Bloomberg BNA

BNA's
Health Law Reporter™

Mergers and Acquisitions

Eleventh Circuit Hands FTC Defeat in Suit Over State Action Immunity Merger Defense

The Federal Trade Commission suffered a setback Dec. 9 when a federal appeals court ruled the merger of two hospitals consummated under the direction of a Georgia hospital authority is immune from antitrust scrutiny under the state action doctrine (*FTC v. Phoebe Putney Health System Inc.*, 11th Cir., No. 11-12906, 12/9/11).

The U.S. Court of Appeals for the Eleventh Circuit ruled that the merger of Phoebe Putney Memorial Hospital (PPMH) and HCA Inc.-owned Palmyra Park Hospital (PPH) does 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.

State-action immunity applied to the merger because the Hospital Authority of Albany-Dougherty County, which nominally owns the PPMH assets and would nominally acquire the PPH assets, was acting under powers granted by the Georgia Legislature. The state, in granting that power, gave the authority the right to take such an action and recognized that such power could displace competition, the court said.

''This grant makes clear that the Authority is authorized to acquire and lease Palmyra,'' the court said. ''Moreover, in granting the power to acquire hospitals, the legislature must have anticipated that such acquisitions would produce anticompetitive effects.''

The Federal Trade Commission and the state attorney general's office brought the lawsuit under Section 7 of the Clayton Act alleging the merger would substantially lessen competition or create a monopoly in the inpatient general acute-care hospital services market in and around Dougherty County, Ga.

Substantial Harm to Come? Richard Feinstein, the director of the FTC's Bureau of Competition, said in a statement that the FTC is considering all of its options in response to the Eleventh Circuit's decision.

That decision, however, allows the hospitals to consummate a deal that will raise prices for general acute-care hospital services charged to commercial health plans and substantially harm patients and local employers and employees, he said.

''The Eleventh Circuit agrees with the Commission that this deal will create a monopoly and eliminate competition. We remain very concerned that it will raise health care costs dramatically in Albany, Ga.,'' he added.

Those concerns were echoed by Joe Miller, general counsel with America's Health Insurance Plans, Washington, who said the court ''appeared to follow its precedent but did so in a way that will, from a policy and consumer perspective, lead to bad results.''

Toby G. Singer, with Jones Day, Washington, clarified, however, that there was no finding of monopoly or reduced competition in the appeals court's decision. The court merely cited the allegations, which were not proved but merely were conceded for purposes of the defendants' motion to dismiss, she noted. ''There were no findings that the FTC was correct in its allegations.''

Straightforward Ruling. Douglas C. Ross, with Davis Wright Tremaine LLP in Seattle, called the court's opinion ''straightforward,'' noting that ''the Eleventh Circuit saw only one issue: whether, in 1941, when the state passed the hospital authority statute, it was reasonably foreseeable that a hospital authority established by a city or county might one day engage in an anticompetitive acquisition of another hospital.''

To the appeals court, ''the answer must have been as plain to every legislator in 1941 as the nose on his face: if a hospital authority in rural Georgia were to purchase a rival operating in the same community that might eliminate competition,'' Ross said.

''Based on this common sense logic, and not much more, the court of appeals said the state action doctrine applies and the transaction is exempt.''

Miller, however pointed to this ''foreseeability'' ruling as a flaw in the court's reasoning. ''Based on the court's rationale, it is hard to imagine what would not be foreseeable,'' he said.

Oversight Issue Ignored. Jack Rovner, with The Health Law Consultancy, Chicago, said the appeals court accepted the position that the Georgia Legislature ''understood'' and ''articulated'' that hospital authorities may engage in anticompetitive activities, such as embracing monopolistic mergers, but ignored the ''active supervision'' component, apparently reasoning that the Georgia legislation created a ''state actor'' that did not need to be supervised.

''That approach made short shrift of the FTC's argument that the authority is a shell for a private actor, which as a result of the merger, will have monopoly power in Albany and Dougherty County and under its lease with the Authority apparently has full discretion to set prices,'' Rovner said

''So while in theory a 'state actor' can be allowed to monopolize because its abuse of such monopoly power can be 'cured' by the citizens voting the 'state actors' out of office and installing replacement that would exercise the monopoly power to benefit the citizenry, such

a cure, in reality, is not a viable option,'' Rovner continued.

''In Albany, the citizenry would have to replace the majority of the members of the city and county governing bodies; get the new members to replace the existing appointees to the authority; and then wait 40 years until the lease to the private hospital management company expired so that the authority could exert some control over the pricing of the merged hospitals!'' Rovner said.

''Hardly a 'political' check on private exercise of monopoly power to the detriment of the citizenry, so hardly consistent with the principles underlying the state action antitrust immunity doctrine,'' he added.

Singer agreed that the court essentially ignored the FTC's argument that the private party acquiring the hospital should be required to be actively supervised under the second prong of the state action defense.

Sham Transaction. The Eleventh Circuit also rejected the FTC's '' 'sham' transaction/rubber stamp argument, refusing to look behind the action of the hospital authority to determine whether it was really in essence private activity,'' Singer said.

Ross agreed, saying the court ''refused to address the FTC's argument that it is important not to look only at the surface of the transaction but to figure out that what was really going on was a ruse.''

Although the FTC charged that the hospital authority ''had no real involvement in the takeover of the Palmyra hospital and that it was being used as a pawn to cloak a plainly private and plainly anticompetitive transaction with state action protection, the court had no interest in going down this road,'' Ross said.

''The result makes sense. It isn't up to a court, let alone the FTC, to decide when a government body has allowed its functions to be usurped by private actors,'' Ross continued. ''If that were something courts and enforcement agencies could deconstruct, there would be no clear stopping point.''

Enforcement Defense. The state action doctrine reflects the notion that states and their subdivisions are sovereigns under the U.S. Constitution and that federal antitrust laws cannot prevent states from managing competition or eliminating it altogether.

The appeals court said the doctrine applies to the facts of the case, affirming a June decision in which a federal trial court ruled that the proposed acquisition by Phoebe Putney Health System (PPHS) was immunized from antitrust scrutiny by the state action doctrine. The court in that decision refused to grant a preliminary injunction (20 HLR 1017, 7/7/11).

FTC and Georgia officials challenged that decision, arguing that the doctrine did not apply when a private party orchestrates the transaction and the state entity merely acquiesces to being the nominal acquirer. They obtained an injunction from the Eleventh Circuit pending resolution of the dispute (20 HLR 1062, 7/14/11).

A government brief filed in July said the authority was a mere ''straw man'' or stand-in for PPHS in its efforts to achieve monopoly power and eliminate competition. The trial court's decision provided 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 (20 HLR 1173, 8/4/11).

Health care antitrust practitioners said at the time that a decision in the case would have ramifications for provider consolidation in other areas of the country that have or create public hospital districts because hospitals are trying to use the state action doctrine to protect their mergers wherever possible. Others questioned whether there was adequate state supervision to justify application of the doctrine.

Active Supervision? The Eleventh Circuit, however, did not spend time addressing the FTC's ''active supervision'' argument, looking only at the statutes that established health care authorities, asking whether these entities were given the power to enter into such deals, and concluding that the Legislature was well aware that these entities could result in monopolies and hurt competition.

''The Georgia legislature must have anticipated anticompetitive harm when it authorized hospital acquisitions by the authorities,'' the appeals court said. ''It defies imagination to suppose the legislature could have believed that every geographic market in Georgia was so replete with hospitals that authorizing acquisitions by the authorities could have no serious anticompetitive consequences.''

The court also said that it did not matter that the merger was merely being ''rubber-stamped'' by the authority and that the merger did not become ''private action'' simply because it was presented to the authority by PPHS and HCA. What mattered was that the acquisition was authorized by state law and that the state recognized the potential for anti-competitive effects.

The federal government was 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 was represented by Sidney Ray Barrett Jr., Isaac Byrd, Samuel Scott Olens, and Alex Fredrick Sponseller, with the state AG's office, Atlanta.

The Phoebe Putney appellees were 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 were 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 was represented by Emmet J. Bondurant, Michael A. Caplan, Ronan P. Doherty, and Frank M. Lowrey IV, with Bondurant Mixson & Elmore LLP, Atlanta; 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.

The court's decision is available at http://op.bna.com/hl.nsf/r?Open=psts-8pgswr.

  HLR ISSN 1064-2137