my be subject to reexamination, and there may be a significant damper on 'public-private' transactions, in the health care field and elsewhere,'' he added.

Robert W. McCann, with Drinker Biddle & Reath LLP, Washington, agreed that the ruling, although not unexpected, is a significant victory for the FTC. ''I think there has always been a concern at the FTC with the possibility that hospitals would find ways to use the state action doctrine to end-run the Clayton Act—as was the perception with 'certificate of public convenience' laws,'' McCann said.

''However, I don't think the Supreme Court's result is at all that surprising given the disfavor into which the state action doctrine has fallen,'' McCann continued. ''I was always surprised that the 11th Circuit had come down in favor of the state action argument in this case because the Eleventh Circuit rejected a virtually identical argument in *FTC v University Health Inc.*, 938 F.2d 1206 (11th Cir. 1991), over 20 years ago,'' he added.

Leibenluft agreed. ''Over a very long time, the Commission has tried to circumscribe the reach of antitrust immunity under the state action doctrine, and especially high on its list was trying to overturn the more expansive view of the immunity under the Eleventh Circuit's decision in the Lee Memorial Hospital case [*FTC v. Hospital Board of Directors of Lee County*, 38 F.3d 1184 (11th Cir. 1994)], which the FTC lost almost 20 years ago.''

Clarity, Timing. Stephanie W. Kanwit, with Stephanie Kanwit LLC, Alexandria, Va., said the decision is important because of its clarity and timing. ''The Supreme Court opinion could not be clearer: it reiterates with sweeping rhetoric the principle that state-action immunity is disfavored—as the Department of Justice and FTC have been arguing for years—and outlines the numerous hurdles required to make a viable state-action claim,'' she said.

''The opinion also goes out of its way to re-emphasize that the antitrust laws apply with full force to the health care sector, which is critical now, with the exponential growth in accountable care organizations (ACOs) that have sprung up under the new health care law and the resulting concern with providers having excessive market power,'' Kanwit continued.

''Given that about two-thirds of ACOs have been sponsored by hospitals or hospital systems, the Phoebe Putney opinion sends a strong message that the provider consolidation inherent in ACOs must be carefully monitored to avoid possible anticompetitive effects that could result in higher prices (and lower quality) to payers and ultimately health care consumers,'' she concluded.

Douglas Ross, with Davis Wright Tremaine LLP, Seattle, said that, in the end, the court decided this potentially very complicated case in a simple way by determining that the Georgia statute did not clearly articulate and affirmatively express a policy to displace competition. ''The basis the Supreme Court chose to decide the case is the ground on which the Eleventh Circuit most clearly deviated from decisions in other circuits and so was the easiest basis on which the Court could reverse,'' he said.

''The FTC has been concerned for many years with the scope of the state action doctrine so, if the Supreme Court had ruled for the hospitals here, a great deal of the FTC's enforcement activity now would be slowed and thrown into question,'' Ross added.

Importance for Health Care. Attorneys agreed that the high court's ruling was extremely important for the FTC and health care sector.

Axel Bernabe, with Constantine Cannon LLP, New York, said the fact that this was a unanimous court delivering a victory to the FTC in a hospital merger case makes this an important win for the FTC. ''Historically the FTC has not had much luck in blocking hospital mergers, so this may just be the shot in the arm they need,'' he said.

  HLR ISSN 1064-2137

''Especially in the context of provider collaboration as ACOs, the FTC has been vocal of its concern about growing provider power. A loss in this case could have been used to immunize future mergers from scrutiny when one of the parties was a public entity,'' Bernabe continued.

''While the court has not really made new law, the decision may help put the brakes on a trend in hospital consolidation that concerns the FTC. Also, in the context of rolling out the Affordable Care Act, state governments will want to be very clear about when they are intending to displace competition and exert their state immunity rights,'' he added.

According to Ross, the decision is also important because it comes at a time when the hospital industry consolidation is occurring at a rapid pace. ''In some regions, consolidation has reached the point where any further consolidation likely will draw a challenge from the FTC,'' Ross said. ''If this decision had gone in favor of the hospitals, hospitals in those parts of the country where public hospitals exist would be at the drawing boards today designing creative ways to affiliate with those public hospitals to take advantage of their state action immunity.''

''This decision tells everyone that the ground rules have not changed. An affiliation with a public hospital can still be immune from the antitrust laws, but only if the affiliation occurs in a state where the law clearly contemplates that takeovers that might be anticompetitive can occur,'' he said.

''The FTC also will be encouraged by the court's rejection of the defendants' argument that, because the state authority is responsible for providing access to health care, it has the authority to do so in anticompetitive ways,'' Ross continued. ''This argument has been made by some proponents of the Affordable Care Act who assert that the act embodies a federal policy to promote access and the FTC should recognize this and give way when potentially anticompetitive mergers are proposed so long as those are consistent with the ACA's goals,'' Ross noted.

''The FTC has said repeatedly this is not the agency's view and the *Phoebe Putney* decision will give the agency more cover for that position as the court made clear that 'our national policy favoring competition' is not to be cast aside lightly,'' Ross said.

Ross said he thought it interesting that the Supreme Court never got to the issue that clearly agitated the FTC—the structure of the deal. ''The FTC felt the structure of the deal was a sham, but the Supreme Court didn't go there,'' he said. ''While inventive lawyers are going to continue to structure deals creatively, in the future they will need to select the jurisdictions where they do so more carefully.''

Next Steps? With respect to possible next steps, Lerner speculated that the Georgia Legislature may attempt to resolve the matter by passing a new law. Ross, in turn, predicted the FTC ''will seek full divestiture as the deal closed not just during the investigation but during the litigation of the matter.''

Leibenluft said that, although he could not predict what might happen on remand, if the hospitals decide to continue their fight, the FTC will have to show whether the transaction would substantially lessen competition or tend to create a monopoly. He noted that the FTC alleged a combined market share of 86 percent of the market for acute care hospital services provided to commercial health care plans in the six counties surrounding Albany, Ga.

Burns said the parties have a number of ''interesting'' options on remand. ''If the parties want to try to 'save' the deal, one would expect they will seek a legislative 'fix' rather than seeking to defend the transaction on the merits in the district court—particularly given that the lower court decisions all but state that if a challenge were permitted, the FTC would prevail,'' he said.

''But even a legislative fix may not suffice if it does not include clear language setting up an alternative to competition—as opposed to simply blessing the transaction—because the state, as the Supreme Court has now made even more clear, needs an alternative regulatory scheme that displaces competition,'' Burns said.

Challenged Conduct. The FTC and the Georgia attorney general challenged the de facto merger of the only two hospitals operating in Dougherty County as violative of Clayton Act § 7. The FTC argued that operation of Palmyra Park by PPHS, accomplished through a sale and lease-back arrangement set up through the local county hospital authority, created a monopoly and would severely lessen competition for hospital services in the local area.

PPHS arranged for the local hospital authority to purchase Palmyra and lease it back to PPHS when its negotiations with Palmyra's parent broke down. The FTC alleged that:

- PPHS provided the money for the purchase;
- an entity formed by PPHS to hold Palmyra's assets received control of Palmyra under a management agreement with the hospital authority immediately following the sale;
- all agreements, including a proposed 40-year lease at the rate of $1 per year, were prepared by PPHS; and
- the hospital authority approved the proposed transaction, unnegotiated, exactly as it was presented by PPHS.

Based on these facts, the FTC charged that Palmyra's sale to the hospital authority was a sham to shield the consolidation from antitrust scrutiny.

PPHS countered that it was itself created by the hospital authority to operate a hospital in Albany based on a 40-year, dollar-per-year lease. Characterizing the transaction as a simple attempt by the hospital authority to increase capacity and carry out its mission, PPHS argued that the state intended to empower hospital authorities to displace the market in exactly the way that the hospital authority had in this case.

The FTC was represented by Willard K. Tom, John F. Daly, and Imad D. Abyad, with the commission, and Donald B. Verrilli Jr., Sharis A. Pozen, Malcolm L. Stewart, and Benjamin J. Horwich, with the Department of Justice, Washington.

The hospitals and authority were represented by Seth P. Waxman, Edward C. DuMont, and Eric F. Citron, with Wilmer Cutler Pickering Hale and Dorr LLP, Washington; James E. Reynolds Jr., with Perry & Walters LLP, Albany, Ga.; and Thomas S. Chambless, with Phoebe Putney Health System Inc., also in Albany.

BY PEYTON M. STURGES

The court's decision is at http://op.bna.com/hl.nsf/r?Open=psts-953lr3. A transcript of the oral arguments is at http://op.bna.com/hl.nsf/r?Open=psts-92etrm.

  HLR ISSN 1064-2137