DEPARTMENT OF JUSTICE

COMMENTS ON THE ANTITRUST ASPECTS OF HOSPITAL VIRTUAL MERGERS:

When might the antitrust laws condemn joint negotiation with managed care plans as *per se* illegal?

Presented by

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[1] This paper expresses only my own views. Nothing in it is intended, or should be construed, to express any policy or position of the Department of Justice or its Antitrust Division.

Numerous articles in the last three years have commented on the waive of hospital transactions forming affiliations, networks, joint ventures, partnerships and new corporations that result in joint marketting of the hospitals' services but generally are not viewed as mergers.[2] The American Hospital Association believes this development is so significant that it has urged the Department of Justice and the Federal Trade Commission ("FTC") to provide guidance on their approach in analyzing such transactions under the antitrust laws.[3] The Justice Department and the FTC have included the analysis of such hospital transactions within their broader inquiry into the appropriate treatment of joint ventures generally.[4]

This paper comments on the antitrust analysis of whether joint negotiation with managed care plans and other cooperative activities of competing hospitals following such virtual mergers are *per se* illegal, or otherwise can be summarily condemned without an extensive inquiry into whether the transaction increases the parties' market power or is likely to cause, or has caused, anticompetitive effects in the relevant markets.[5] The paper begins by providing some

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[2] *See, e.g.*, How Close Is Too Close in Hospital Partnerships, Modern Healthcare, at 26 (April 17, 1995), *and*, This Is Not A Merger: Hospital Partnerships Bring Synergy Without Touchy Ownership Issues, AHA News, at 5 (Nov. 17, 1997).

[3] Statement of the American Hospital Association submitted to the Federal Trade Commission, August 1, 1997.

[4] *See* the FTC's Roundtable Agenda, "Implications of *Copperweld Corp. v. Independence Tube* for Single Firm Treatment of Some Competitor Collaborations," which may be found at http://www.ftc.gov/bc/adops/index/agenda2.htm.

[5] This paper does not examine the antitrust analysis applicable if the transaction does not give rise to a *per se* violation of section 1 of the Sherman Act. In that event, the antitrust analysis moves to a fuller analysis of the relevant markets and the actual or likely effects of the transaction under either section 1's Rule-of-Reason analysis, or section 7 of the Clayton Act's substantial lessening of competition or tending to create a monopoly analysis. One source of general guidance on the Rule-of-Reason analysis under section 1, although not directly addressing virtual mergers and hospital affiliations, is U. S. Dep't of Justice & Federal Trade

background on general antitrust principles. It then describes a proposed transaction between two Long Island, New York hospitals that the Department of Justice investigated. During that investigation, the Department raised the possibility of challenging joint managed care contracting by the hospitals following the proposed "virtual merger" as *per se* illegal. Next the paper discusses two crucially important questions in determining whether joint managed care contracting following that virtual merger would have been *per se* illegal: first, whether the virtual merger would have resulted in a "single entity" for antitrust purposes; and, second, if a single entity did not result, whether the procompetitive aspects of that transaction would have justified joint managed care contracting. If the answer to both questions were no, then joint managed care contracting following the proposed transaction would probably have been *per se* illegal.

I. BACKGROUND

Under section 1 of the Sherman Act,[6] certain agreements among competitors may be summarily condemned without extensive inquiry into their actual or likely anticompetitive effects.[7] Summary condemnation generally applies to "naked" agreements among competitors

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Comm'n, Statements of Antitrust Enforcement Policy in Health Care (1996), *reprinted in*, 4 Trade Reg. Rep. (CCH) ¶ 13,153 ("Health Care Policy Statements"). The Justice Department's and FTC's Horizontal Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 (1992), as amended on April 8, 1997, provide an appropriate framework for the antitrust analysis of such transactions under section 7 of the Clayton Act.

[6] 15 U.S.C. § 1.

[7] *See generally Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332 (1982); *United States v. Classic Care Network, Inc.* 1995-1 Trade Cas. (CCH) ¶ 70,997 (E.D.N.Y. 1995) (consent decree); Joel I. Klein, Acting Assistant Attorney General, Antitrust Division, U.S. Dep't of Justice, "A Stepwise Approach to Antitrust Review of Horizontal Agreements," Address before the ABA's Antitrust Law Section Semi-Annual Fall Policy Program, (Nov. 7, 1996) ("Klein, Stepwise Approach").

that restrict competition or reduce output,[8] such as agreements on price,[9] agreements allocating customers or territory,[10] and agreements not to compete.[11]

On the other hand, an agreement requires more than one actor, and if the virtual merger leaves only a single entity, then section 1 by its own terms does not apply to the activity of the entity after the transaction is consummated.[12] Alternatively, if the facially anticompetitive aspects of the transaction are "ancillary" to an otherwise procompetitive goal, summary condemnation is unlikely, even if the virtual merger does not result in a single entity.[13]

A transaction clearly does not result in a single entity if it merely incorporates an agent for the purpose of setting price or engaging in other conduct that eliminates competition. It is axiomatic that the substance, not the form, of a transaction controls whether it results in a single entity or whether a restraint on competition is ancillary rather than naked.[14] For example, in 1994, the Department of Justice challenged the Classic Care network of eight hospitals on Long Island. The hospitals there had formed a new, nonprofit corporation, Classic Care, Inc., in the

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8 Klein, Stepwise Approach, n.7, *supra*.

9 *Maricopa*, *supra*.

10 *United States v. Cooperative Theaters of Ohio, Inc.*, 845 F.2d 1367, 1373 (6th Cir. 1988).

11 *United States v. General Elec. Co.*, 1997-1 Trade Cas. (CCH) ¶ 71,765 (D.Mont. 1997).

12 *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).

13 *See generally* John J. Miles, *Joint Venture Analysis and Provider Controlled Health Care Networks*, 66 Antitrust L. J. 127 (1997).

14 *Timken Roller Bearing Co. v. United States*, 341 U.S. 593, 598 (1951); *Palmer v. BRG of Georgia*, 498 U.S. 46, 49 (1990).

fall of 1991 to negotiate contracts jointly with managed care plans.[15] Each hospital became a member of Classic Care, received a seat on its board of trustees, and committed to conduct its managed care contracting exclusively through Classic Care.[16] The Department challenged the managed care contracting of the hospitals through this structure as a *per se* illegal horizontal price fixing agreement. Ultimately, the hospitals consented to entry of a judgment against them on this charge.[17]

The principal argument that managed care contracting is not *per se* illegal after a virtual merger has been that the transaction results in a single entity under *Copperweld* because it aligns the incentives of the hospitals by ceding some actual or potential control over the hospitals to the newly formed network.[18] An example is a 1997 transaction between Long Island Jewish Medical Center ("LIJ") and North Shore Health System ("North Shore"). During the investigation of that transaction, the Department of Justice advised LIJ and North Shore that it had significant questions under section 1 about the legality of the hospitals' joint managed care contracting

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15 57 F.R. 67,719, 67,724 (Dec. 30, 1994).

16 *Id.* at 67,725.

17 Similarly, the State of New York this year filed suit against two hospitals in Poughkeepsie, New York charging price fixing as a result of their virtual merger. In *New York v. St. Francis Hosp.*, No. 98-0939 (S.D.N.Y. filed February 10, 1998), the State has challenged as *per se* illegal under the Sherman Act the managed care negotiations by a third corporation on behalf of the hospitals that incorporated it. While at this juncture the lack of available detail on that transaction makes it difficult to comment on the full extent of the State's position with regard to virtual mergers, it is clear from the State's complaint that the transaction involves something more than the mere formation of a new corporation to conduct managed care contracting.

18 Matthew C. Rosser, *Poughkeepsie and Beyond: Antitrust Analysis of Hospital Joint Operating Arrangements*, Antitrust Health Care Chronicle, v. 12, no. 1, at 2 (ABA 1998).

following the transaction because of its structure.[19] The original structure of that transaction provides a set of useful facts for examining the issues presented by virtual mergers.

LIJ and North Shore operated competing nonprofit general acute care hospitals on Long Island, New York. Those hospitals were profitable and independently viable. As originally structured, their transaction reflected their commitment that it would not sacrifice each hospital's continued independent identity and would assure equality in terms of the role each of the institutions would play in the future.

LIJ and North Shore agreed to form a third corporation, Newco. NewCo would have become the sole member of each hospital. Each hospital would have appointed seven of the original trustees to NewCo's fourteen-member board. All actions of NewCo would require at least a majority vote. For the first three years, each hospital would have had the right to replace its appointees without cause and to fill independently any vacancies created when one of those appointees left the board. After three years, NewCo's board would become self-perpetuating. Each hospital would then have had the right to present to NewCo nominees for any open seat on its board. NewCo's board could not accept the nominee without a majority vote.

The boards of LIJ and North Shore were self-perpetuating. However, NewCo's board would have been able remove a trustee of either hospital's board by a supermajority vote (75%) of NewCo's board. NewCo's board could not have exercised this authority to remove a hospital trustee at the first board meeting at which the question was presented; rather, it would have had

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[19] The hospitals maintained that the transaction, as proposed, would create a single entity. Without conceding the validity of the Department's concerns, however, the hospitals restructured their transaction to eliminate the problems that gave rise to these *per se* questions. The Department ultimately challenged the transaction based on a merger analysis and did not claim that post-transaction joint contracting would be *per se* unlawful.

to wait until at least the next meeting to act. NewCo would not have been a "hospital" under state law, and it could not have eliminated the corporate structure of LIJ or North Shore. Thus, while it could have replaced trustees of the hospitals, it could not have eliminated their boards of trustees.

The proposed agreement specified voting requirements for NewCo's board and reserved powers to the boards of LIJ and North Shore that had the clear purpose of protecting their independent interests. A supermajority vote of NewCo's trustees was required to initiate such things as a consolidation of services offered at each hospital. Each hospital's board then would have had to approve independently any such major changes that affected it.

The parties intended a perpetual relationship. The agreement had no termination date and made no provision for either party to withdraw unilaterally from it. On the other hand, the agreement did provide that the parties could mutually agree to modify or amend the agreement.

The agreement specified that, after the transaction, NewCo be the exclusive agent for negotiation and contracting with managed care plans. The agreement, however, did not provide for the sharing of profits and losses. This agreement to negotiate and contract with managed care plans jointly is the type of agreement that, absent single-entity status or some justification, would normally be summarily condemned or found *per se* unlawful under the antitrust laws under section 1.

II. WOULD THE TRANSACTION HAVE RESULTED IN A SINGLE ENTITY?

Whether the transaction would have resulted in a single entity turns on the meaning and scope of the Supreme Court's *Copperweld* decision. While the caselaw does not provide an explicit answer, an examination of *Copperweld* and two later decisions of courts of appeals that have extended it indicates that a transaction results in a single entity only when it completely aligns the economic interests of the parties and cedes sufficient authority to a single decision maker to compel actions intended to achieve efficiencies. The proposed LIJ-North Shore transaction appeared to fail this test.

A. The Caselaw

This paper will not attempt to canvass the relevant caselaw on the single entity issue. No case has yet addressed this issue in the context of a transaction similar to that contemplated by LIJ and North Shore. *Copperweld* itself certainly provides no definitive answer.

In *Copperweld*, the Supreme Court held only that a for-profit corporation and its wholly-owned subsidiary were legally incapable of "agreeing" with each other for purposes of section 1 because, despite their separate corporate existence, they were merely a single entity. A single person cannot "agree" with itself. The *Copperweld* decision explicitly limited its holding to parents and their wholly-owned subsidiaries:

> We limit our inquiry to the narrow issue squarely presented: whether a parent and a wholly owned subsidiary are capable of conspiring in violation of § 1 of the Sherman Act. We do not consider under what circumstances, if any, a parent may be liable for conspiring with an affiliated corporation it does not completely own.[20]

The Court described single firms as those not involving "separate actors pursuing separate economic interests."[21] It reasoned that a parent and its subsidiary share a common purpose because "the parent may assert full control at any moment if the subsidiary fails to act in the

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20 *Copperweld*, 467 U.S. at 767.

21 *Id.* at 769.

parent's best interests."[22] The Court concluded that "reality" rather than "form" should determine whether an enterprise is a single actor.[23]

The "reality" the Court was concerned with was one of economic efficiency. It relied on the concept that a parent and subsidiary corporation, while separately incorporated, pursue the "common interests of the whole rather than separate interests from those of the corporation itself,"[24] observing that "[w]ith or without a formal "agreement," <u>the subsidiary acts for the benefit of the parent</u>, its sole shareholder.[25] (Emphasis supplied.) Additionally, the Court observed that the parent could "assert full control at any moment if the subsidiary fails to act in the parent's best interest."[26] These passages reflect two separate, essential characteristics of a single entity: (1) alignment of the corporations' economic interests and (2) the ability of the parent corporation to ensure that the aligned interests are pursued.

These two essential considerations flowed from the Court's concern that courts not apply section 1 in a manner that undermines economic efficiency:

> Especially in view of the increasing complexity of corporate operations, a business enterprise should be free to structure itself in ways that serve efficiency of control, economy of operations, and other factors dictated by business judgment without increasing its exposure to antitrust liability.[27]

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22 *Id.* at 771-72.

23 *Id.* at 772.

24 *Id.* at 770.

25 *Id.* at 771.

26 *Id.* at 771-72.

27 *Id.* at 773.

The alignment of economic interests reflects this concern for economic efficiency. The profit-maximizing motive of the subsidiary and the parent should be completely aligned and result in their seeking to minimize their costs; and, the parent should be able, as a single decision maker, to compel economically rational actions by its subsidiary to implement these interests.

The importance of the "aligned economic interests" inquiry to the single entity determination is apparent in two subsequent courts of appeals opinions that extended the *Copperweld* decision beyond its facts to substantially different structures: *Mt. Pleasant v. Associated Electric Cooperative* ("*Mt. Pleasant*")[28] and *Chicago Professional Sports Ltd. Partnership v. National Basketball Association* ("*Chicago Bulls*").[29]

The *Mt. Pleasant* decision involved an alleged agreement among the separately incorporated cooperatives, which were the owner/members of another entity--a rural electrical cooperative formed to generate electricity for resale by those owner/members to their owner/customers. The cooperative sold excess energy to other parties, one of which, the city of Mt. Pleasant, sued it for charging the city a higher price for excess power than it charged its rural owner/member cooperatives. The Eighth Circuit observed that "an analysis solely in terms of legal ownership and control would probably lead to the conclusion that" the cooperative was not a single entity.[30] It, however, found "critical" that the members had never "pursued interests antithetical to those of the cooperative as a whole" but rather had pursued "a common goal--the provision of low-cost electricity to its rural consumer-members." The plaintiff failed to produce

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28 838 F.2d 268 (8th Cir. 1988).

29 95 F.3d 593 (7th Cir. 1996).

30 838 F.2d at 276.

facts showing that "any two of the defendants are, or have been, actual or potential competitors . . . or, at the very least, interests which are sufficiently divergent so that a reasonable juror could conclude that the entities have not always worked together for a common cause."[31] The court found that the cooperative members clearly could not have generated power independently and in competition with one another.[32] In short, the arrangement considered in *Mt. Pleasant* was unequivocally one that increased output and did not restrain competition.

In *Chicago Bulls*, the Seventh Circuit evaluated whether the National Basketball Association was a single entity in connection with restrictions it imposed on the broadcasting rights of the separately incorporated basketball teams. The majority observed that "[c]onduct that 'deprives the marketplace of the independent decision makers that competition assumes', . . . without the efficiencies that come with integration inside a firm, go on the 'concerted' side of the line."[33] The court ultimately did not decide whether the NBA was a single entity but rather observed that this was "a tough question." In favor of a single entity, the court pointed to the fact that "the NBA has no existence independent of sports. It makes professional basketball; only it can make 'NBA Basketball' games; and . . . the NBA also 'makes' teams. . . . All of this makes the league look like a single firm."[34] On the other side of the ledger, the Court pointed to the fact that the relationship between the teams and the NBA was unlike the relationship between

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31 *Id.* (citations omitted).

32 *Id.* at 277.

33 95 F.3d at 598-99 (internal citations omitted, quoting *Copperweld*).

34 *Id.*

operating units of a corporation and the corporation itself because "the teams have not surrendered their power to arrange things yet again."[35]

The economic efficiency concerns motivating these decisions explain why the single-entity inquiry turns on whether a transaction both aligns the economic interests of the parties and cedes adequate control to a single decisionmaking body. Reliance on either characteristic alone could lead to untenable results. The parties to a naked cartel, for example, have aligned their economic interests at least to some degree, but that fact alone does not negate application of the *per se* rule to their price fixing.[36] Judge Posner's recent observations in different circumstances seem to make this point well:

> A merger between competitors and a price-fixing agreement between competitors have the same effect in extinguishing price competition between the parties, but the merger is more likely to produce offsetting cost savings and is therefore treated more leniently by the antitrust laws.[37]

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35 *Id.*

36 One article makes a similar point in criticizing jury instructions on the single entity question approved in *International Travel Arrangers v. NWA, Inc.*, 991 F.2d 1389 (8th Cir.), *cert. denied*, 114 S. Ct. 345 (1993):

> The instructions have a specific substantive flaw as well. They declare that there can be no conspiracy when two entities have "an inherent unity of economic interest and purpose." Yet when two firms achieve "unity of economic interest," the law declares they *have* conspired. The *International Travel Arrangers* instruction seemingly teaches that when defendants have agreed with specificity to harm consumers, raise prices, drive out competition, and share equally in the returns, the defendants can be found incapable of conspiring! . . . Although the jury instruction finds support in *Copperweld*'s language, the instruction invites mischief.

Stephen Calkins, <u>Copperweld</u> *In The Courts: The Road to* <u>Caribe</u>, 63 Antitrust L.J. 345, 362 (1995).

37 *Kahn*, 93 F.3d at 1360.

The shifting of control to a single decision maker creates assurances that the virtual merger is more likely to produce the offsetting cost savings that would distinguish that transaction from a cartel. But, merely ceding control, without complete economic alignment of interests, should not suffice for single-entity status. The courts have repeatedly struck down arrangements that have ceded sufficient control merely to eliminate completely all competition between the parties.[38] Extending *Copperweld* to insulate such activity would turn the decision on its head.

On the other hand, where a virtual merger replicates the complete alignment of economic interests of the parent-subsidiary relationship and creates an ultimate decision maker with the equivalent authority of the parent to compel the family of corporations to pursue the most economically rationale course, the transaction should result in a single entity. The presence of decision makers who themselves have divergent economic interests, however, would mean that the family of corporations is not necessarily a single entity under *Copperweld*; the independent decision makers, with potentially diverging economic interests, erode the promise of cost savings that offset the reduction in competition inherently flowing from the transaction. Applying this analysis, as explained next, suggests that the proposed transaction between LIJ and North Shore might not have resulted in a single entity.

B. Would NewCo Have Been a Single Entity?

The relationship between NewCo and the hospitals would not have fit squarely within the facts of *Copperweld*. NewCo's relationship to the hospitals, while similar to a parent-subsidiary relationship in that NewCo would have become the sole member of each nonprofit hospital, would have been significantly different because of substantive rights reserved to the hospitals

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[38] *Timken,* 341 U.S. at 598; *Palmer*, 498 U.S. at 49.

and procedural protections of those rights built into the agreement. Examination of those substantive rights and procedural protections indicates that the family of corporations would maintain divergent economic interests and not have a single decision maker able to compel actions to achieve efficiencies.

That there would be divergent interests seemed to be explicitly recognized in the commitments that the hospitals would not sacrifice their continued independent identity and would have equal future roles. The economic divergence of those interests appeared to be embodied in the procedural requirements that circumscribed NewCo's ability to act and protected substantive the rights reserved to the hospitals. For example, NewCo could not have initiated certain efficiency enhancing actions, such as consolidating its "subsidiaries" services without a super-majority vote of NewCo's board. Presumably, had NewCo attempted to violate these procedural requirements, the adversely affected hospital could have blocked its action. Moreover, each hospital would have had the substantive right to reject NewCo's attempts to change that hospital's services. The procedural limitations on NewCo's ability to remove the boards of trustees of the individual hospitals protected the hospitals in the event they pursued their individual economic interest rather than the interest of the whole. At the end of the day, these procedural and substantive rights resulted in multiple decision makers and imposed potentially insurmountable barriers to NewCo's ability to impose efficiency-enhancing actions.

The absence of a single entity is also indicated by the contrast between the proposed transaction and the factors in *Mt. Pleasant* and *Chicago Bulls* indicating a single entity. Without the cooperative at issue in *Mt. Pleasant*, the increased output of low cost electricity would not have occurred. Similarly, in *Chicago Bulls,* the NBA is necessary for professional basketball to exist. NewCo, however, was not necessary for the hospitals to deliver inpatient hospital services. To the contrary, LIJ and North Shore operated as general acute care hospitals in competition with each other before the formation of NewCo. While the NBA "makes" teams, NewCo did not make the hospitals.

LIJ and North Shore retained one additional right that was fundamentally at odds with the proposition that they would have become essentially “subsidiaries” of NewCo. LIJ and North Shore, like the NBA teams in *Chicago Bulls*, did "not surrender[] their power to arrange things yet again." In explaining why the NBA might not be a single entity because the teams retained such authority, Judge Easterbrook contrasted the powers held by the teams to the limitations on the powers of a corporate division of General Motors that one would expect:

> [T]he 29 clubs, unlike GM’s plants, have the right to secede (wouldn’t a plant manager relish that!) and rearrange into two or three leagues.[39]

In short, LIJ and North Shore would have reserved powers to themselves that were antithetical to the idea that they would become a single entity.

An example illustrates the contrast between NewCo’s proposed relationship with these hospitals and a true parent-subsidiary relationship. Say consolidation of the hospitals’ OB/GYN services would have lowered the costs of delivering such care. Absent countervailing business or quality considerations, one has a hard time imagining a sole shareholder not imposing such efficiency-enhancing action on its wholly-owned subsidiary.

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[39] *Id.* at 599.

It is far from clear, however, that NewCo would take this action. Loss of OB/GYN services might erode the ability of the hospital surrendering the service to compete as an independent facility and might be viewed as eroding the full-service reputation of the hospital. Moreover, given the lack of profit and loss sharing in the arrangement, the hospital would lose revenues to the other hospital as patients flowed away from it. NewCo's requirement of a supermajority vote would have impeded the decisionmaking on whether to consolidate the OB/GYN services. Moreover, the "adversely" affected hospital could reject the proposal even if NewCo's board approved it. To be sure, NewCo's board could, then, in theory replace the hospital's board through another supermajority vote delayed over two board meetings[40] (that is, it could ultimately take the action that a sole shareholder would undoubtedly take). But, even assuming NewCo would act to replace the hospital's board, there is no assurance that replacing the trustees would, or should, permit NewCo to force the reluctanct hospital to shut its OB/GYN service. The new trustees, just as the old, owe a fiduciary duty to the hospital on whose board they serve (not to NewCo) and thus might take the same action.

The structure of NewCo, then, while well tailored to preserving the independent identities and interests of the hospitals sacrifices critical aspects of a single-entity concept as contemplated by the *Copperweld*: an ultimate single decisionmaker operating (or with the authority to operate) the different parts of the organization to achieve a unified corporate goal of efficient delivery of services. A merger results in this single decisionmaker and thus a substantially greater

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40 State laws on the authority of members of non-profit corporations could have a significant impact on this analysis by limiting the authority of NewCo to remove the trustees of LIJ and North Shore. This paper assumes that NewCo's ability to remove trustees is roughly the equivalent of a sole shareholder's ability to remove directors of the corporation that it owns.

likelihood that the combining entities will achieve those efficiencies, even if the actions necessary to do so are not in the best economic interests of one of the entities. NewCo's structure, however--adopting procedures and rules intended to impair the ability to implement some of the decisions that could result in efficiencies--goes in the opposite direction.

III. WOULD MANAGED CARE CONTRACTING HAVE BEEN ANCILLARY TO THE PROCOMPETITIVE GOALS OF THE TRANSACTION?

That the formation of NewCo would not result in a single entity does not necessarily mean that LIJ's and North Shore's use of NewCo to jointly negotiate contracts with managed care plans would violate section 1.[41] Instead, it might be that this otherwise anticompetitive aspect of NewCo would be reasonably necessary for LIJ and North Shore to achieve some of the procompetitive goals of their agreement.

The argument for NewCo as a significantly integrated joint venture is that somehow its formation inherently offers the promise of some efficiency; for example, the consolidation of services flowing from the formation of NewCo might enhance the efficiency with which care is delivered in the relevant markets.[42] An argument could be made that the authority given to NewCo to evaluate and propose clinical consolidations and other procompetitive activity holds the promise that those efficiencies will be realized.[43] The argument is that the type, scope and

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[41] *See generally Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 215-16 (D.C. Cir. 1986)(finding no single entity but upholding restraints), *cert. denied*, 479 U.S. 1033 (1987).

[42] This paper will not attempt to evaluate how tight the nexus must be between a facially anticompetitive practice and the procompetitive justification for it. For a good discussion of this issue, see Miles, *supra*, 66 Antitrust Law Journal at 145-52.

[43] This paper is not intended to imply that this argument for efficiencies describes the only circumstances in which hospital affiliations could result in something procompetitive or that clinical consolidations are the only type of efficiency that might flow from hospital

intensity of the interactions between LIJ and North Shore through the formation of NewCo holds a particular promise of achieving efficiencies and that the parties' joint negotiations with managed care plans are ancillary--that is, reasonably necessary--to achieving this goal.[44]

Why formation of NewCo is a sufficient justification for the joint negotiation with managed care plans is not readily apparent. There are significant reasons to be skeptical. The relative timing and certainty of the anticompetitive activity when compared to the possible efficiencies undercut the claimed justification. As originally proposed, NewCo would immediately engage in the anticompetitive activity and <u>might in the future</u> pursue some procompetitive steps, assuming they were not halted by the procedural barriers discussed above. NewCo could elect to take no action to achieve efficiencies and yet still would jointly price its services. NewCo could not colorably argue, to justify its price fixing, that its otherwise anticompetitive actions were ancillary to clinical integration and other procompetitive activities that never occurred.[45] Rather, it would be left with the argument that its price fixing was ancillary to efficiencies that might have been.

The stregnth of such an argument is also undercut by the availability of a more sequential approach to joint negotiation with managed care plans. Many hospitals have merged or jointly pursued procompetitive projects without first jointly pricing their services. Indeed, competing hospitals have actually offered services through a single facility without pricing the consolidated services jointly. For example, the Department obtained a consent decree from two hospitals in

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affiliations.

44 Rosser, n.18, at 6.

45 In the typical case, the otherwise problematic conduct promotes an actual procompetitive goal. *Rothery Storage*, 792 F.2d at 215-16.

Pinnellas County, Florida, which permits them to offer certain tertiary care services through a single facility but requires them to sell and price those services independently.[46] Similarly, the Department approved a transaction between two hospitals in Marin County, California, to consolidate their adult inpatient mental health services while separately competing in the sale of those services.[47] That letter is predicated on the hospitals' representation that they could achieve substantial efficiencies without joint pricing.

These examples indicate that LIJ and North Shore probably would have been in a better position to justify joint negotiations with managed care plans if NewCo had first studied and recommended actual efficiency enhancing activities that the hospitals then independently agreed to implement before joint negotiations with managed care plans. The argument in favor of joint pricing particular, or all, services would be enhanced by the context of an actual agreement, for example, to consolidate one or more services. The argument would have to address why such joint pricing is reasonably necessary in the context of hospital contracting. The argument would also have to explain whether, for example, a consolidation of inpatient OB/GYN services justified only joint pricing of those services, or also justified joint pricing of services which were not consolidated.

IV. WOULD THE JOINT NEGOTIATION WITH MANAGED CARE PLANS HAVE BEEN *PER SE* ILLEGAL?

If the foregoing analysis is correct, it follows that the joint negotiation with managed care plans would have been unlawful under Section 1. Indeed, in 1964, the Supreme Court's *Citizen*

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46 *United States v. Morton Plant Health System, Inc.*, 1994-2 Trade Cas. (CHH) ¶ 70,759 (M.D. Fla. 1994) (consent decree).

47 Marin County Business Review letter.

Publishing decision declared unlawful joint pricing arising out of a relationship similar to some of today's virtual mergers among hospitals. That opinion addressed the joint setting of newspaper subscription prices and advertising rates through a joint operating company formed by two competing newspapers in Tucson, Arizona.[48] The Department of Justice challenged this activity many years after the joint operating company was formed. By the time the case was brought, the newspapers had actually consolidated their printing facilities, distribution and marketing under the control of the new corporation. The newspapers, however, had preserved their separate newspapers by keeping their individual news and editorial departments and maintaining a separate corporate existence. The Department argued and the Supreme Court held that the newspapers committed a *per se* violation of section 1 by agreeing to set jointly the prices for subscriptions and advertising through the joint operating company, to share profits and losses, and not to compete in the newspaper business.

The *Citizen Publishing* case, additionally, demonstrates the Supreme Court's willingness to condemn anticompetitive activity even where connected to, but not truly ancillary to, procompetitive behavior. While joint pricing, the profit pooling, and the agreement not to compete were condemned in *Citizen Publishing*, the procompetitive aspects of the venture were not thwarted, namely the consolidation of printing plants, distribution and marketing. The remedy in that case permitted the parties to maintain the efficiency enhancing consolidations but required them to stop the anticompetitive activities. Implicit in the *Citizen Publishing per se* condemnation of the newspapers' joint pricing is a conclusion that the pricing was not ancillary to the actual consolidation of operations. For parties to a virtual merger to justify their joint

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[48] *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969).

managed care activity, then, they would need to explain how doing so legitimately advances their potential to achieve efficiencies, when in *Citizen Publishing* the actual achievement of such efficiencies was not enough to justify the joint pricing, profit pooling and non-competition agreements. Accordingly, the mere fact that a proposed virtual merger holds some promise of efficiencies should not insulate price fixing after the transaction.

V. CONCLUSION

While the legality of joint managed care contracting following "virtual mergers" of competing hospitals has not been directly reviewed in the courts or extensively addressed by enforcement agencies, the antitrust analysis of those transactions is relatively straight forward. Where the goals of parties to such transactions are efficiency enhancing and procompetitive, the foregoing analysis suggests that the antitrust laws are flexible enough to permit hospitals to pursue them.

That does not mean, however, that competing hospitals may fix prices while contemplating the achievement of those goals. Indeed, the proposed LIJ-North Shore transaction described in this paper probably went further in the direction of a single entity than other virtual mergers. Suppose hospitals to a transaction merely established a partnership in which each hospital appointed an equal number of the partnership's governing board members. The partnership would not become the sole member of each not-for-profit hospital. In *Citizen Publishing*, the newspapers similarly controlled the new corporation they formed. *Citizen Publishing* would control this case and require a finding that joint negotiation with managed care plans was *per se* illegal.

The argument might be made that *Citizen Publishing* is no longer viable in light of doctrinal developments flowing from the *Copperweld* decision.[49] As discussed above, the *Copperweld* decision and the cases like *Chicago Bulls* and *Mt. Pleasant* that have extended *Copperweld* have not extended it so far as to create a conflict with *Citizen Publishing*. Quite to the contrary, the rationale applied by recent cases would support the result in *Citizen Publishing*.

Judge Bork's influential opinion in *Rothery Storage*,[50] addressed a situation closely analogous to that presented by *Citizen Publishing* and supports the continued viability of *Citizen Publishing* today. In *Rothery Storage*, a group of independent moving companies agreed to offer interstate moving services exclusively through Atlas Van Lines, Inc.[51] Substantial efficiencies were actually achieved through this arrangement.[52] Representatives of the independent moving companies controlled the board of directors of Atlas.[53] The district court held that Atlas was a single entity under *Copperweld*. Judge Bork's opinion reversed as a matter of law, noting that the presence of "actual or potential competitors of Atlas" on its board took the "case out of the *Copperweld* rule."[54] In short, it seems unlikely that the courts would extend *Copperweld* to overrule *Citizen Publishing*.

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49 It bears observation initially that the lower courts would probably lack the authority to overrule *Citizen Publishing* unless they could point to a clear conflict between that decision and *Copperweld*. *Kahn v. State Oil Co.*, 93 F.3d 1358, 1362-64 (7th Cir. 1996), *vacated*, 118 S. Ct. 275 (1997).

50 792 F.2d 210 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1033 (1987).

51 792 F.2d at 213.

52 *Id.* at 214.

53 *Id.* at 215.

54 *Id*. at 215.

The Department's questioning of the original North Shore structure and the State of New York's challenge to the Poughkeepsie arrangement indicate that enforcement agencies are scrutinizing virtual mergers.   Parties to such transactions, then, should not read too much into the Department's lack of challenge to "virtual mergers," as may have been inferred from the possibility that the Department has reviewed, but not challenged, "virtual mergers" between hospitals that were reported under the Hart-Scott-Rodino Act. The Department's focus on the structure of the North Shore transaction during that investigation demonstrates that the Department has not determined that joint managed care contracting following a virtual merger poses little or no antitrust issue.

Additionally, the mere fact that a challenge is not brought at the time of a virtual merger does not mean that the transaction may not later be challenged. In the Poughkeepsie case, the State brought its challenge three years after the transaction was consummated. In *Citizen Publishing*, the Department challenged the transaction twenty-five years after its consummation despite the complete integration of the newspapers' printing facilities, distribution and marketing. In *Classic Care*, the network was operating for three years before the Department challenged it.   There is thus reason to believe that future challenges to "virtual mergers" of hospitals could be brought if the activities following the transaction were found to be *per se* illegal or otherwise warranting summary condemnation, even though the arrangement is already in place and operating in the marketplace.