St. Luke's: A Major Step Back In Merger Efficiencies

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One of the most puzzling aspects of merger analysis and litigation is the treatment of efficiencies. Although for decades the antitrust enforcers have acknowledged the "primary benefit of mergers to the economy is their potential to generate [] efficiencies,"[1] the agencies rarely approve a merger based on likely efficiencies, and the courts have difficulty grappling with the role of efficiencies.

With high expectations, the Clinton administration revised the Merger Guidelines in 1997 to acknowledge the important role of efficiencies, but the wisdom of that approach is largely unfulfilled. Most recently, the Ninth Circuit's St. Luke's decision involving the vertical acquisition of a provider group by a health system in Idaho seems to severely restrict the efficiencies defense in a fashion inconsistent with the goals of antitrust law and sound enforcement policy.[2]

In many respects, the St. Luke's case seemed like a perfect candidate for a careful evaluation of efficiencies. The vertical acquisition of Saltzer Medical Group by St. Luke's would not only improve coordination of care between providers allowing for the institution of population health management, but also allow the parties to move physician payment away from fee-for-service towards risk-based payment initiatives. And, as noted by consumer group amici, the transaction would improve patient access by allowing the Saltzer physicians to treat all patients regardless of their ability to pay.[3]

As Steven Brill observed, there is a tremendous need for precisely these types of efficiencies to improve the quality of health care, improve integration, and ultimately deliver better care at a lower cost.[4] Indeed, even though the district court determined that the acquisition violated the antitrust laws, it found that the transaction's efficiencies would “improve patient outcomes” and even “applauded” the parties for their efforts.[5]

Yet in ruling against the merging parties, the Ninth Circuit took efficiency analysis in reverse. Relying on decades-old statements from antitrust experts such as Robert Bork and Richard Posner, the court in St. Luke’s argued that efficiencies analysis in Section 7 cases “are difficult enough ... to predict future anticompetitive effects without also adding to the judicial balance a prediction of future efficiencies.” (Of course Posner and Bork weighed in during the 1970s when our understanding of efficiencies was far less sophisticated than today). The court noted that it “remain[s] skeptical about the efficiencies defense in general and about its scope in particular.”

The court did permit some analysis of efficiencies, but ultimately rejected any consideration of claims that the merger would enhance quality — “[i]t is not enough to show that the merger would allow St. Luke’s to better serve patients. The Clayton Act focuses on competition, and the claimed efficiencies must show that the prediction of anticompetitive effects from the prima facie case is inaccurate.”[6] Unfortunately, as pointed out by amici supporting rehearing of the case, the International Center for Law & Economics and 17 prominent antitrust scholars and economists, the Ninth Circuit’s decision completely removes improvements in quality as part of the competitive calculus. In particular, these amici stated that the Ninth Circuit’s decision “implied that only price effects can be cognizable efficiencies” and “wrongfully denied application of known procompetitive efficiencies.”[7]

The Ninth Circuit’s decision is inconsistent with both modern antitrust jurisprudence and economic theory concerning efficiencies. Economists and legal scholars have long recognized the benefits of pro-competitive efficiencies and have called for the courts and the agencies to do the same.[8] And while it took some time, antitrust legal theory on efficiencies has departed from only considering pro-competitive efficiencies in “exceptional circumstances.”[9] The Clinton administration incorporated efficiency analysis under the leadership of Federal Trade Commission Chairman Robert Pitofsky.[10] The Merger Guidelines efficiency section was revised to expand efficiency analysis. Now, the guidelines go beyond only accepting efficiencies of lower price to include efficiencies such as “improved quality, enhanced service, or new products.”[11] Today, the antitrust agencies still are supposed to consider these efficiencies when analyzing an acquisition.[12]

However, that promise of the consideration of efficiencies in merger analysis goes largely unfulfilled. In the past decade, there have been less than a handful of mergers that the agencies publicly permitted because of claimed efficiencies. As former FTC Chairman Timothy Muris stated, "[t]oo often, the Agencies found no cognizable efficiencies when anticompetitive effects were determined to be likely and seemed to recognize efficiency only when no adverse effects were predicted."[13] Moreover, as the Ninth Circuit observed, to date, there has not been a single case in which a defendant has "rebutted a prima facie case with an efficiencies defense."[14]

All of this is a far more pronounced public policy concern because the United States is grappling with the issue of health care quality. While there is little legal authority on the subject, there is some support for accepting health care efficiencies in antitrust matters. Some courts, particular in cases involving health care provider mergers, have recognized the importance of quality enhancing efficiencies. In FTC v. Tenet Healthcare Corp., the Eighth Circuit not only criticized the lower court for "an inordinate emphasis on price competition," but also noted that the lower court had failed to sufficiently analyze the quality efficiencies of the hospital merger.[15] Furthermore, the FTC will consider improvements in the quality of care in administrative merger litigation and other proposed arrangements.[16] The Clayton Act protects all aspects of competition that benefit consumers — not simply price competition.

Another problem is that merger enforcement "has long been dominated by a focus on only one side of the ledger –anticompetitive effects."[17] While merger litigation is a question of predictions, the agencies place a disproportionate and asymmetric burden on the parties. To demonstrate a potential violation of law, the agencies can presume competitive harm via predictive models and presumption of harm. But to rebut that presumption, merging parties must definitely prove efficiencies to offset the predicted harm. According to the Merger Guidelines, definitive proof of efficiencies means that the stated efficiencies need to be "verified and do not arise from anticompetitive reduction in output or service."

Merging parties also must demonstrate the "likelihood and magnitude of each asserted efficiency, how and when each would be achieved ..., [and] how each would enhance the merged firm's ability and incentive to compete."[18] FTC Commissioner Wright has cautioned that such an approach "is a potentially dangerous asymmetry from a consumer welfare perspective."[19] To Commissioner Wright's point, due to these asymmetric burdens, efficiencies offered by the merger parties often go uncalculated or unanalyzed by the agencies.[20] As a result, consumer welfare enhancing efficiencies, such as those found in St. Luke’s, are simply not considered in a merger investigation, or, to the extent that St. Luke’s is followed, in merger litigation.

The issue of less restrictive alternatives further compounds this problem. The Merger Guidelines require that efficiencies be “merger-specific” and will not count when a “less restrictive alternative” is available. However, in practice, along with proving efficiencies with certainty, defendants are forced to also address any and every less restrictive alternative to ensure efficiencies are merger-specific. The leading antitrust treatise notes that “[p]lacing a general burden of ‘no less restrictive alternative’ on the defendant effectively requires it to prove a negative potentially covering an infinite number of possibilities.”[21] As stated by Commissioner Wright, “the merger specificity requirement could be interpreted narrowly to exclude any efficiency that can be recreated with any form of creative contracting.”[22] Therefore, as seen in St. Luke’s, pro-competitive efficiencies are often rejected where they should be a significant part of the competitive analysis.

The defendants in St. Luke’s have petitioned the Ninth Circuit for a rehearing en banc. If the Ninth Circuit’s decision stands, it will represent a severe step back in merger analysis and the careful consideration of efficiencies. Hopefully, the Ninth Circuit will rehear the Panel’s decision to set efficiency analysis in the right direction.

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DISCLOSURE: The authors were counsel for amici curiae ICLE and the 17 antitrust scholars and economists, and submitted their brief to the Ninth Circuit in the St. Luke's matter.

[1] U.S. Dep't of Justice & Fed Trade Comm'n., Merger Guidelines at § 4 (1997).

[2] See St. Alphonsus Med. Ctr. – Nampa Inc. v. St. Luke's Health Sys. Ltd., No. 14-35173 (9th Cir. Feb. 10, 2015).

[3] Brief for Amici Curiae International Center of Law & Economics and Medicaid Defense Fund in Support of Defendants-Appellants Urging Reversal, St. Alphonsus Med. Ctr. – Nampa Inc. v. St. Luke's Health Sys., Ltd., No. 14-35173 (9th Cir. June 9, 2014).

[4] See Steven Brill, Bitter Pill: Why Medical Bills Are Killing Us, Time, April 4, 2013.

[5] St. Luke's Health Sys. Ltd.,, 2014 WL 407446 at *3.

[6] St. Luke's Health Sys. Ltd., No. 14-35173 at *28.

[7] Brief for Amici Curiae Professors and Scholars of Law and Economics and International Center of Law & Economics in Support of Defendants-Appellants Urging Rehearing En Banc, at 6, 9, St. Alphonsus Med. Ctr. – Nampa Inc. v. St. Luke's Health Sys. Ltd., No. 14-35173 (9th Cir. Apr. 6, 2015).

[8] See Ronald Coase, The Nature of the Firm, 4 Economica 386 (1937); see also Oliver E. Williamson, Economies as an Antitrust Defense: The Welfare Tradeoffs, 58 The Am. Econ. Rev. 18 (1968).

[9] U.S. Dep't. of Justice, Merger Guidelines at § 10.A (1982).

[10] Prior to becoming Chairman, Robert Pitofsky published the seminal article advocating for a broader and more effective analysis of efficiencies in Section 7 matters. See Robert Pitofsky, Proposals for Revised United States Merger Enforcement in a Global Economy, 81 Geo L.J. 195 (1992).

[11] 1997 Merger Guidelines, supra note 1 at § 4.

[12] U.S. Dep't of Justice & Fed Trade Comm'n., Merger Guidelines at § 10 (2010).

[13] Timothy J. Muris, The Government and Merger Efficiencies: Still Hostile After All These

Years, 7 Geo. Mason L. Rev. 729, 731 (1999) (emphasis added).

[14] St. Luke's Health Sys., Ltd., No. 14-35173 at *24.

[15] 186 F.3d 1045, 1054-55 (8th Cir. 1999).

[16] See FTC Staff Advisory Opinion to Norman PHO, (Feb. 13, 2013), available at http://www.ftc.gov/sites/default /files/documents/advisory-opinions/normanphysician-hospital-organization/130213normanphoadvltr _0.pdf (FTC still considered efficiencies of a collaboration between dominant health care providers in Norman, Oklahoma even though the groups could not "quantify... the likely overall efficiency benefits of [their] proposed program.").

[17] Daniel A. Crane, Rethinking Merger Efficiencies, 110 Mich. L. Rev. 347, 390 (2011).

[18] 2010 Merger Guidelines, supra note 12 at § 10.

[19] Dissenting Statement of Commissioner Joshua D. Wright at 5, In the Matter of Ardagh Group SA, and Saint-Gobain Containers Inc., and Compagnie de Saint-Gobain, File No. 131-0087 at 5 (Apr. 11, 2014).

[20] Malcom B. Coate & Andrew J. Heimert, Merger Efficiencies at the Federal Trade Commission 1997-2007 at 6-7 (2009), available at http://www.ftc.gov/os/2009/02/0902mergerefficiencies.pdf (From 1997 to 2007, of 342 efficiencies claims offered to the FTC by merging parties, only 29 were accepted by FTC staff, 109 were rejected, and 204 received no decision).

[21] Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶1914c.

[22] Wright, In the Matter of Ardagh Group S.A., supra note 19 at 5.