Bloomberg BNA

BNA's
Health Law Reporter™

Mergers and Acquisitions

FTC Claims Hospital Authority Straw Man, Urges Court to Reject State Action Immunity

A hospital merger that will create a monopoly in the delivery of inpatient general acute care hospital services in a six-county area and that was ''rubber stamped'' by a Georgia hospital authority is not immune from antitrust scrutiny under the state action doctrine, the Federal Trade Commission said in an appellate brief filed July 27 (*FTC v. Phoebe Putney Health System Inc.*, 11th Cir., No. 11-12906, *brief filed* 7/27/11).

A decision in the case likely will have ramifications for provider consolidation in other areas of the country that have or create public hospital districts because hospital efforts to use the state action doctrine to protect consolidations from antitrust review are ''part of a larger trend,'' Douglas C. Ross, Davis Wright Tremaine LLP, Seattle, said.

The case is before the U.S. Court of Appeals for the Eleventh Circuit, which issued an injunction against the merger of Phoebe Putney Memorial Hospital (PPMH) and HCA Inc.-owned Palmyra Park Hospital (PPH). The FTC's brief said the merger is not insulated from antitrust review due to the fact the Hospital Authority of Albany-Dougherty County, which nominally owns the PPMH assets and would nominally acquire the PPH assets, does not, and will not under the proposed lease arrangements with PPMH's parent, Phoebe Putney Health System Inc. (PPHS), exercise any control over the two hospitals' operations.

FTC Arguments. Rather, PPHS ''conceived, structured, financed, and guaranteed'' the acquisition in order to eliminate competition and accomplish what it had not been able to do through other anticompetitive practices, the brief said.

The state action doctrine stems from the notion that states and their subdivisions are sovereigns under the U.S. Constitution, that federal antitrust laws cannot prevent states from managing competition or eliminating it all together, and that authorized state and local bodies—as long as they are properly authorized and overseen—may permit private parties to do the same.

According to the FTC appellate brief, a federal district court erred in concluding in a June 27 decision that PPHS's proposed acquisition was immunized from antitrust scrutiny by the state action doctrine, when the private party orchestrated the transaction and the state entity merely acquiesced to being the nominal acquirer (20 HLR 1017, 7/7/11).

Because the proposed transaction is not immunized by the state action doctrine, and because the anticompetitive effects of the transaction are not in doubt or contested, the FTC should have been granted a preliminary injunction to allow it to pursue administrative proceedings it brought, the FTC said.

The brief urged the Eleventh Circuit to reverse the trial court's decision denying the FTC a preliminary injunction to block the merger while the FTC completes an administrative enforcement action pending before an FTC administrative law judge (*In re Phoebe Putney Health System Inc.*, FTC, No. 9348).

Road Map to Evade Review? Joe Miller, general counsel with America's Health Insurance Plans, said the case is important because the transaction would create a clear monopoly that is likely to raise costs to health care consumers in the region. More generally, he said, it comes at a time when anticompetitive provider consolidation should be discouraged, not cloaked by state and federal governments.

''The effort by the hospitals in Georgia to take advantage of the state action immunity is particularly aggressive.''

DOUGLAS C. ROSS,
DAVIS WRIGHT TREMAINE LLP, SEATTLE

''If this practice is upheld—essentially using a hospital district to bless an otherwise illegal transaction—it will provide a road map for further anti-consumer consolidation by hospitals that would prefer to acquire pricing power instead of doing the hard work of identifying efficiencies within their own systems'' he said.

''The legal issues underlying the state action immunity are pretty straightforward in the case, and the FTC's brief does an excellent job of articulating why the district court erred,'' Miller said. ''We agree with the FTC that the trial court misapplied the law and hope the Eleventh Circuit will grant the relief the FTC requests.''

Robert W. McCann, however, said ''the arguments against immunity in this case are not as clear as the FTC would make them out.'' McCann, with Drinker Biddle & Reath LLP, Washington, said ''the state action doctrine has always had fuzzy edges, and this case is a good example.''

In this case, ''you have a state law of general applicability (which generally supports a state action argu-

ment) implemented by a special-purpose authority through a contract with a private actor. But that said, a state action argument failed in *FTC v. University Health Inc.*, 938 F.2d 1206 (11th Cir. 1991), a case also involving Georgia hospitals and facts that arguably were more compelling,'' McCann said.

Jack Rovner, with The Health Law Consultancy, Chicago, said it will be interesting to see how the Eleventh Circuit resolves the case. ''Generally, antitrust law has not accepted a situation where there is no 'active state supervision' as qualifying for state action immunity,'' Rovner said.

''Crediting the FTC's factual allegations, it's hard to discern the active state supervision that should exist for a private party to gain state action antitrust immunity. Even crediting the trial court's view that PPHS is the 'agent' of the Authority, on the alleged facts there has been no active Authority supervision of the 'agent,' '' he added.

''Such supervision is necessary to ensure that the 'agent' is acting in the Authority's interest rather than PPHS's private self-interest under the guise of acting on behalf of the state,'' Rovner said.

Larger Ramifications? According to Ross, hospitals responding to health care reform believe they must consolidate if they are to achieve the kinds of efficiencies of scale that they need to provide care as government both expands its reach in terms of the size of the population for which it provides health care and ratchets down the amount it is willing to pay for that care.

''At the same time as hospitals are attempting to accomplish this, they perceive the antitrust enforcement agencies attempting aggressively to prohibit larger systems from forming,'' Ross said. ''The effort by the hospitals in Georgia to take advantage of the state action immunity is particularly aggressive.''

In states where existing statutes provide hospitals with a state action immunity argument, they will try to structure deals to fall within the scope of the state action doctrine, he said. ''And in some states, as we've seen recently (in New York, for example) legislatures are passing immunity laws to give hospitals an opportunity to make a state action argument they otherwise would not have had.''

''In this case, the FTC knows it is operating in a judicial circuit that hasn't been friendly to it before when the state action doctrine was at issue, but the FTC argues forcefully the transaction engineered by Phoebe Putney and Palmyra fails the basic test for state action immunity: the transaction simply is not the action of the state but is the action of private parties and so is precisely the kind of activity the state action immunity doctrine is not supposed to protect,'' Ross said.

While the FTC ''appears to have the better of this argument,'' if the FTC loses it definitely will cause other hospitals to look closely at what Phoebe Putney did and consider whether and how they can use that experience as a model for future transactions. ''If the Eleventh Circuit affirms the district court, every private lawyer will look closely at that decision and consider whether transactions on which they are working can be similarly structured to avoid antitrust review. Not to do so would be malpractice,'' Ross concluded.

Trial Court Erred. The FTC brief says the trial court misconstrued the FTC's theory of the case, relied on factual inferences that contradicted the allegations in the government's complaints, and misapplied established legal principles governing application of the state action immunity doctrine.

''If allowed to stand, the district court's ruling could provide a roadmap for private parties wishing to bypass any antitrust scrutiny, by structuring their hospital mergers as nominal acquisition-and-leases by the many state hospital authorities empowered to do such transactions, not only in Georgia but in other states as well,'' the brief said.

According to the brief, PPHS had a stated intention to ''control all hospital beds'' in the Albany, Ga., region and, after the merger, PPHS would control 100 percent of the licensed general acute care hospital beds in Dougherty County. In addition, PPHS already has ''substantial leverage'' in negotiating with health plans and pursued the merger only after the Eleventh Circuit reinstated PPH's Clayton Act lawsuit (*Palmyra Park Hospital Inc. v. Phoebe Putney Memorial Hospital Inc.*, 604 F.3d 1291 (11th Cir. 2010)).

In that decision the Eleventh Circuit held PPH could pursue its illegal tying claim based on PPMH's use of its exclusive capacity to provide certain hospital services to get health insurers to exclude PPH from their networks. PPH was an appropriate party to sue to enforce antitrust laws especially where other injured parties, such as insurance companies and policyholders affected by higher rates and premiums, were unlikely to sue, the court added (19 HLR 640, 5/6/10).

The brief also assailed the process used to consummate the agreement, saying the PPHS board approved ''an aggressive formal offer to buy PPH from HCA . . . judging that the acquisition of a monopoly was worth it.'' Moreover, the brief stated, PPHS conducted the entire negotiations with HCA without any input from the authority, and the authority has no budget, paid employees, acts as an ''absentee landlord,'' and neither controls nor actively supervises PPHS.

'Gauzy Cloak of State Involvement'? ''If the Authority's role in this case is *not* the 'gauzy cloak of state involvement' that the Supreme Court has repeatedly rejected as a basis for antitrust exemption, then it is difficult to conceive of what would be,'' the government concluded.

The government is represented by Imad D. Abyad, John F. Daly, Edward D. Hassi, Leslie Rice Melman, and Priya B. Viswanath, with the FTC in Washington, and Stewart R. Brown and Michael J. Moore, with the U.S. Attorney's Office, Macon, Ga.

The state is represented by Sidney Ray Barrett Jr., Isaac Byrd, Samuel Scott Olens, and Alex Fredrick Sponseller, with the Attorney General's Office, Atlanta.

The Phoebe Putney appellees are represented by Robert M. Brennan, James C. Egan Jr., and John H. Parker Jr., with Parker Hudson Rainer & Dobbs LLP, Atlanta; Jonathan L. Sickler, with Weil Gotshal & Manges LLP, Washington; and Lee Kavel Van Voorhis, with Baker & McKenzie LLP, Washington.

HCA and Palmyra Park are represented by Kevin J. Arquit, Nicholas F. Cohen, Paul C. Gluckow, Aimee H. Goldstein, Meryl G. Rosen, and Jennifer Rie, with Simpson Thacher & Bartlett LLP, New York, and Charles E. Peeler, with Flynn & Peeler LLC, Albany, Ga.

The authority is represented by Emmet J. Bondurant, Michael A. Caplan, Ronan P. Doherty, and Frank M. Lowrey IV, with Bondurant Mixon & Elmore LLP, At-

   ISSN 1064-2137

lanta; Robert J. Baudino Jr. and David J. Darrell, Baudino Law Group, Des Moines, Iowa; Amy J. McCullough, Baudino Law Group, Atlanta; Karin Allen Middleton, Baudino Law Group, Albany, Ga.; and Edgar B. Wilkin Jr., with Perry & Walters LLP, Albany, Ga.

BY PEYTON M. STURGES

The government's brief is available at http://op.bna.com/hl.nsf/r?Open=psts-8k8jvm.