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Antitrust Enforcement Update: Spotlight On Physician Transactions

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At both the state and federal level, antitrust enforcement agencies continue to pursue successful challenges to physician practice transactions. This article summarizes two recent enforcement actions, as well as a new state law that requires prior notice of healthcare provider transactions. We also offer practical takeaways for providers pursuing practice acquisitions.

IN DEPTH

Last week, the Eighth Circuit Court of Appeals upheld the grant of a preliminary injunction barring a health system's attempted acquisition of a multi-specialty practice in North Dakota, and last month, the Washington Attorney General settled a challenge to a health system's acquisition of physician practices. Washington state also passed a law that will require prior notice of transactions involving seven or more health care providers. Health care providers should engage in careful planning for antitrust enforcement agency review of provider transactions of all sizes.

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Key Takeaways

Structure of Transaction: The Washington Attorney General challenged the structure of one of the physician practice acquisitions—a professional services agreement for physician services in connection with the sale of practice assets—a not uncommon physician transaction structure. The Washington Attorney General alleged that post-closing, the parties remained competitors under the antitrust laws, and that their joint contracting with payors was *per se* unlawful under the antitrust laws. It remains to be seen whether any other state attorneys general or the federal antitrust enforcement agencies take a like stance when presented with similar facts. Health care providers, however, should be mindful of the position that the Washington Attorney General took in this case when determining the structure of their provider transactions, particularly those where the physician practice target entity remains in existence under separate ownership post-closing.

Size of Transaction: As these enforcement actions demonstrate, providers should not assume that transactions involving physician practices are too small to garner antitrust scrutiny from federal and state antitrust enforcers. Parties to transactions should engage in careful antitrust review, including analyzing potential transactions with physician practices on a specialty-by-specialty basis. Parties should also be prepared to explain how a proposed merger or acquisition with a physician practice will lead to lower costs, higher quality or greater access to services.

State Reporting Requirements: Providers should monitor state reporting requirements. Washington state's new legislation requires prior notification of health care provider transactions involving as few as seven health care providers. It remains to be seen whether other states will follow suit, although Florida recently considered a similar bill, Florida HB 1243, which would have required notice of health provider transactions involving as few as four providers (although the bill passed the state house, the legislative session ended without the state senate taking any action on the bill).

Sanford Health/Mid-Dakota Clinic

On June 13, 2019, the Eight Circuit Court of Appeals upheld the district court's grant of a preliminary injunction barring Sanford Health's acquisition of Mid-Dakota Clinic (MDC) in Bismarck and Mandan, North Dakota, pending an administrative trial on the merits. The appeals court found that there was no legal error by the district court.

The Federal Trade Commission (FTC) and the North Dakota Attorney General (ND AG) sued in June 2017 to block the acquisition. The FTC also filed an administrative complaint challenging the transaction. In December 2017, a federal district court preliminarily enjoined the acquisition. The court concluded that the FTC showed a likelihood of ultimate success on the merits that the merger violates Section 7 of the Clayton Act, 15 U.S.C. § 18.

In the Bismarck and Mandan areas, Sanford Health operates a general acute care hospital and clinics consisting of approximately 160 physicians. MDC is a multispecialty medical practice employing 61 physicians who provide services in Bismarck.

The FTC challenged the combination of providers in four physician specialty markets: adult primary care, pediatric, obstetrics/gynecology (OB/GYN) and general surgery. The district court cited the testimony of the FTC's expert witness and previous cases to determine that the relevant product markets must be defined by specialty. The three primary commercial insurers—Blue Cross Blue Shield of North Dakota (BCBSND), Sanford Health Plan and Medica—also testified that insurance networks must include each distinct specialty to be marketable as a successful health plan. The district court agreed with the FTC that the relevant geographic market encompassed four North Dakota counties, collectively called the "Bismarck-Mandan" area.

The district court examined the increase in market shares and market concentration, and found that the four physician markets in the Bismarck-Mandan area were already highly concentrated and would be even more so post-transaction. The FTC and Department of Justice (DOJ) Horizontal Merger Guidelines define a highly concentrated market as one with a Herfindahl-Hirschman Index (HHI), a market concentration measure, of more than 2,500. The HHI evidence showed post-merger HHIs ranging from 7,363 to 9,964 in the four physician services markets. Under the FTC/DOJ Horizontal Merger Guidelines, the FTC and DOJ presume that mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points are likely to enhance market power.

In its analysis of the competitive effects of the transaction, the district court relied on testimony predicting pricing effects, diversions, upward-pricing pressure (UPP) and a willingness to pay analysis (WTP). The lower court began its competitive analysis by crediting hearing testimony that "each of the two entities views the other as its primary competitor." The lower court then explained that the diversion ratio indicates the percentage of patients who would switch to another provider if theirs was no longer available. The FTC's expert testified that this ratio, performed in the Bismarck-Mandan area, demonstrated that patients at Sanford and MDC view the other as their "next best option." Next, the lower court described UPP as the incentive to increase prices post-transaction. The FTC's expert found a UPP of 6–22%, equating to $16–27 million dollars annually. Finally, the lower court explained that the WTP analysis demonstrated that there were no other close substitute providers in the four physician markets.

The district court then concluded that the proposed transaction was "presumptively unlawful" for each physician specialty market. The appeals court found that this determination was supported by the empirical analysis of claims data and payor testimony.

The district court considered various defenses by Sanford and MDC, including the argument that BCBSND is a dominant buyer that sets reimbursement rates using a statewide, rather than an individually negotiated, pricing schedule. Relying on testimony that BCBSND expects an immediate increase in Sanford's bargaining leverage if the transaction is consummated, the district court rejected the power buyer argument. The appeals court found that the district court properly found a relationship between market concentration after the merger and increased bargaining leverage.

The district court had also rejected as inadequate the argument that a private agreement between Sanford and Medica would prevent price increases, and arguments of entry or expansion in the market, especially those that another area health system and its acute care hospital could recruit enough physicians to balance the anticompetitive effects of the transaction. Finally, the court rejected defendants' arguments that MDC was a "weakened competitor," concluding that there was no indication that MDC would "imminently depart" the market if the merger failed. The appeals court found that the district court's findings were not clear error.

CHI Franciscan Health/The Doctor's Clinic

On May 13, 2019, the Washington Attorney General announced a consent decree with CHI Franciscan to resolve an antitrust complaint challenging two physician practice acquisitions in the Kitsap Peninsula immediately west of

Seattle. Under the terms of the consent decree, CHI Franciscan will pay two million dollars and divest a controlling interest in an outpatient surgery center.

In July 2016, CHI Franciscan acquired WestSound Orthopaedics, PS (WSO), an orthopedic practice of seven physicians located in Silverdale, Washington, and in September 2016, CHI Franciscan executed several agreements with The Doctors Clinic (TDC), a 54-physician multi-specialty practice in Silverdale, Washington. The Washington Attorney General alleged that the transactions violated Section 1 of the Sherman Act, Section 7 of the Clayton Act, and two provisions of Washington's Consumer Protection Act.

CHI Franciscan and TDC entered into three primary agreements—a professional services agreement, a management services agreement and an asset purchase agreement. Under the professional services agreement, the TDC physicians remain employees of TDC, but provide services exclusively on behalf of CHI Franciscan. CHI Franciscan bills for services rendered by TDC physicians under CHI Franciscan's name, tax identification number and payor contracts. CHI Franciscan is entitled to retain all compensation received from payors for TDC physician services and compensates TDC physicians on a productivity-based model. The state alleged that this conduct constituted per se unlawful price-fixing in violation of Section 1 of the Sherman Act. The state argued that CHI Franciscan and TDC remained separate economic entities with no overlapping ownership or boards. The state also noted that the parties maintained their own electronic health record systems, and carried out their own back office functions and day-to-day operations.

The complaint alleged that CHI Franciscan and TDC have a combined market share of over 50% for adult primary care services and a combined market share of over 63% for orthopedic physician services in a geographic area no broader than the Kitsap Peninsula. The complaint alleges that as a result of the Westsound acquisition, the post-transaction HHI is at least 3,591 (with an increase of 2,222) in the orthopedic physician services market and, as a result, is presumptively unlawful.

CHI Franciscan and TDC moved to dismiss the state's claims on the grounds that the state misconstrued the affiliation agreements. The court, however, denied the motion to dismiss. The court subsequently denied summary judgment for the defendants regarding the state's ability to challenge the affiliation agreements as per se illegal under Section 1 of the Sherman Act. The defendants argued that the affiliation was not automatically illegal because, absent the affiliation, TDC would have gone out of business. The court rejected this argument and found that the competitive loss of a market participant was not a defense to an otherwise illegal price-fixing agreement.

Following the district court's denial of the defendants' motion for summary judgment, the defendants entered into a settlement with the state. WSO joined the settlement for purposes of the release of claims and is not bound by the injunction or reporting provisions. Under the terms of the proposed consent decree:

- ***Future Contract Prohibitions:*** For a period of seven years, CHI Franciscan and TDC cannot negotiate with any commercial payor on behalf of any unemployed physician for which the defendants already employ physicians in the same specialty. The defendants also are prohibited from facilitating the exchange of information among employed and non-employed physicians concerning price or other payor contract terms.

- ***Notice Provisions for Certain Transactions and Arrangements:*** CHI Franciscan and TDC also agreed to provide 60 days' advance written notice to the state attorney general before entering into an arrangement with seven or more unemployed physicians who practice at facilities within 15 miles of where CHI Franciscan-employed physicians in the same specialty already practice. CHI Franciscan agreed to provide the same advanced notice to the state attorney general before engaging in any non-reportable clinically integrated joint arrangements or risk-sharing joint arrangements. The settlement does not prevent CHI Franciscan from entering into such arrangements or transactions after the applicable notice and expiration period has lapsed.

- ***Incentive and Quality Compensation:*** CHI Franciscan and TDC must amend their contracts to remove incentive compensation and quality bonus provisions for physicians.

- ***Independent Contracting:*** CHI Franciscan is required to offer each commercial payor the option to negotiate price and other terms of physician payor contracts separately for TDC and CHI Franciscan physicians. CHI Franciscan is prohibited from conditioning any payor contract or the availability of certain terms for CHI Franciscan on reaching agreement with TDC physicians. The defendants also must implement firewall mechanisms to prevent the sharing of competitively sensitive contracting information.

- ***Transfer of Assets:*** CHI Franciscan is required to divest an ambulatory surgery center that Franciscan acquired through its agreement with TDC. The state had alleged that after CHI Franciscan acquired the ambulatory surgery center, it began referring surgeries to another CHI Franciscan-owned medical center at a much higher cost.

- ***Patient Notification:*** CHI Franciscan and TDC are required to inform patients of other independent competitive alternatives for laboratory and imaging services in the relevant geographic area.

- ***Monetary Penalty:*** The defendants are required to pay a $2 million fine to the state. The state will use the funds to increase access to health care and the availability of health care services.

New Washington State Health Provider Transaction Reporting Statute

Presumably in response to the facts that gave rise to the CHI Franciscan physician practice merger challenge—namely that those transactions were not reportable under any federal or state pre-merger notification program in effect at the time—the Washington legislature passed a new law requiring certain in-state health care providers to provide at least 60-days' notice of any material transaction to the state attorney general. The statute is effective July 28, 2019, and applies to transactions that are anticipated to be effective of close on or after January 1, 2020. The notice provision applies to mergers, acquisitions or contracting affiliations between two or more hospitals, hospital systems or provider organizations representing at least seven health care providers. "Health care provider" is broadly defined to include approximately 40 categories of licensed health care personnel, including physicians, nurses, chiropractors, podiatrists, optometrists, dentists and pharmacists. The notice must include the names and addresses of parties, a listing of all practice locations of both parties, a brief description of the nature and purpose of the transaction, and the anticipated closing/effective date of the transaction. For transactions reportable under the federal Hart-Scott-Rodino (HSR) Act, a copy of the HSR notification forms is to be provided in lieu of notice. The Washington attorney general has 30 days after notice is received to request additional information. The statute provides for civil penalties of up to $200 per day for failure to report.