

## Seventh Circuit Hands FTC Another Geographic Market Definition Victory in Chicago Hospital Merger Case

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On October 31, 2016, the US Court of Appeals for the Seventh Circuit overturned a district court decision that denied a motion by the **Federal Trade Commission (FTC)** and Illinois Attorney General (IL AG) to enjoin the proposed merger of Advocate Health Network (Advocate) and NorthShore University HealthSystem (NorthShore) pending conclusion of an FTC administrative trial on the merits of the proposed merger. Earlier this year, the US District Court for the Northern District of Illinois held that the FTC and IL AG failed to prove a relevant geographic market and, therefore, did not demonstrate a likelihood of success on the merits as required for a preliminary injunction.

On appeal, the Seventh Circuit reversed, finding that the district court committed clear error in its geographic market finding. The Seventh Circuit found that the district court incorrectly characterized the test used to define geographic markets as circular reasoning, and erred in rejecting evidence that (1) most patients prefer to receive inpatient hospital care closer to home and (2) that commercial insurers cannot market healthcare plans to employers in Chicago's northern suburbs without including at least some of Advocate's and NorthShore's hospitals. The Seventh Circuit remanded the case back to the district court.

### Background

Advocate owns and operates 11 general acute care hospitals, two of which are in Chicago's northern suburbs, as are all of NorthShore's four general acute care hospitals. The court's opinion referenced [this map](#) showing the merging parties' facilities as well as nearby hospitals.

Advocate and NorthShore (collectively, the Parties) announced their proposed merger in September 2014. On December 18, 2015, the FTC filed an administrative complaint alleging that the transaction would substantially lessen competition for general acute care services sold to commercial insurers in the northern suburbs of Chicago. The FTC's proposed geographic market included 11 hospitals, six of which are collectively owned by the Parties. Together with the State of Illinois, the FTC a week later filed suit in the US District Court for the Northern District of Illinois on December 22, 2015, seeking a preliminary injunction pending the resolution of the FTC's administrative trial.

After a six-day hearing, the district court held that the FTC and IL AG failed to define the relevant geographic market properly. The court said plaintiffs' exclusion of certain hospitals from the proposed geographic market "assumed the answer" to the geographic market question. Further, the court criticized plaintiffs for excluding from their proposed geographic market so-called "destination hospitals," *i.e.*, academic medical centers located outside of the proposed geographic market that attract patients from throughout the Chicago area. According to the court, there was no "economic basis" for distinguishing between academic medical centers and local community hospitals for market definition purposes. The court similarly criticized the plaintiffs for excluding from the market hospitals that compete with only one of the Parties, and not both, without first analyzing whether those hospitals would constrain the Parties post-merger. Finally, the court found the evidence "equivocal" as to



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whether patients prefer access to local hospital care, pointing to evidence that the second-choice hospitals for 52 percent of patients in the plaintiffs' proposed geographic market were located outside that proposed market.

Finding that the FTC and IL AG had not shown a relevant geographic market, the court denied plaintiff's motion for a preliminary injunction, and the FTC and IL AG appealed.

## **Analysis**

The Seventh Circuit observed from economic literature, case law and the Merger Guidelines that one common method used to define geographic markets in merger cases, including hospital mergers, is the hypothetical monopolist test. This is an iterative test that examines a proposed area for whether a hypothetical monopolist that owned all the hospitals in that area could profitably impose a price increase. If the answer is no (due to competition from hospitals outside the area), then the area is expanded to include one or more additional hospitals, until a hypothetical monopolist of those hospitals could profitably impose a price increase. The Seventh Circuit also observed that for hospital mergers, geographic markets have three notable features: (1) there are often only a few hospitals in a relevant geographic market for antitrust purposes, because patients prefer to receive care in nearby hospitals; (2) patients vary in their hospital preferences, but often a "silent majority" of local patients will not travel for hospital care to avoid a price increase; and (3) insured patients do not directly pay the full cost of hospital care, and so the geographic market is most directly determined by the likely responses of health insurers to a hypothetical price increase. Given these observations, the Seventh Circuit identified four factual errors in the district court's analysis of the plaintiffs' proposed geographic market.

First, the Seventh Circuit found the district court incorrectly interpreted the hypothetical monopolist test as circular reasoning. As mentioned, geographic markets for hospital mergers are examined by applying an iterative test that examines a proposed area and increases it in size until a hypothetical monopolist that owns all of the hospitals in a proposed area could profitably impose a price increase. Although the district court criticized the plaintiffs' proposed market as "assum[ing] the answer" to the geographic market question by excluding certain hospitals from the market, the Seventh Circuit observed that the court did not discuss the results of the hypothetical monopolist test as applied to the plaintiffs' proposed market, nor did the court or the Parties explain why a narrow market would produce incorrect results under the hypothetical monopolist test. The Seventh Circuit noted that if the plaintiffs' proposed market was too narrow, application of the hypothetical monopolist test itself would show that, and further iterations of the test would broaden the market definition as appropriate.

Second, the Seventh Circuit held that the district court erred in not recognizing the differences between community hospitals and academic medical centers for purposes of analyzing the geographic market. Although the district court found that there was no "economic basis" for distinguishing academic medical centers from community hospitals and excluding the former from the geographic market, the Seventh Circuit highlighted record evidence that witnesses, including commercial health plan executives, differentiated academic medical centers from community hospitals in terms of the complexity of services provided and in patients' willingness to travel further for care. For purposes of analyzing the geographic market in this merger, the presence of third party academic medical centers in the Chicago area did not mean that the Parties, which the Seventh Circuit concluded did not own academic medical centers, would be constrained from raising prices post-merger.

Third, the Seventh Circuit held that the district court erred in finding the evidence "equivocal" that patients generally choose hospitals close to their homes. The Seventh Circuit found that the district court incorrectly focused on testimony that workplace locations and outpatient relationships influence patient choices, because that testimony relates to medical care broadly and not to general acute care inpatient services specifically. Instead, focusing on general acute care inpatient services, the Seventh Circuit found strong evidence that patients have a preference for receiving those services close to home. For example, 73 percent of patients living in the plaintiffs' proposed geographic market receive hospital care there, and eighty percent of those patients drive less than 20 minutes for hospital care.

In addition, the Seventh Circuit faulted the district court for focusing on hypothetical patients who might travel further for their care to avoid higher prices post-merger, rather than on those patients ("the silent majority") who would remain close to home for their care. To the Seventh Circuit, this silent majority fallacy (*i.e.*, the assumption that a significant number of local patients would travel outside the proposed relevant market to obtain inpatient services in response to a price increase) meant that the scope of the geographic market is smaller than if one only focuses on where hypothetical patients might travel. As evidence, the Seventh Circuit pointed to commercial health plan witnesses, who unanimously testified that a health plan network that did not include either Advocate's or NorthShore's hospitals located in Chicago's northern suburbs could not be successfully marketed to patients who live in that area.

## **Key takeaways**

## ***Merger Enforcement in Healthcare Remains Vigorous***

This decision is the second straight appellate victory in 2016 for the FTC, following its win this past September in the US Court of Appeals for the Third Circuit in *FTC v. Penn State Hershey*. Like that prior case, the *Advocate* decision is a strong endorsement for the FTC's analytical approach to hospital merger antitrust enforcement. That approach often leads to narrow geographic markets and is largely based on the views of the commercial health plans and self-insured employers that negotiate with hospitals over price and would most directly feel the effects of higher prices, should they result from a merger. The FTC's winning streak can only enhance its likelihood of continuing to challenge healthcare transactions that the agency views to be anticompetitive.

### ***Number of Competitors***

Hospitals should not assume that merger challenges will only occur in non-urban areas with only a handful of hospitals. In this case, the FTC alleged a geographic market consisting of 11 hospitals in a major metropolitan area. Hospitals considering mergers with competitors even in large, populous metropolitan areas should undertake an antitrust analysis early in the transaction process to assess potential antitrust risk, especially because the FTC may not share the parties' view regarding how many hospitals impose significant competition to them.

### ***Geographic Market Definition***

Another related reason to focus early in the transaction process on rigorous antitrust analysis is to determine the area of effective competition between the parties. How broad or narrow a geographic market may be—and the number and strength of competitors within that market—may be outcome-determinative. Hospitals should consult numerous sources of evidence in this regard, including internal documents, managed care contracting history, network configuration, patient preferences and economic data, among other sources. Doing so would be consistent with the primary lesson from *Advocate* and *Penn State Hershey*, which is that geographic markets are defined in large measure on evidence showing the area where commercial insurers must have hospitals in their networks to be able to market a health plan successfully to local employers and their employees.

### ***Acquisition History***

Hospitals pursuing mergers or acquisitions should contemporaneously document any demonstrated reductions in costs, improvements in quality or other procompetitive benefits resulting from those transactions. The Seventh Circuit's opinion also highlighted NorthShore's own history of consolidation followed by higher prices. The FTC and courts may view a party's acquisition history as a "natural experiment"—both in terms of the efficiencies that were realized and any price increases that resulted—to assist in their analysis of the potential competitive effects from a proposed merger.

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