The rising costs of providing quality healthcare as well as pressures on revenue from both government insurance programs and a larger uninsured population have undermined the financial strength of hospitals across the country. Many stand-alone hospitals have sought shelter in partnerships with stronger organizations. The complex regulatory scheme in the Patient Protection and Affordable Care Act (ACA) has further incentivized stand-alone hospitals to merge with larger hospital systems in an effort to cut costs and increase profitability. Commercial payors’ demands for value-based contracts also have led hospitals to seek greater scale of operations through mergers and acquisitions. Notwithstanding these merger-rich conditions, the Federal Trade Commission (FTC) and the U.S. Department of Justice’s Antitrust Division (collectively, the Agencies) remain vigilant in challenging alleged anticompetitive hospital mergers. Nowhere has the Agencies’ stance on merger enforcement in the hospital industry been on more prominent display than in the FTC’s recent challenge of ProMedica Health System’s (ProMedica) acquisition of St. Luke’s Hospital.

One defense to a merger challenge that parties frequently invoke, albeit with limited success, is the weakened competitor justification. Indeed, this was one of the parties’ central arguments in ProMedica. The weakened competitor justification essentially discounts the competitive significance, i.e., the current market share, of the firm to be acquired based on its weakened (and weakening) financial condition. To avail themselves of the defense, the merging parties must show that the acquired firm’s predicted decrease in market share undermines the Agencies’ *prima facie* case that the merger would reduce competition substantially. The parties’ use of this justification in ProMedica did not persuade the FTC to allow the merger, leaving open the question of how weak must a hospital be to successfully invoke the defense.
Recent Market Conditions and Healthcare Reform
Since 2009, the number of hospitals involved in a merger has increased 62%. Unique circumstances dictate the rationale for each merger, but one factor consistently stands out: the costs associated with providing quality healthcare services continue to rise faster than overall reimbursements. One example of increased costs is the ACA’s requirement that hospitals invest heavily in technology, such as electronic health records (EHR) to meet “meaningful use” requirements. Increases in costs that outstrip reimbursements have the ability to weaken the competitive significance of stand-alone hospitals that were once able to compete with large hospital systems.

Hospital systems that own and operate several hospitals are better positioned than stand-alone hospitals to meet the demands of the changing climate in the healthcare industry. A multi-hospital system, for example, may be able to implement technological advancements, such as an EHR system, across several hospitals, leading to reduced per-unit costs. Stand-alone hospitals do not benefit from the same economies of scale. Additionally, larger systems may have the patient volume to manage value-based payor contracts in a way that stand-alone community hospitals cannot. Faced with increasing compliance and technology costs, stand-alone hospitals have struggled to maintain their profit margins, leading many to seek a hospital system as a merger partner.

Agency Enforcement of Hospital Mergers
The antitrust laws prohibit mergers and acquisitions where their effects “may be substantially to lessen competition, or to tend to create a monopoly.” If the Agencies determine that a proposed merger is likely substantially to lessen competition, they have the authority to commence a legal proceeding to prevent the merger (or require divestiture if the merger has already been consummated). To gauge the probable competitive effects of a merger, the Agencies closely follow the framework set forth in the Horizontal Merger Guidelines (Merger Guidelines). The Merger Guidelines describe the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition. The Merger Guidelines are not binding on the courts, but they are persuasive authority, and courts often rely on them.

The Weakened Competitor Justification
The weakened competitor justification affords the merging parties the opportunity to rebut the presumption of an illegal merger if they “can prove that the acquired firm’s current market shares overstate its future competitive significance due to its weak financial condition.” Traditional market analysis assumes that merging firms will continue to operate at pre-merger levels into the foreseeable future. Merging parties asserting the weakened competitor justification argue that the merger would not harm competition due to the acquired firm’s declining competitive position in the marketplace.

No precise standard exists for establishing the weakened competitor justification, and courts have struggled with its application. Courts do recognize, however, that evidence of an acquired company’s weakened position in the market is a factor when considering a merger’s probable effects on competition. For example, one court stated that an “examination of the particular market[,] its structure, history and probable future can provide the appropriate setting for judging the probable anticompetitive effect of the merger.”

The weakened competitor justification is especially applicable to certain hospital mergers due to the impact of recent economic and regulatory changes on stand-alone hospitals’ ability to compete with hospital systems. Proper application of the defense requires courts and the Agencies to analyze the future structure of the market, taking into account the effect that changes in payment models will have on stand-alone hospitals, including increased regulatory and compliance costs and the threat of lower reimbursement rates. Higher costs and the threat of lower reimbursement rates have the potential to squeeze the margins of stand-alone hospitals, leading to lower market shares and a weakened competitive position in the market.

Evolution of the Weakened Competitor Justification
The weakened competitor justification has evolved since the Supreme Court’s decision in United States v. General Dynamics Corp. In General Dynamics, the Court held that the government’s competitive effects analysis challenging the merger of two coal companies was insufficient to sustain its case. Most importantly, the Court held that the government overestimated the future ability of the acquired firm to compete in the market because it failed to take into account properly the fact that the acquired firm’s coal reserves were depleted or committed under long-term contracts. The Court recognized that the proper method of assessing a merger’s likely competitive effect on competition is to analyze the merging firm’s “probable future ability to compete—rather than in terms of past production.” Importantly, the Court held that “[t]he failing-firm defense is simply inapposite” to the inquiry of whether the acquired firm’s current market share overstates its future competitive significance due to its weak financial condition, and the “the failure of [the merging parties] to meet the prerequisites of [the failing firm defense] did not detract
One explanation for why courts and the Agencies have struggled with applying the weakened competitor justification is that, unlike the failing firm defense, the weakened competitor justification is not an elements-based test.

from the validity of the lower court’s analysis of the acquired coal company’s weakened competitive position in the market. General Dynamics stands for the proposition that a company may be a far less significant competitor than current market shares indicate if its future competitive position looks dim.

A few years later, in United States v. International Harvester Company, the Seventh Circuit accepted International Harvester’s argument that its acquisition of 39% of fellow farm-equipment manufacturer Steiger’s stock would not harm competition substantially due to Steiger’s weakness as a competitor. The court held that the pre-merger market shares were an inaccurate prediction of the merger’s probable effects on competition. Indeed, the evidence of Steiger’s weakened competitive position “establishes that the Government’s past market statistics are really insufficient to constitute a prima facie case because Steiger’s weak financial reserves (like the acquired firm’s weak coal reserves in General Dynamics) would not allow it to be as strong a competitor as the bald statistical projections indicate.” The court stated that even if it did accept the government’s market share statistics as the primary index of market power, “only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger.” Ultimately, International Harvester was able to show “that even if Steiger remained in the market, it did not have sufficient resources to compete effectively.” Thus, the court held that International Harvester’s acquisition of Steiger’s stock “would not substantially lessen competition.”

Thirty years after General Dynamics Corp., the U.S. District Court for the District of Columbia in FTC v. Arch Coal relied on the weakened competitor justification and refused to enjoin Arch Coal’s acquisition of Triton, a competitor in the mining business. In finding that Arch Coal’s acquisition of Triton was not likely to harm competition, the court stated that Triton was a “relatively weak competitor,” “with no convincing prospects for improvement.” The court pointed to Triton’s “high costs, [] low coal reserves,” “uncertain prospects for loans,” and “no realistic prospects for other buyers.” Based on these findings, the court held that the FTC’s “claims of Triton’s past and future competitive significance in the [relevant] market have been far overstated.” Indeed, “[a] weak financial condition . . . may mean that a company will be a far less significant competitor than current market share, or production statistics, appear to indicate.” By offering evidence to show that Triton’s competitive position in the marketplace would decrease in the future, Arch Coal was able to rebut the presumption that the merger would harm competition.

Despite the holdings in General Dynamics and its progeny, courts have been skeptical of the weakened competitor justification and are quick to reject the defense. For example, courts have stated that “financial weakness, while perhaps relevant in some cases, is probably the weakest ground of all for justifying a merger” and “certainly cannot be the primary justification” for an otherwise anticompetitive merger. Courts have disfavored the weakened competitor justification on the grounds that it “would expand the failing [firm defense], a defense which has strict limits.”

Statements from the Agencies on the Weakened Competitor Justification

FTC Commissioner J. Thomas Rosch and other agency representatives have recognized that the current economic climate has reduced the competitive significance of some companies. For example, Commissioner Rosch stated that, “[n]otwithstanding the mixed treatment of the defense in the case law, [the FTC] staff gives serious consideration to such arguments when presented by merging parties.” In 2009, when discussing the precarious economic conditions, Commissioner Rosch stated that “General Dynamics may play a greater role” in merger analysis. Commissioner Rosch rightly recognized that “market conditions as you see them now, and the health of the parties as you see them now, are not what they are likely to be in the future.” Rosch remarked, however, that “counsel put too much emphasis” on the weakened competitor justification and have “poorly developed” their arguments. Around the same time, former Deputy Assistant Attorney General for Economics at the Antitrust Division Carl Shapiro stated that “there can be efficiencies when one firm acquires its financially weak rival” and questioned “whether some mergers may be pro-competitive, even if the acquired firm does not meet the failing firm test, because the acquired firm is financially weak.”

Recent Developments: In re ProMedica Health System, Inc.

Most recently, Toledo-based ProMedica argued that St. Luke’s Hospital’s weakened competitive position was sufficient to rebut the FTC’s allegations that the ProMedica’s acquisition of St. Luke’s would harm competition substantially. According to the FTC, the merger would have given ProMedica control of 60% of the market for general acute-care hospital services in Lucas County, OH. In response, ProMedica argued that the merger would not harm competition due in part to St. Luke’s weakening competitive position in the market.
Since 2007, St. Luke’s has consistently been operating at a loss, which forced it to defer making capital expenditures, such as upgrading its facilities. St. Luke’s financial plight led one of the bond rating agencies, Moody’s, to downgrade St. Luke’s bond rating to Baa2, which, according to the administrative law judge (ALJ), was “close to ‘junk bond’ status.” St. Luke’s also faced below-cost reimbursement rates from some its commercial payors, further compounding its operating losses.

As part of its merger plan, ProMedica planned to invest $30 million in St. Luke’s during the first three years of the partnership. ProMedica’s capital injection would allow St. Luke’s to make a full range of improvements, including adding 17 private rooms, converting additional semi-private rooms to private rooms, updating its IT system, constructing an outpatient lobby, expanding surgical areas, and expanding its well infant nursery.

The ALJ’s Findings and the Commission’s Opinion
Following a full hearing, the ALJ found that “St. Luke’s was struggling financially as a stand-alone entity” and “faced significant obstacles to going forward as an independent hospital.” The ALJ stated that “the evidence does not support the conclusion that, absent the Joinder, St. Luke’s would be a viable hospital for the foreseeable future.” The ALJ recognized that St. Luke’s was on the brink as a result of “continuing losses, depletion of cash reserves, deferring capital expenditures, and employee cost cutting measures.” The evidence led the ALJ to conclude that St. Luke’s “future viability beyond the next several years is uncertain.”

Despite these factual findings, the ALJ rejected ProMedica’s weakened competitor defense, finding that St. Luke’s remained “a strong competitor” because it “succeeded in significantly raising its patient volume and market share.”

The Commissioners similarly rejected ProMedica’s weakened competitor justification. The FTC distinguished St. Luke’s financial condition from that of Triton in Arch Coal, finding that St. Luke’s, unlike Triton, had increased its market share leading up to the merger. In addition, the FTC found that St. Luke’s—unlike Triton, which was dependent on a finite and depleted natural resource and had little chance to become more competitive in the future—“was improving its financial performance,” citing St. Luke’s cash reserves and potential borrowing power. Finally, the FTC held that St. Luke’s had two alternative merger partners who “would have posed significantly fewer competitive concerns.”

Ultimately, the FTC stated that an acquired firm’s financial difficulties “are relevant only where they indicate that market shares would decline in the future and by enough to bring the merger below the threshold of presumptive illegality.” To meet the FTC’s test, ProMedica needed to show that St. Luke’s financial difficulties would lead to a sharp decline in its market share of the general acute-care inpatient hospital services market (from 11.5% to 2.1%) and the obstetrics market (from 9.3% to 1.4%). Ultimately, ProMedica was unable to show that St. Luke’s financial condition so reduces its competitive significance as to undermine [the FTC’s] prima facie case.

Takeaways from ProMedica
Two important takeaways arise from the ProMedica case. First, and most importantly, parties arguing in favor of the weakened competitor justification should be prepared to offer future market-share predictions to show that the acquired firm’s competitive significance will decline to a point sufficient to rebut the Agencies’ prima facie case. Second, merging parties should carefully distinguish their weakened competitor justification from the failing firm defense. Importantly, a failing firm must show that it has been unable to find an alternative merger partner that would pose a less severe danger to competition to qualify for the defense. The weakened competitor justification, at least arguably, has no such requirement. Courts and the Agencies should not reject the weakened competitor justification based on the acquired firm’s ability (or inability) to find an alternative merger partner that poses a less severe risk to competition. Indeed, if an acquired firm’s inability to find an alternative merger partner is a required element of the defense, the line between the failing firm defense and the weakened competition justification may soon vanish.

Final Thoughts: What to Argue in Front of the Agencies
One explanation for why courts and the Agencies have struggled with applying the weakened competitor justification is that, unlike the failing firm defense, the weakened competitor justification is not an elements-based test. To invoke the weakened competitor justification with success, Commissioner Rosch stated that,

Parties need to explain and present evidence that their financial difficulties are serious and durable, will adversely affect their long-term competitiveness, and can only be resolved by the proposed merger. The weakened firm defense tends to be more effective when it is presented in conjunction with other credible reasons to believe that a transaction will not substantially lessen competition, rather than as the sole, or principal, defense to a transaction.

This is a high bar, to be sure, and the circumstances under which the Agencies will recognize the weakened competitor justification in the hospital merger context remain unclear. The weakened competitor justification, while not appropriate in every merger challenge, does have its place in certain hospital mergers, especially given changes in the payment environment and current economic conditions.

About the Author
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“Meaningful use” of health information technology is an umbrella term for rules and regulations that hospitals and physicians must meet to qualify for federal incentive funding under the American Recovery and Reinvestment Act of 2009 (ARRA). The ARRA specifies three main components of Meaningful Use:

1. The use of a certified EHR in a meaningful manner, such as e-prescribing;
2. The use of certified EHR technology for electronic exchange of health information to improve quality of healthcare, and
3. The use of certified EHR technology to submit clinical quality and other measures.

“Simply put, ‘meaningful use’ means providers need to show they are using certified EHR technology in ways that can be measured significantly in quality and in quantity.” CMS EHR Meaningful Use Overview, CMS.gov, https://www.cms.gov/EHRIncentivePrograms/30_Meaningful_Use.asp (last visited Feb. 14, 2011).


Merger Guidelines, § 1.

United States v. Kindred, 64 F.3d 757, 771 n.22 (2d Cir. 1995) (“Although it is widely acknowledged that the Merger Guidelines do not bind the judiciary in determining whether to sanction a corporate merger or acquisition for anticompetitive effect, courts commonly cite them as a benchmark of legality.”).


Id. at 503-04.

Id. at 503.

General Dynamics Corp., 415 U.S. at 508.

Int’l Harvester Co., 564 F.2d at 773-75.

Id. at 773.

Id. at 774 (quoting Brown Shoe Co., Inc. v. United States, 370 U.S. 294 n.38 (1962)).

Id.


Id. at 157.

Id.

Id.

Id. at 153.

Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1339 (7th Cir. 1981); see also FTC v. Warner Commc’ns, 742 F.2d 1156, 1165 (9th Cir. 1984).

Warner Commc’ns, 742 F.2d at 1164. See also Merger Guidelines, § 11. The failing firm defense permits an otherwise illegal merger when the acquired firm’s financial position is so dire that, but for the merger, it would no longer be able to remain in the market. In addition, there must be no other suitors posing a less severe danger to competition willing to purchase the failing firm’s assets.


Interview with J. Thomas Rosch, Commissioner, Federal Trade Commission, 23 Antitrust No. 2, at 41 (Spring 2009), available at www.ftc.gov/speeches/rosch/090126abainterview.pdf. (In response to a question about the potential of more failing firm arguments to justify mergers, Commissioner Rosch stated that: “I think it’s possible the agencies will take a closer look at that.”).

Id.

See supra note 26.

Remarks of Carl Shapiro, Deputy Assistant Attorney General for Economics, Antitrust Division, U.S. Department of Justice, Prepared for Delivery to ABA Antitrust Symposium, Competition as Public Policy, Competition Policy in Distressed Industries, May 13, 2009. (“One can also ask whether some mergers may be pro-competitive, even if the acquired firm does not meet the failing firm test, because the acquired firm is financially weak. This is sometimes called the “failing firm” defense. In principle, of course, there can be efficiencies when one firm acquires its financially weak rival. However, following Section 4 of the Horizontal Merger Guidelines, to invoke an efficiency defense, the merging parties would have to establish that these efficiencies are large enough so that consumers are not harmed by the loss of competition resulting from the merger.”)


FTC Opinion, at 1.

Id. at 4.

Id. at 10.


FTC Opinion, at 31.

Id. at 2.

Id. at 13.

Id. at 28.

ALJ Decision, at 189 (emphasis added). On appeal, the FTC disagreed with the ALJ on this point, stating that St. Luke’s “viability in the foreseeable future is not seriously at risk.” FTC Opinion, at 58.

ALJ Decision, at 187.

Id. at 189.

Id. The ALJ also stated, however, that “St. Luke’s overall payor ratio was insufficient to cover its total costs.” Id. at 188. If that was the case, increased patient volume would lead to a higher market share based on the number of patient discharges, but it may not lead to increased profitability.

FTC Opinion, at 29, 34.

Id.

Id.

Id. at 34. The ALJ stated that a merger between St. Luke’s and either alternative purchaser “would also likely have been subject to antitrust scrutiny.” ALJ Decision, at 189.


Id. at 32.

Id. at 34.

See Merger Guidelines, § 11 (“The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless . . . it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition that does the proposed merger.”).

See Arch Coal, Inc., 329 F.3d at 156-57 (analyzing Triton’s prospects for an alternative purchaser, and holding that, although Triton was “not a failing firm in the technical sense,” it was “a relatively weak competitor”).


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