IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

FEDERAL TRADE COMMISSION and COMMONWEALTH OF PENNSYLVANIA, Appellants, v. PENN STATE HERSHEY MEDICAL CENTER and PINNACLEHEALTH SYSTEM, Appellees.	No. 16-2365

REPLY OF THE FEDERAL TRADE COMMISSION AND THE COMMONWEALTH OF PENNSYLVANIA IN SUPPORT OF THEIR EMERGENCY MOTION FOR AN INJUNCTION PENDING APPEAL

The Government showed in its motion that the four-county Harrisburg area is a proper antitrust geographic market because a hypothetical hospital monopolist in that area could force insurers to accept a price increase for general acute care inpatient services. Expert and fact evidence, including the deposition testimony of Pennsylvania's two largest insurers, decisively establishes that without either Hershey or Pinnacle in their provider network insurers cannot successfully sell policies to their Harrisburg area customers. Market forces thus would compel insurers to pay a higher rate demanded by a hypothetical monopolist of all Harrisburg area hospitals. The Harrisburg area therefore is a proper geographic market.

As we showed, the district court fundamentally erred by ignoring this basic economic reality of the healthcare marketplace and addressing the wrong question. It asked whether Hershey draws patients from outside the Government's proposed market and whether those patients could turn to hospitals other than Hershey or Pinnacle. But the behavior of those patients does not answer the relevant question: whether the direct purchasers—insurers—would pay a higher price to one of defendants' hospitals rather than attempt to sell policies that have no Harrisburg area hospitals in the network. By ignoring that issue, the district court "misapprehended the weight of the evidence" and committed clear error in assessing the geographic market. *Lame v. U.S. Dep't of Justice*, 767 F.2d 66, 70 (3d Cir. 1985). The court committed a second clear error by considering private

rate contracts in its geographic market analysis. Those flaws tainted the remainder of the analysis.

Defendants' opposition does not salvage the court's decision. They charge mostly that by focusing on the role of insurance companies, the Government improperly ignored patient preferences. But insurers, which sell policies in a competitive market, *must* and *do* respond to those preferences. Because consumers demand access to defendants' hospitals, insurance networks must offer their policyholders access to those hospitals and would readily agree to a price increase to retain them.

ARGUMENT

I. THE GOVERNMENT IS LIKELY TO SUCCEED ON THE MERITS

A. The District Court Wrongly Rejected The Government's Proposed Geographic Market.

A geographic market is the area where buyers look to obtain the product they need. A market is proper for antitrust analysis if a hypothetical monopolist in that area would be able to demand a price increase, or SSNIP. Here, the pertinent buyers are the insurers that negotiate prices with hospitals. The evidence showed overwhelmingly that insurers would pay a SSNIP to a hypothetical hospital monopolist of all Harrisburg area hospitals rather than exclude those hospitals from their networks.

Specifically, to sell policies, an insurer's network must contain hospitals its policyholders demand. *Saint Alphonsus Med. Ctr. v. St. Luke's Health Sys.*, 2014

WL 407446, at *7 (D. Idaho Jan. 24, 2014), *aff'd* 778 F.3d 775 (9th Cir. 2015). The district court reached an irrational result at odds with the evidence when it reasoned that the travel patterns of Hershey's patients disprove that they strongly prefer access to local hospitals. Op. 9-10. The undisputed evidence showed that over 90% of Harrisburg area patients seek care within the area and do not travel far for care. Mot. 6. Defendants' own witnesses testified that receiving care close to home is a "big determinant in people's choice of health care," and that patients tend not to travel very far for GAC services. Hrg. 474:7-10,521:19-522:6. That some patients from outside the Harrisburg area choose to seek care at Hershey does *not* mean that most patients inside or outside the Harrisburg also would do so.[1]

Defendants wrongly assert that the Government's case rests on the idea that "there is no connection between *patients'* hospital alternatives … and *payors'* ability to resist a SSNIP." D.Opp. 9. To the contrary, the parties agree that "patient[] preferences drive payor-hospital negotiations." D.Opp. 1. But both the defendants and the district court ignore the obvious import of that agreement: because patients demand local care, insurer's networks must contain local hospitals

Unrebutted evidence from one of the area's two largest insurers showed that without Hershey or Pinnacle, "there would be no network," the insurer would lose

[1] The Government accounted for the preferences of patients outside of the Harrisburg area by conducting a "diversion analysis" that evaluated hospitals and patients both inside and outside the Harrisburg area. Hrg. 327:23-328:17. This analysis confirmed that the defendants' combined hospitals alone would be able to increase prices in excess of a SSNIP. PX01424 (Wilson Rebuttal) at 18-19, 141.

half its customers, and it would have no realistic alternative but to pay 25 percent more to avoid that result. PX01236 at 48:17-22, 49:8-15, 144:6-16. Unrebutted evidence from the other large area insurer also showed it could not successfully market a health plan in the Harrisburg area without the combined entity. PX00804 at 64:13-20. Unrebutted evidence from yet a third insurer showed that a network without either Pinnacle or Hershey is not viable, even if it contains hospitals outside the Harrisburg area. Mot. 7-8.

By blinding itself to that evidence and economic reality, the district court reached the irrational result that hospitals up to 65 minutes away "provide a realistic alternative that patients would utilize." Op. 10. That is flatly contradicted by the unrefuted testimony that insurers need *Harrisburg area* hospitals in their networks and would pay at least a SSNIP to keep them in-network. Hospitals outside the area plainly are *not* realistic alternatives for insurers.

Instead of considering whether insurers would pay a SSNIP, the district court speculated that Hershey patients from distant areas might seek care at hospitals in those areas in response to a price increase. Op. 10. Defendants presented not a shred of evidence for this proposition, and the court cited none. The court's baseless conclusions that (1) patients choose hospitals based on reimbursement rates negotiated by insurers; and (2) that Hershey patients who travel longer distances to receive care would switch to local hospitals instead in the event of a small price increase charged to insurers, are clearly erroneous.

Defendants appear to recognize this error when they concede that patients "do not directly bear price increases," thus acknowledging that insurers are the true customers. D.Opp. 9. They attempt to salvage the district court's decision by reading in an "inference that the presence of 'readily' available alternatives for *patients* would help *payors* resist a SSNIP." D.Opp. 10. But the District Court determined no such thing. Indeed, it would not have been possible to do so given the clear evidence from insurers that if Hershey/Pinnacle raised prices they would have no choice but to pay a SSNIP, for there were *no* other alternatives.

Defendants next contend that the district court's decision is justified by the fact that Hershey and Pinnacle compete with "a large number of hospitals outside the Harrisburg Area." D.Opp. 7. That is wrong as an economic matter because Harrisburg area hospitals, including Hershey and Pinnacle, do not compete with such hospitals *for inclusion in insurer networks* marketed to Harrisburg area employers. That Hershey "competes" in a vernacular sense or to some limited degree with other hospitals throughout Pennsylvania does not alter the conclusion that insurers would not turn to these distant hospitals in response to a SSNIP from a hypothetical monopolist of Harrisburg area hospitals. Such competition has no bearing on a geographic market analysis, which examines the area that would be affected by the elimination of competition between the Defendants.[2]

[2] The *Merger Guidelines* recognize that "properly defined antitrust markets often exclude some [competitors of the merging parties] which some customers might

Defendants' have no convincing defense for the district court's clear error in ignoring whether defendants could raise prices at Pinnacle's hospitals. The hypothetical monopolist test asks whether the monopolist could impose a SSNIP "from at least one location" of the merging firms. *Merger Guidelines* § 4.2.1. The district court plainly did not engage in this analysis with respect to Pinnacle, which is barely mentioned in the opinion. The failure to consider price increases at Pinnace is especially striking in light of the testimony of Hershey's own CEO, who recognized that insurers were specifically concerned that the merger would allow defendants to raise prices specifically at Pinnacle. Mot. 16.

Finally, the district court plainly erred when it relied on defendants' temporary rate agreements as an element of the geographic market analysis. Defendants (who did not make the claim below) attempt to obscure the problem by claiming that the court examined the agreements only when "considering *the import* of the hypothetical monopolist test." D.Opp. 13. That description cannot be squared with the district court's opinion. Semantics aside, the court found the agreements "extremely compelling" and they clearly infected its geographic market analysis. Op. 10.

If anything, the rate agreements highlight the district court's error. Unrebutted testimony and contemporaneous business documents show that the two

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turn in the face of a price increase even if such substitutes provide alternatives for those customers." *Merger Guidelines* § 4.

largest insurers sought these agreements as "protection" precisely because they feared uncontrollable rate increases post-merger. The agreements prove that insurers do not view hospitals outside the Harrisburg area as "realistic alternatives" to the defendants that would allow them to defeat a SSNIP. Otherwise, the rate agreements would have been unnecessary.

Beyond mere error, the court's reliance on private price agreements to define a geographic market marks an unprecedented departure from the standard framework of antitrust analysis employed by the nation's antitrust enforcers. The district court's ruling has troubling implications beyond this case, for it would empower merging parties with presumptively unlawful market shares to stymie a proposed geographic market by privately agreeing not to impose a SSNIP.

B. Defendants Did Not Show That Anticompetitive Effects Are Unlikely Or That Alleged Benefits Justify The Merger

Defendants' contention that the district court's other findings offer an independent basis for affirming its decision is meritless. D.Opp. 14, 18. If the district court had properly found the Harrisburg area to be a relevant geographic market, it would have necessarily found the merger to be presumptively illegal. Thus, the burden would have shifted to defendants to "'clearly' show that their combination would not cause anticompetitive effects," Op. 12, or to show "extraordinary efficiencies" *FTC v. HJ Heinz Co.*, 246 F.3d 708, 720-21 (D.C. Cir. 2001). But the District Court did not undertake a rigorous analysis of these issues, which would have revealed that Defendants failed to meet their heavy burden.

No merging parties have ever shown efficiencies that outweigh a presumption of illegality. Given the exceptionally high market concentration here, defendants are unlikely to be the first. Yet the district court conducted no efficiency analysis and considered purported efficiencies only in weighing the equities. Op. 13. The court completely ignored that "efficiency" claims are cognizable only if they are merger-specific, verifiable, substantiated, and unrelated to a reduction in output or service. *Merger Guidelines* §10.

Defendants' bed-tower claim meets none of those criteria. Avoiding construction of a $277 million, 100-bed facility is not a benefit of the transaction; it is an anticompetitive restriction of output. Hrg. 341:5-15; PX00757 § 10. *FTC v. ProMedica Health Sys., Inc.*, 2011 WL 1219281 at *36 (N.D. Ohio Mar. 29, 2011). The claim that the merger will increase bed capacity (D.Opp. 15 n.4) is particularly untenable. The merger will not add a single bed, and today patients may go to Pinnacle, which provides most of the same services, whether or not the hospitals merge.

Regarding competitive effects, defendants rely significantly on the district court's observation that "as a precaution … the Hospitals presented ample evidence demonstrating that anticompetitive effects would not arise through the merger of Hershey and Pinnacle." Op. 12-13. This single conclusory statement, unsupported by any citation or discussion does not constitute a holding that defendants successfully proved an absence of anticompetitive effects.

"Repositioning" by nearby hospitals bears on anticompetitive effects. Op. 20-22. But the District Court did not apply the legal standard for assessing such an effect. Repositioning of existing competitors must be "equivalent to new entry" of a competitor and must be in response to the merger. *FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26, 57 (D.D.C. 2009); *Merger Guidelines* § 6.1.

Defendants next contend that the merger would allow them to engage in more risk-based contracting, a potentially efficient form of reimbursement. Op. 23. Any benefit plainly is not merger-specific; the court acknowledged directly that the merger is not *necessary* for such contracting. *Id*.

Finally, although the district court addressed the rate agreements only as part of its geographic market analysis, defendants argue that they mitigate the merger's anticompetitive effects. D.Opp. 17. In fact, the agreements do not freeze existing rates but allow yearly increases. PX01200 at 78:8-21, 103:17-104:6; PX00804 at 87:15-22; PX01201 at 169:4-24, 170:5-20, 201:6-202:18. They also do not prevent rate increases to other insurers, offer no protection against increased rates on risk-based contracts, and do not address quality of care. Such arrangements cannot save an otherwise anticompetitive merger. *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 67 (D.D.C. 1998); *FTC v. OSF Healthcare Sys.*, 852 F. Supp. 2d 1069, 1085 (N.D. Ill. 2012).

C. CLOSING THE MERGER WILL CAUSE IRREPARABLE INJURY; ENJOINING THE MERGER WILL NOT.

Closing the merger will likely cause irreparable harm. The FTC has had

unfortunate experiences trying to unwind unlawful healthcare mergers. In *Phoebe Putney*, the FTC successfully challenged the merger after it had closed. Two years later, divestiture remained too difficult to achieve, and the FTC allowed the parties to remain merged. *See* https://www.ftc. gov/system/files/documents/public_ statements/634181/150331phoebeputneycommstmt.pdf. In *St. Luke's*, divestiture has not yet occurred well over a year after the court of appeals found the merger unlawful. Here, among other changes, defendants plan to lay off redundant doctors, who likely will leave the area and become unavailable if the merger is unwound, transfer patients, and take other conclusive actions.

Closing the merger will also irreparably harm competition. Rate negotiations are ongoing, and upon closing, defendants may share competitively sensitive information, including rate information, business plans, and negotiating strategies with respect to ongoing negotiations. Indeed, defense counsel argued against public disclosure of the complaint on that very ground. PX01382-004. Even if the merger could be unwound, there is no way to unring the bell.

By contrast, enjoining the merger pending appeal will not substantially harm defendants. They do not contest that there is no deadline for their deal. They claim only that the public will suffer from the delay in the merger's benefits. But as shown above, the merger will deliver no genuine public benefits. A short delay is far outweighed by the substantial public interest in maintaining competition between these hospitals and effectively enforcing the antitrust laws.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on May 19, 2016, I electronically filed with the Court's CM/ECF system the foregoing Reply in Support of Emergency Motion for Injunction Pending Appeal. The counsel for defendants-appellees will be served by the CM/ECF system.

s/ Michele Arington