

Physician Affiliation Price Fixing Case Settled for \$2.5 Million



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A proposed settlement was filed earlier this month in federal district court in Washington State under which a health system will pay \$2.5 million and divest controlling interest in an ambulatory surgery center to resolve the antitrust price fixing claims brought by the State of Washington. *State of Washington v. Franciscan Health System*, Case No. 3:17-cv-05690 (W.D. Wash.) (May 13, 2019). The State had initially challenged two separate consummated transactions of the health system—the first an alleged violation of Section 7 of the Clayton Act for the acquisition of a physician practice, and the second an alleged violation of Section 1 of the Sherman Act for a professional services agreement with a different physician practice. The district court previously granted summary judgment dismissing the State’s Clayton Act claims against the first transaction. This settlement, which occurred on the eve of trial, resolves the Sherman Act claims against the second transaction, which were particularly noteworthy because the allegations focused on the structure of the affiliation and whether it resulted in a single entity. A hearing for entry of the settlement is currently scheduled for June 19, 2019.

Background

The State of Washington filed a [lawsuit](#) against Franciscan Health System (“CHI Franciscan”) in 2017 for harm to competition and increased prices in the market for orthopedic physician services and primary care physician services in the Kitsap Peninsula region in violation of both federal and state antitrust laws. The case challenged two separate, but close-in-time, transactions between CHI Franciscan and two independent physician practices. The State’s case arose out of complaints it received following consummation of both transactions. According to CHI Franciscan and the two physician practices, the transactions were largely motivated by the practices’ struggling financial situations and their perceived need to affiliate with a hospital. CHI Franciscan owns the only hospital in the Kitsap Peninsula. In 2018, the district court denied defendants’ motion to dismiss.

The first transaction was the acquisition of WestSound Orthopaedics, P.S. (“WestSound”) in July 2016. Westsound, located in Silverdale on the Kitsap Peninsula, has seven orthopedic surgeons. At the time of the transaction, CHI Franciscan only had one orthopedic surgeon. In the WestSound transaction, CHI Franciscan acquired all of its assets, assumed its lease, and entered into individual employment contracts with each of the physicians. The WestSound physicians then joined the CHI Franciscan payer contracts. The second transaction was an affiliation between CHI Franciscan and The Doctors Clinic (“TDC”) in September 2016. TDC, a multispecialty practice of approximately 54 physicians including orthopedists and primary care doctors, has seven locations in the Kitsap Peninsula region. The TDC transaction was structured as a professional services agreement (“PSA”) that could be terminated after three years. Under the PSA and related agreements, CHI Franciscan acquired only ancillary assets of the practice (including an ambulatory surgery center, as well as lab and imaging assets), and assumed its leases. The TDC physicians remained employed by TDC, but all TDC patients were considered CHI Franciscan patients and the TDC physicians joined the CHI Franciscan payer contracts.

The State’s challenge to the WestSound transaction was based on its allegation that CHI Franciscan had accumulated market share through years of expansion via acquisition that harmed competition in violation of Section 7 of the Clayton Act. Importantly, the State based its claim on the cumulative market share and market concentration in the Kitsap Peninsula region for orthopedic physician services of CHI Franciscan, WestSound, *and* TDC. Defendants argued that the Clayton Act claims should only consider whether the WestSound transaction was illegal *at the time it occurred*, not later when the TDC affiliation occurred. At the time of the WestSound transaction, CHI Franciscan only had one orthopedic surgeon, so the addition of WestSound’s seven physicians resulted in a minimal change to market concentration. The later addition of the TDC orthopedic surgeons was irrelevant to the Clayton Act claims, according to defendants. The district court agreed. In March 2019, the district court granted summary judgment for defendants on the State’s challenge of the WestSound acquisition.

The threshold issue in the State’s Sherman Act Section 1 challenge of the TDC transaction was whether, like the WestSound transaction, CHI Franciscan and TDC merged into a single entity. If so, there would be no Section 1 claim. The State

argued that, even with the PSA and related agreements, CHI Franciscan and TDC remained separate entities and thus their joint payer contracting was *per se* illegal price fixing in violation of Section 1, or in the alternative, illegal under the rule of reason. According to the State, evidence showed that the parties intentionally structured their arrangement to keep the groups separate because the TDC physicians did not want to be employed by CHI Franciscan. Defendants argued that the transaction resulted in a single entity that operated with common decision making and common goals. They further argued an affirmative defense that they would have been weakened without the transaction, and that the agreements saved TDC from going out of business. In March 2019, the district court denied summary judgment for defendants.

Settlement

The Consent Decree, which has a term of seven years, settles all of the State's Sherman Act Section 1 claims without defendants admitting liability of fault, and dismisses the complaint with prejudice. Under the terms of the settlement, defendants must pay within 30 days at least \$2 million (and up to \$2.5 million) to the State. The State will use those funds for the purpose of increasing health care access for residents of the Kitsap Peninsula region. CHI Franciscan is also required to maintain and preserve the ambulatory surgery center it had acquired from TDC until it can divest it, with the divestiture occurring at least within 120 days. In addition, the terms of the settlement include the following:

- Future Contract Prohibitions. CHI Franciscan and TDC are barred from entering into similar agreements to the ones challenged by the State. Specifically, they cannot enter into, participate in, or otherwise facilitate any agreement to negotiate with payers on behalf of any physicians who are not their employees. However, the Consent Decree does not prohibit any such arrangements that are reasonably necessary to a legitimate clinical integration or risk-sharing arrangement. CHI Franciscan and TDC must also provide 60-days advance written notice to the State of any arrangement under which CHI Franciscan will establish payer contracts for physicians not employed by CHI Franciscan, if those physicians compete in the same specialty within a 15-mile radius of any CHI Franciscan employed physician.
- Notification Requirement for Future Transactions. CHI Franciscan and TDC will provide 60-days advance written notice to the State of any transaction involving a practice with seven or more physicians that is not reportable under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended ("HSR"). Starting in January 2020, Washington State will have a mandatory notice requirement for certain health care transactions where federal HSR filings are not required, similar to the requirement included in the Consent Decree.
- Incentive and Quality Compensation. CHI Franciscan and TDC must allow for incentive-based payments to TDC physicians for providing higher quality of care.
- Separate Commercial Payer Contract Negotiations for TDC Physician Services. CHI Franciscan is required to offer payers the option to negotiate and contract

separately with TDC physicians—including reopening current contracts. To support this, CHI Franciscan and TDC must each establish and maintain separate negotiating teams that will operate independent of, and in competition with, each other for payers who elect to separately contract. The parties will be required to keep the information related to separately negotiated contracts separate and confidential from each other.

- Patient Notification of Competitive Alternatives. Within ten days, CHI Franciscan and TDC must provide notice in writing to imaging patients of imaging facility alternatives at the time of or before referral. Such notice must include at least two alternative imaging facilities that are not affiliated with CHI Franciscan or TDC.

While the resolution of this case through settlement does not provide any new case law on the merits, it still presents important guidance and reminders for health care provider affiliations. It represents another example that where the FTC and DOJ strongly favor structural solutions, state attorney generals, who are also very active in policing health care transactions, are more willing to resolve them with conduct or mixed conduct/structural consent decrees. This case is particularly notable in that it was heavily litigated, with several summary judgment rulings, up to the brink of trial.

Also of particular note here was the State's and the defendants' differing views on whether the TDC PSA sufficiently integrated the entities to allow for joint payer contracting. The State looked to whether there was common ownership, the degree of control CHI Franciscan had over TDC, whether there was unified economic decision making as a result of the transaction, and if the entities still compete for patients or physicians. These factors are critical for providers considering any form of affiliation that will include joint contracting.

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