New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 256—NO. 7
TUESDAY, JULY 12, 2016

ANTITRUST TRADE AND PRACTICE

Expert Analysis

A Busy Few Months of Merger Enforcement at the FTC

By **Shepard Goldfein**

And **James Keyte**

Over the last two months, the FTC's merger enforcement bureau has been a busy group. The FTC has litigated three merger-related preliminary injunction applications during the period, winning one (*FTC v. Staples*[1]) and losing two (*FTC v. Penn State Hershey Medical Center*[2] and *FTC v. Advocate Health Care*[3]). And while the FTC's victory in *Staples* reflects what can now fairly be called a "string" of victories in cases involving highly concentrated industries within relatively static marketplaces, the two hospital decisions sit at the other end of that spectrum.

There is, however, learning to be found for antitrust practitioners in comparing these cases and outcomes. What we see are the challenges that must be overcome when the FTC (or Department of Justice) can persuade a court that it is dealing with a merger in an industry with very little entry, expansion, or repositioning by competitors (and, of course, the challenges when the parties decide not to put in a defense); conversely, the hospital losses serve as good examples of the difficulties the FTC faces when parties can demonstrate such competitive dynamics, in which case any presumption of anticompetitive effects based on market structure is lost.

> Defining the market narrowly was critical to the court's decision in 'FTC v. Staples' because the FTC's proposal excluded from the market Staples' and Office Depot's traditional, regional competitors.

'FTC v. Staples'

In *FTC v. Staples*, defendants Staples and Office Depot tried to merge, hoping that, unlike their last attempt, antitrust regulators would approve the transaction. The FTC argued in *Staples* that the product market should be limited to include only office supplies purchased by very large customers, typically Fortune 100 companies (sales referred to as business-to-business, or "B2B," transactions). When classifying B2B sales as its own market, according to the FTC, the post-transaction firm would control as much as 80 percent of the market. The U.S. District Court in D.C. agreed with the FTC and defined B2B sales as its own market for the purposes of assessing the transaction's competitive effects.

Defining the market so narrowly was critical to the court's decision because the FTC's proposal excluded from the market Staples' and Office Depot's traditional, regional competitors, all of which—according to the FTC—were unable to compete for large national accounts. A WB Mason executive testified, for example, that the company could not compete with Staples and Office Depot for national B2B accounts, and that WB Mason had abandoned a plan to expand nationally.

SHEPARD GOLDFEIN *and* JAMES KEYTE *are partners at Skadden, Arps, Slate, Meagher & Flom.* LUKE TAESCHLER, *an associate at the firm, assisted in the preparation of this column.*

The court consequently found that Staples and Office Depot were the only two companies capable of supplying office supplies to B2B customers with national accounts. Because the relevant market consisted of only two competitors—the merging parties—the FTC was able to present a highly concentrated market that, post-transaction, would transform from having two competitors to having only one. Such 2-to-1 mergers—and often 3-to-2 mergers as well—trigger a "structural presumption" of anticompetitive effects that, in many cases, can be quite difficult to overcome.

The defendants attempted to counteract this structural presumption by cross-examining the FTC's witnesses on Amazon Business' recent entry into the market. Defendants tried to show that Amazon Business (Amazon's new B2B office supply business)—which first entered the market in 2015 and sought specifically to target large companies in need of office supplies—would restore any lost competition resulting from the merger. But the court disagreed, in part, it appears, because defendants decided not to call any witnesses in their own case in chief to bolster the points relating to Amazon's predicted expansion within the alleged market. In fact, the court explicitly highlighted that "defendants did not offer testimony from other industry experts or offer any other credible evidence," and thus concluded that "[t]he evidence before the Court simply does not support a finding that Amazon Business will, within the next three years, either compete for large RFPs in the same way that Office Depot does now, or so transform the industry as to make the RFP process obsolete."[4]

Faced with a paucity of evidence from the merging parties, the court relied on the FTC's expert, who testified that Amazon Business could not feasibly compete for B2B customers within the next two to three years in a way that would offset the deal's allegedly anticompetitive effects. Without Amazon Business being included in the relevant market, Staples and Office Depot were the only two competitors, a fact that triggered a strong structural presumption favorable to the FTC.

'FTC v. Penn State Hershey'

The FTC's recent experience challenging hospital mergers paints a different story. In *FTC v. Penn State Hershey*, defendants were two competing hospitals near Harrisburg, Pa. One defendant, Penn State Hershey Medical Center, was a leading academic medical center that served as the primary teaching hospital for the Penn State College of Medicine. The other defendant, PinnacleHealth System, was a not-for-profit health system comprised of three hospitals located on three different campuses.

Critical to the case was the identification of a geographic market. The FTC, claiming that hospital services are "inherently local,"[5] argued that the relevant market comprised only four counties in Harrisburg (the Harrisburg Area[6]). The defendants disagreed: In their view, the FTC ignored the commercial realities and behaviors of what Pennsylvania patients do (or could do in the face of the claimed anticompetitive effects) and, as a result, defined the market far too narrowly.

In a detailed opinion, the U.S. District Court in the Middle District of Pennsylvania rejected the FTC's proposed "Harrisburg Area" market. First, the court found that a substantial number of the defendants' patients reside outside of the Harrisburg Area and, therefore, must travel into the area every time they visit defendant hospitals. In the case of Hershey's patients, for example, 43.5 percent travel from outside the FTC's proposed area to receive treatment. Given this historical influx of patients from outside the proposed market, the court refused to accept the FTC's characterization that hospital services were "inherently local."

Second, the court found—contrary to the FTC's assertion—that there were numerous hospitals outside of the proposed Harrisburg Area that could exert competitive pressure on defendant hospitals if they were to raise prices after the merger. In fact, the court found that 19 other hospitals were located within 65 minutes of the Harrisburg Area, and that many of the hospitals were in fact closer to Hershey's patients than Hershey itself. Accordingly, applying a dynamic analysis of the marketplace, the court held that such hospitals were realistic alternatives but were inappropriately excluded from the FTC's proposed market. Taking these findings together, the court held that the FTC's proposed "Harrisburg Area" market was impermissibly narrow.

Putting aside the issue of market definition, the court also found very important the parties' proffered efficiencies for the transaction. Specifically, the court determined that Hershey faced serious capacity constraints that would be solved only by constructing a new tower to hold additional beds for patients. As the court recognized, building the bed tower would take time and require serious capital expenditures. By contrast, allowing the transaction to proceed would create additional capacity immediately available to Hershey, unquestionably benefiting patients. Weighing the equities, the court concluded that the efficiencies—and resulting benefits to patients—favore d the merging parties and their patients.

Finally, unlike the court in *Staples*, the Hershey court also found that recent market developments were causing a repositioning in the relevant market, and that such repositioning would help other competitors constrain the merged parties post-transaction. The court specifically addressed three other mergers and partnerships in the relevant market, finding that such developments would likely counteract any anticompetitive actions attempted by the defendants in a timely and sufficient manner.

'FTC v. Advocate Health Care'

As in *Hershey*, the court in *Advocate Health Care* rejected the FTC's proposed geographic market for being insufficiently narrow. There, two competing health care systems, one that included four hospitals and one that included 11 hospitals, decided to merge. The FTC sought to define the geographic market as the "North Shore Area,"[7] which would consist of 11 hospitals in total, six of which would be owned by the merged firm post-transaction. In making its case, the FTC again tried, like in *Penn State Hershey*, to exclude so-called "destination hospitals"[8]—hospitals to which patients had to travel to receive treatment. The court, in the Northern District of Illinois, flatly rejected the proposition, finding that the FTC's economic expert provided "no economic basis"[9] to support the exclusion of so-called destination hospitals from the relevant market.

Also persuasive to the court was that many hospitals located outside the FTC's proposed geographic area were associated with outpatient facilities and doctor offices located within the proposed area. Indeed, as the court found, these associations often caused doctors and facilities within the North Shore Area to refer patients to hospitals outside the North Shore Area. The FTC could not ignore such relationships because, like in *Penn State Hershey*, doing so would ignore completely "the commercial realities of the industry," again, showing that the potential for marketplace suppliers to reposition or expand can be quite important to the analysis.[10]

Conclusion

Given the FTC losses in the hospital cases, the Staples victory cannot easily be described as indicative of a broader, anti-merger trend. Yet it does show the continued strength of structural evidence in litigated merger cases, especially where the government can show a lack of dynamic competition and the defendants decide not to present their own economic case-in-chief to the court.

In sum, while no one can say for certain how the Staples court would have ruled had the defendants presented their own case-in-chief to try to counteract the FTC's structural presumption and related evidence, the recent hospital decisions illustrate that courts are willing to consider antitrust arguments rooted in the economic realities of the marketplace, particularly when defendants present concrete evidence showing that (i) existing marketplace facts or likely repositioning will ensure continued competition in a timely and sufficient matter, and (ii) the transaction can generate substantial, consumer-benefitting synergies.

1. *FTC v. Staples*, No. 15-2115, 2016 WL 2899222 (D.D.C. May 17, 2016).
2. *FTC v. Penn State Hershey Medical Center*, No. 1:15-cv-2362, 2016 WL 2622372 (M.D. Pa, May 9, 2016).
3. *FTC v. Advocate Health Care Network*, No. 15 C 11473, 2016 WL 3387163 (N.D. Ill. June 20, 2016).
4. *FTC v. Staples*, No. 15-2115, 2016 WL 2899222, at *23 (D.D.C. May 17, 2016)
5. *Penn State Hershey Medical Center*, 2016 WL 2622372, at *3.
6. Id.
7. *Advocate Health Care Network*, 2016 WL 3387163, at *3.
8. Id.
9. Id. at *4.
10. Id.