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Health Mergers May Face Antitrust Hurdles Amid Pandemic

By Kevin Hahm and Matthew Jenkins
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The economic effects of COVID-19 on every facet of American industry have been devastating, but perhaps none more profoundly than the health care industry.

Prior to COVID-19, we observed our largely privatized health care system migrate unevenly toward a value-based payment system away from fee-for-service medicine. But overnight, we transitioned to watching that system rapidly confront the compounding stressors of substantially increased demand for critical care inpatient capacity and the forced abandonment of the sustaining revenue streams from elective surgical procedures.

The impact of COVID-19 led hospitals to furloughing (or cutting back of hours) of hundreds of health care workers idled by the cessation of nearly all elective cases.[1] Rural hospitals are especially at risk.[2]

The combined effects on many health care delivery systems and physician groups has been the equivalent of a cash bonfire, causing even those with healthy balance sheets to spend down their days cash on hand to levels certain to challenge solvency.[3] The American Hospital Association estimates hospitals will lose $200 billion between March 1 and June 30.[4]

These entities face difficult choices for survival. Some providers that had historically valued independence may now see transactions with other health care systems as the only way to remain viable. Financially distressed providers may turn to reorganization through bankruptcy as a way to address their looming insolvency. If reorganization is unrealistic, some providers may find themselves a party to a transaction pursuant to a bankruptcy proceeding.

Among providers, perhaps the most financially stressed are physician groups that have seen revenues drop precipitously with little opportunity to regain ground lost over the past several months.[5] While some have called for a moratorium on provider mergers,[6] the stark reality may be that there are no better options for survival.

In the balance of this article, we explore the various antitrust issues arising from transactions that may be driven by providers' recent financial woes. We review the high standard for claiming the failing firm defense, the importance of meeting the "no alternative purchaser" prong, and the agencies' pronounced skepticism of the defense.

We also discuss the potential intersection of bankruptcy and antitrust law and how core policies under each legal construct might come into conflict. Lastly, we identify the types of provider transactions that are most likely to be priorities for antitrust enforcers.

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The Failing Firm Defense

While the failing firm defense to mergers has traditionally been a high bar, some have suggested that the current pandemic may pave the way for future successful claims in merger review.[7]

However, in a recent blog post, the Federal Trade Commission's Director of the Bureau of Competition Ian Conner responded that the FTC will

continue to apply the test set out in the Guidelines and reflected in our long standing practice, and in doing so we will require the same level of substantiation as we required before the COVID pandemic. As I noted previously, we have not relaxed and will not relax, the intensity of our scrutiny or the vigor of our enforcement efforts.[8]

He stated that "the Bureau has faced a surprising number of failing firm claims by merging parties" in the past few years.[9] Recent enforcement matters include Post/TreeHouse, Axon/VieVue and Jefferson/Einstein.[10] Managers of the FTC's Mergers IV Division — which reviews provider transactions — have stated that the current analytical framework for assessing the failing firm defense has sufficient flexibility to account for the current pandemic.[11]

Entities asserting the failing firm defense often fall short in meeting the requirement that the acquirer is the only available purchaser.[12] If the seller conducts an inadequate shop process or simply selects the highest bidder among multiple bidders, the agencies will not credit the failing firm defense.

Moreover, the merger guidelines explain that any bid over liquidation value will be regarded as a reasonable alternative offer.[13] In both the Scott & White Healthcare matter[14] and a previous blog post, the FTC made clear that "the most financially challenged firm must do more than window shop the assets."[15] Thus, providers looking to sell themselves, whether in the context of bankruptcy or otherwise, must make "good faith efforts to elicit reasonable alternative offers"[16] in order to claim the failing firm defense.

Some commentators have raised the issue of whether there will be sufficient time for sellers to find alternative purchasers.[17] Like all antitrust analysis, this will be a very fact-specific inquiry, but merging parties face an uphill battle if the selling company has only conducted a cursory search for alternative purchasers.

If the selling company cannot meet the strict requirement of the failing firm defense, it may still qualify for the flailing firm or weakened competitor defense. The legal standard for this defense is also a high bar and has been described by the U.S. Court of Appeals for the Sixth Circuit as "the Hail-Mary pass of presumptively doomed mergers."[18]

Nevertheless, the FTC has been receptive to this argument in a few instances where "the hospital lacks sufficient reserves to make identified capital improvements, resulting in declines in its competitive significance."[19] A key consideration will be the likely duration of the selling company's diminished competitive significance and the prospect for longer term recovery.

Interplay Between Bankruptcy and Antitrust

Physician groups (and other providers) that file for bankruptcy may face antitrust hurdles to completing their transactions. For transactions that are reportable under the Hart-Scott-Rodino Antitrust Improvements Act, Section 363(b)(2) of the Bankruptcy Code requires the trustee or debtor in possession

to give the required premerger notification to the government, and bankruptcy court approval of the sale must await the expiration of the 15-day waiting period, or longer if extended.[20]

When the highest bidder for a debtor's assets is a direct and close competitor to the debtor, the policy goals of the Bankruptcy Code (maximization of value for the benefit of creditors) and antitrust law (preventing acquisitions leading to market power) may diverge. While that bidder may offer the highest value to creditors, the debtor may find itself subject to an antitrust merger challenge.

For instance, the U.S. Department of Justice filed an antitrust challenge against SunGard AS's acquisition of ComDisco Inc. on the eve of the bankruptcy court's approval of the sale. In a highly unusual expedited process, after a two-week discovery period, the court conducted a permanent injunction hearing 18 days after the filing of DOJ's complaint and issued its decision six days later.[21]

Bankruptcy transactions that fall below the HSR threshold have also been challenged on antitrust grounds by the government[22] and private plaintiffs.[23] These merger challenges were ultimately unsuccessful as the plaintiffs failed to meet their burden on market definition.[24]

In certain cases, the bankruptcy court will manage a sale process by initially considering and approving bid procedures that govern the sale process. In order to address potential antitrust concerns and potentially maximize value for creditors, parties should consider requesting the bankruptcy court to require bidders make separate bids on individual assets rather than make all-or-nothing bids.

Forcing bidders to break up their bids for individual assets may very well serve the interests of both bankruptcy and antitrust.[25] The takeaway is that providers availing themselves of the bankruptcy process should be aware of potential antitrust issues that may pose an impediment to closing.

Physician Transactions Can Raise Different Issues

Finally, while the agencies are most likely to continue their focus on horizontal transactions among providers (i.e., hospital/hospital or physician/physician), other types of transactions can also raise competitive issues.

In the two litigated FTC cases involving acquisition of physician groups, Saint Luke's Health System Ltd.[26] and Sanford Health,[27] the acquirer was a hospital system. The FTC's theory of harm in both cases was based purely on the horizontal overlap between the hospital-employed physicians and the target physician group.

The private plaintiffs in St. Luke's, rival hospitals, also alleged a foreclosure theory of harm.[28] However, the district court found it unnecessary to address this theory of harm as it had already found the horizontal nature of the acquisition violated Section 7.[29] Hence, there is little guidance on whether a court would find a pure hospital/physician transaction a Section 7 violation.

Insurer/physician transactions may also raise competitive issues as seen in the FTC's recent United HealthCare Services Inc./DaVita Inc. matter. In the only geographic market it sought relief — Las Vegas — the FTC alleged both a horizontal and vertical theory of harm.[30] The vertical theory of harm was based on raising rivals' costs or even full foreclosure.[31]

The FTC majority declined to pursue enforcement action in Colorado where the transaction was purely

vertical.[32] For provider transactions reviewed by the agencies, we foresee the large majority of those investigations to remain focusing on horizontal transactions.

Conclusion

Many small hospitals and physician groups hit especially hard by the COVID-19 crisis will certainly explore multiple options to remaining viable. Transactions with other providers may be a logical option. The agencies have made clear that they have not relaxed their standard for reviewing mergers including their application of the failing firm defense.

We note that acquisition of providers resulting from the bankruptcy process can raise significant antitrust issues, and certain transactions may even put the policy considerations of bankruptcy and antitrust laws in conflict. Finally, our prognosis is that the spotlight of antitrust review will continue to shine on horizontal transactions but that other types of transactions are not immune from antitrust scrutiny or challenge.

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Notes

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12. Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969); U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 11 (2010) ("Horizontal Merger Guidelines").

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21. United States v. SunGard Data Systems, Inc., 172 F. Supp. 2d 172, 174(D.D.C.2001).

22. See, e.g. F.T.C. v. Lab. Corp. of Am., 2011 WL 3100372 (C.D. Cal. Feb. 22, 2011).

23. See, e.g. Gulf States Reorganization Grp., Inc. v. Nucor Corp., 721 F.3d 1281 (11th Cir. 2013).

24. See Lab. Corp. 2011 WL 310372 at *20; Gulf States, 721 F.3d at 1287.

25. Take the example of a health system (Bidder 1) that bids on the assets of a four-hospital system in bankruptcy, but Bidder 1 competes closely with one of the debtor's hospitals (Hospital A) thus raising antitrust issues. Add to this example that a second bidder (Bidder 2) exists for Hospital A and raises no competitive issues. Antitrust enforcers would likely clear Bidder 1's purchase of three hospitals and Bidder 2's purchase of Hospital A. Should the bankruptcy court require Bidder 1 to submit separate bids for each of the debtor's four hospitals? It seems logical to require this if one possible outcome is the debtor obtains a higher overall value by "mixing and matching" bids from both bidders. But what if Bidder 1's price for Hospital A on a standalone basis is still higher than Bidder 2? Bankruptcy courts are charged with choosing the "highest and best bid" for the debtor's assets but what weight should it give to the uncertainty of closing injected by a possible antitrust challenge in its assessment of "best" bid?

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27. FTC v. Sanford Health, 926 F.3d 959 (2019).

28. Amended Compl. ¶¶ 98-105, Saint Alphonsus Medical Center-Nampa Inc. v. Saint Luke's Health System, Ltd., 1:12-cv-00560-BLW, ECF No. 63 (D. Idaho Jan. 15, 2013).

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31. Id.

32. Public Statement of Commissioner Noah Joshua Phillips and Commissioner Christine S. Wilson, In the Matter of UnitedHealth Group and Da Vita, No. 181-0057 (June 19, 2019), https://www.ftc.gov/system/files/documents/public_statements/1529366/181_0057_united_davita_statement_of_cmmrs_p_and_w.pdf. But note that the CO AG sought enforcement action and settled the case through a non-structural (behavioral) remedy. Press Release, Antitrust challenge and settlement to the UnitedHealth Group and DaVita merger will safeguard competition, cost, and quality of healthcare for seniors in the Colorado Springs Area, COAG (June 19, 2019), https://coag.gov/press-releases/06-19-19/.

Kevin Hahm *is a partner in the firm's Antitrust and Consumer Protection group in the firm's Washington D.C. office. Kevin focuses on antitrust merger review, including pre-transaction counseling, merger investigations and merger litigations. He can be reached at +1 (202) 778-2227 or khahm@HuntonAK.com.*

Matthew D. Jenkins *is a partner in the firm's Business Finance & Health Care group in the firm's Richmond office. As the head of Hunton Andrews Kurths' health care practice, Matt devotes his practice to the firm's leading health care clients and coordinates the delivery of comprehensive legal services to such clients across the firm's various practices. He can be reached at +1 (804) 788-8736 or mjenkins@HuntonAK.com.*

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