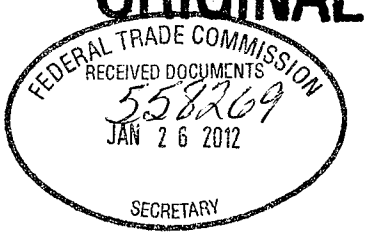
PUBLIC

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

ORIGINAL



COMMISSIONERS: **Jon Leibowitz, Chairman**
J. Thomas Rosch
Edith Ramirez
Julie Brill

In the Matter of	)	
PROMEDICA HEALTH SYSTEM, INC.	)	Docket No. 9346
a corporation.	)	**PUBLIC**

RESPONDENT'S REPLY BRIEF IN SUPPORT OF ITS APPEAL

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The following abbreviations and citation forms are used in this Appeal Brief:

CCAB	Complaint Counsel's Appeal Brief
CCPF	Complaint Counsel's Proposed Findings of Fact
CCBR	Complaint Counsel's Post-Trial Brief
CCRBR	Complaint Counsel's Post-Trial Reply Brief
CCASB	Complaint Counsel's Answering Brief
ID	Initial Decision
IDFOF	Findings of Fact in Initial Decision
PX	Complaint Counsel's Exhibit
RAB	Respondent's Appeal Brief
RPF	Respondent's Proposed Findings of Fact
RBR	Respondent's Post-Trial Brief
RRBR	Respondent's Post-Trial Reply Brief
RCCPF	Respondent's Replies to Complaint Counsel's Proposed Findings of Fact
RX	Respondent's Exhibit

INTRODUCTION

The Commission should reverse the Administrative Law Judge's ("ALJ") Initial Decision, which erroneously found that Respondent ProMedica Health System, Inc.'s ("ProMedica") joinder with St. Luke's Hospital ("St. Luke's") violated Clayton Act Section 7. The record demonstrates that the ALJ wrongly concluded that the joinder will likely result in a substantial lessening of competition because he (1) considered the wrong customers when analyzing unilateral effects, (2) accepted flawed expert testimony, and (3) relied on unsupported and biased testimony of managed care organizations "("MCOs") who compete with ProMedica's MCO affiliate. The ALJ also failed to give appropriate significance to his finding that "St. Luke's was struggling financially prior to the [j]oinder and its future viability as an independent hospital . . . is by no means certain." (ID 214). Finally, the ALJ erred in ordering a divestiture, notwithstanding his conclusion that ProMedica's alternative remedy would likely "restore ProMedica's bargaining power to its pre-[j]oinder state, preserve St. Luke's as a competitive constraint, and secure St. Luke's financial viability, to the benefit of consumers." (ID 215).

Complaint Counsel's Answering Brief does not rectify any errors in the Initial Decision that ProMedica raised in its questions on appeal. Rather than addressing these defects that compel reversal, Complaint Counsel revert to the mischaracterizations of the evidence they have made throughout the case.[1] The Commission should ignore these distractions that merely evince Complaint Counsel's inability to refute ProMedica's evidentiary-based criticisms of the Initial

[1] For example, Complaint Counsel again cite PX0226 for the notion that ProMedica touted "payer system leverage" as a reason for potential partners to affiliate with it, when trial testimony conclusively disproves Complaint Counsel's distortion. (RCCPF 399). Likewise, Complaint Counsel miscite St. Luke's documents as support for "St. Luke's intention to avail itself of ProMedica's leverage," (CCASB at 3), when it is undisputed that St. Luke's did not know what ProMedica's reimbursement rates with MCOs were when it decided to join with it. (Wakeman, Tr. 2995-2996).

Decision, which is riddled with errors of law and lacks supporting "reliable, substantial, and probative evidence." 5 U.S.C. § 556(d); FTC Rule 3.51(c).

ARGUMENT

I. Complaint Counsel Failed To Refute ProMedica's Showing that the ALJ Erred in Finding that the Joinder Violates Section 7

A. St. Luke's and ProMedica Are Not Close Substitutes

1. MCOs Do Not View ProMedica and St. Luke's as Close Substitutes

Complaint Counsel continuously have characterized ProMedica and St. Luke's as each other's closest substitute to invoke the principle that the merger of closest substitutes raises particular concerns. U.S. Dep't of Justice and Fed. Trade Comm'n, *Horizontal Merger Guidelines*, § 6.1 (2010). Complaint Counsel now belatedly concede that Mercy, not St. Luke's, is ProMedica's closest substitute (CCASB 12), eliminating the necessary predicate for that theory. (CCASB 8-14). As Complaint Counsel concede, "the closeness of competition between St. Luke's and ProMedica is what matters," and here the record demonstrates that MCOs, the customers at issue, do *not* view ProMedica and St. Luke's as close substitutes, making a substantial lessening of competition unlikely. (*See* IDFOF 439, *in camera*, 449 (no MCO could substitute St. Luke's for ProMedica in its network); ID 157 (faced with an anticompetitive price increase, no MCO would have dropped ProMedica from its network for St. Luke's); RPF 1110, *in camera*, 1113 (

})).

2. MCOs Are the Proper Customers for the Competitive Analysis

Having abandoned the notion that St. Luke's is ProMedica's closest substitute, Complaint Counsel attempt to bolster their argument that St. Luke's and ProMedica are close substitutes by claiming that MCOs and *their* customers, employers and patients, are the "relevant customers"

for the competitive analysis. (CCASB 9). This approach is misguided. Complaint Counsel's assertion that "an 'MCO's demand for hospital services is largely derived from an aggregation of the preferences of its employer and employee members'" is not in dispute. (CCASB 9 (citing *In re Evanston Nw. Healthcare Corp.*, No. 9315, 2007 FTC LEXIS 210, at *195 (Aug. 6, 2007)). Indeed, member preferences are *already* reflected in the preferences of MCOs, which are the appropriate customers for analysis. (*See* ID 156; *California v. Sutter Health Sys.*, 130 F. Supp. 2d 1109, 1129 (N.D. Cal. 2001) (citing *FTC v. University Health, Inc.*, 938 F.2d 1206, 1213 n.13 (11th Cir. 1991) (holding that the true customers of acute-inpatient services were third party payers)). And, while Complaint Counsel and the ALJ devote much attention to the MCOs' testimony, the best evidence of their preferences is what they do, not what they say. *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1167 (N.D. Cal. 2004) (stating that "the most persuasive testimony from customers is not what they say in court, but what they do in the market"). MCOs' self-serving testimony, thus, cannot overcome what their actions reveal. ProMedica and Mercy are "closest substitutes," and Complaint Counsel's efforts to show otherwise fail.

3. Complaint Counsel Improperly Focus on Only a Subset of St. Luke's Service Area

To overcome the gulf in the competitive capability between ProMedica and St. Luke's, and MCOs' recognition of it (IDFOF 449), Complaint Counsel eschew the undisputed geographic market, Lucas County, Ohio (IDFOF 321-322; ID 145-146) in favor of "a more granular view" of market data in "southwest Lucas County." (*See* CCASB 10). Complaint Counsel contend that because ProMedica and St. Luke's have the highest "market shares" in the zip codes comprising St. Luke's "core service area," it follows that they are close substitutes. (CCASB 10-11). However, Complaint Counsel's focus on the portion of the relevant market

closest to St. Luke's is wrong as a matter of law, and the facts contradict their conclusion. The law requires a review of the "structure, history, and probable future" of the relevant market, not blind reliance on "shares" in a piece of it. *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 498 (1974). Therefore, any discussion of this small segment of Lucas County is irrelevant, and Complaint Counsel's fixation on the "eight zip codes surrounding St. Luke's" (CCASB 10), rather than the entire market, exposes their failure to prove an anticompetitive effect in the proper geographic market.

Moreover, because the Toledo, Ohio area is so small that "[e]verything is twenty minutes away" (Sandusky, Tr. 1282-1283), it makes no sense to focus on only a portion of an admittedly small geographic market. Nor is there a shred of evidence that insinuates that any hospital can price discriminate against the residents of St. Luke's core service area by charging them higher or lower rates simply based on their zip code of residence, making anticompetitive effects unlikely. (RPF 1038-1039). The data shows that residents of St. Luke's core service area, like other Lucas County residents, use all eight hospitals located in the market, rendering any examination of "market" shares within "southwest Toledo" meaningless. (RPF 1036, 1041). Additionally, MCOs, like Anthem and Paramount, have successfully offered hospital networks that did not include St. Luke's at all. (RPF 296-297, 316-317). The Commission should ignore Complaint Counsel's transparent attempt to obscure commercial reality to inflate St. Luke's competitive significance.

4. Complaint Counsel Mischaracterize ProMedica's Contracting Practices

Complaint Counsel seize on ProMedica's past contracting practices as supposed evidence of "vigorous, head-to-head pre-Acquisition competition between ProMedica and St. Luke's," arguing that ProMedica "sought to induce health plans to exclude St. Luke's from their

networks." (CCASB 4). But, trading discounts for volume is not anticompetitive, uncommon, or nefarious. Complaint Counsel conveniently ignore trial testimony proving that Anthem's "fair and competitive" negotiations with ProMedica resulted in a mutually-acceptable contract. *Compare* (Pugliese, Tr. 1554, *in camera*, 1610) *with* (RPF 751). Anthem testified that it { } (Pugliese, Tr. 1588-1592, *in camera*).

Complaint Counsel disregard the most significant aspect of ProMedica's negotiations with Anthem in connection with that 2005 contract – the exclusion of *Mercy* from Anthem's hospital network (RPF 739, *in camera*), for which ProMedica agreed to reduce its rates by an additional { } (RX-208 (Wachsman, Dep.) at 41, *in camera*). When Anthem sought to add Mercy to its hospital network in 2008, Anthem and ProMedica negotiated a new contract to compensate ProMedica for its reduced exclusivity and potential loss of patients, with Anthem agreeing to increase its rates to ProMedica by approximately { }[2] (Wachsman, Tr. 4976-4977, *in camera*; RX-208 (Wachsman, Dep.) at 41-42, *in camera*). In contrast, when Anthem added St. Luke's to its network, it increased ProMedica's rates by just { } (RPF 773, *in camera*). ProMedica's expectation that it would lose significantly more patients to Mercy than to St. Luke's explains the differences in ProMedica's rates (RPF 776, *in camera*) and exposes the gap in how MCOs perceive ProMedica and St. Luke's as substitutes.

[2] Anthem's new contract with ProMedica also included a most-favored-nations clause (at Anthem's request) to ensure that Anthem would receive at least as favorable rates as ProMedica agreed to with any other MCO, further evincing Anthem's own leverage. (RPF 754).

5. Complaint Counsel Fail To Cure Fundamental Flaws in the Consumer Surveys

Complaint Counsel's continued reliance on the consumer surveys that purport to show ProMedica's and St. Luke's closeness of competition is misguided, because they cannot cure the surveys' fundamental flaws highlighted in Respondent's Appeal Brief. The survey results were never validated; the surveys did not ask respondents about their responses to price increases; and the surveys canvassed just 400 households, consisting of residents who may not even participate in the relevant market, in only six of the eight zip codes that accounted for between 56-60 percent of St. Luke's inpatient discharges. (RAB 17-18). These flaws preclude Complaint Counsel's reliance on the surveys as evidence that ProMedica and St. Luke's are close competitors.

6. The Evidence Shows ProMedica and St. Luke's Are Not Close Substitutes

While conceding that "Mercy is ProMedica's closest substitute under the diversion analysis" (CCASB 12), Complaint Counsel make the confounding claim that Professor Town's diversion analysis proves that ProMedica and St. Luke's are close substitutes. (CCASB 11). But, Complaint Counsel have also failed to refute the results of Ms. Guerin-Calvert's diversion analysis of 2009 data, which applies Professor Town's methodology and predicts that if ProMedica were unavailable {

}, a result contrary to what one would expect if ProMedica and St. Luke's were close substitutes. (RPF 1129, *in camera*). MMO alone {

} (RX-71(A) at 000191-000193, *in camera*).

Complaint Counsel also do not attempt to rebut St. Luke's ordinary course patient shift analysis which confirms that St. Luke's and ProMedica are not close substitutes. (CCASB 14). This analysis examined what hospitals St. Luke's patients actually chose when St. Luke's became more expensive once it stopped participating in Paramount's and Anthem's networks. (RX-2162 at 000001). Indeed, St. Luke's analyzed patient discharge data from 2000-2007 and concluded that *UTMC*, not ProMedica, gained most of St. Luke's lost patients. *Id.* Complaint Counsel cannot dismiss UTMC's significance as a closer substitute for St. Luke's than ProMedica because the {

.} (RPF 1139, *in camera*). Complaint Counsel's unilateral effects theory does not properly account for St. Luke's competition with UTMC.

7. Complaint Counsel Improperly Discount a Mercy-UTMC Network's Viability

In bemoaning a Mercy-UTMC network's viability, Complaint Counsel ignore MCOs' undisputed success in marketing limited hospital networks in Toledo. (RPF 709-715). The record shows that until 2008, although Anthem did not have Mercy in its network and MMO did not have ProMedica in its, (RPF 712-714; IDFOF 158), both remained competitive and serviced their members with narrow network configurations. (RPF 719-720, 727-728). Additionally, when United and ProMedica failed to agree on a new contract in 2005. United substituted Mercy for ProMedica in its network. (IDFOF 205, 206). That experience, combined with Paramount's success with a network limited to just ProMedica and UTMC, shows that a competitively-priced Mercy-UTMC network is a viable alternative. (RPF 314-316). As Professor Town stated in his report, {

.} (PX02148 at 018, *in camera*). Because ProMedica and St. Luke's are not close

substitutes and a Mercy-UTMC network is a ready alternative that can constrain ProMedica's post-joinder pricing, the joinder will not substantially lessen competition. *See Oracle*, 331 F. Supp. 2d at 1172 (holding plaintiffs failed to prove unilateral effects because they failed to prove a significant number of customers regard the merging companies as first and second choices); *Sutter Health Sys.*, 130 F. Supp. 2d at 1129-32 (finding patients would turn to non-party hospitals in response to a price increase).

B. The ALJ Erred by Relying on Professor's Town's Flawed Analysis

1. Complaint Counsel's Expert's Pricing Analysis Is Irrelevant and Does Not Support a Finding of Market Power

Merger analysis is concerned with "determining whether the merger would enhance market power, not whether market power currently exists." *Oracle*, 331 F. Supp. 2d at 1121. Complaint Counsel's pre-occupation with ProMedica's *pre-joinder* market power is, therefore, irrelevant to the only question at issue – whether the joinder enhances ProMedica's market power by permitting ProMedica to profitably raise rates above competitive levels for a prolonged period. *United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121, 136 (E.D.N.Y. 1997). Complaint Counsel's Answering Brief nowhere responds to the fact that their expert's pricing analysis, which purported to "construct" case-mix adjusted *pre*-joinder prices across Lucas County hospitals (PX02148 at 145 (Ex. 7), *in camera*), cannot predict how prices may change in the future, which is the relevant inquiry. (RAB at 21-22). Thus, the Commission should disregard Complaint Counsel's expert's pre-joinder pricing analysis and the unsupported inferences they draw from it.

Even so, Complaint Counsel reach the wrong conclusions from their expert's pricing analysis, because courts have held that "when dealing with a heterogeneous product or service, such as the full range of medical care, a reasonable finder of fact cannot infer monopoly power

just from higher prices." *Blue Cross Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1411-12 (7th Cir. 1995). While Professor Town agrees with this proposition (Town, Tr. 4151-4152, 4155), both he and Complaint Counsel do what the case law forbids by erroneously assuming that ProMedica's higher *average* constructed pre-joinder prices result from ProMedica's pre-joinder market share (PX02148 at 037 (¶ 68), *in camera*). Yet they acknowledge that the pricing analysis does not explain why prices across hospitals may differ and admit that those "case-mix adjusted prices may differ by hospital because of market power *or other factors such as cost or quality*." (CCASB 16) (emphasis added). Moreover, Professor Town's failure to take account of key factors, like hospitals' costs of providing care and other competitively-benign reasons why hospitals' prices differ, means neither he nor Complaint Counsel can eliminate the possibility that reasons besides market power account for those differences.[3] (Guerin-Calvert, Tr. 7252-7256, 7466-7467). Complaint Counsel's contention that Professor Town's pricing analysis supports ProMedica's possession of market power before the joinder is, therefore, baseless.

The Supreme Court has instructed that "when indisputable record facts contradict or otherwise render the [expert's] opinion unreasonable, it cannot support a jury's verdict." *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 242 (1993); *see also FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1054 n.13 (8th Cir. 1999). Here, MCO testimony that attributes the differences in Lucas County hospitals' prices to the complexity of the different services that they offer undermines Professor Town's pre-joinder pricing analysis. (RX-27 (Sheridan, Dep.) at 124-125, *in camera*). And, ordinary course analyses, unchallenged by

[3] Professor Town's inclusion of some, but not sufficient, variables to account for these competitively-benign reasons in his merger simulation model is a glaring contrast. Although flawed, even his analyses show Mercy's prices for some MCOs exceeded ProMedica's. (RAB 23).

Complaint Counsel, of case-mix adjusted prices conducted by MCOs and St. Luke's diverge from Professor Town's constructed price results, casting further doubt on their reliability. *Compare* (Radzialowski, Tr. 684, *in camera*) *and* (PX01016 at 009) *with* (PX02148 at 145, *in camera*). Because, contrary to Complaint Counsel's claim (CCASB 15), Professor Town's pricing analysis is not consistent with the evidence, it is not the "reliable, probative, and substantial evidence" needed to support an initial decision.[4] 5 U.S.C. § 556(d); FTC Rule 3.51(c).

2. Complaint Counsel Cannot Rehabilitate Their Expert's Flawed Merger Simulation Model

Similarly, Complaint Counsel's expert's merger simulation model ("the model") does not satisfy the requirements of "reliable, probative, and substantial evidence" to support an initial decision. 5 U.S.C. § 556(d); FTC Rule 3.51(c). The Commission cannot blindly accept Complaint Counsel's expert's predicted price effects from the joinder, because a tribunal "must look behind [an expert's] ultimate conclusion" and "analyze the adequacy of its foundation." *Mid-State Fertilizer Co. v. Exch. Nat'l Bank of Chi.*, 877 F.2d 1333, 1339 (7th Cir. 1989). When it does, the Commission will find Professor Town's model deficient.

First, Complaint Counsel's assertion that the model "specifically isolates and identifies the effect of the Acquisition on prices" (CCASB 18) is wrong because it fails to "incorporate all aspects of the economic reality of the [relevant] market," as required. *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1056-57 (8th Cir. 2000) (citing *Virgin Atl. Airways Ltd. v. British Airways PLC*, 69 F. Supp. 2d 571, 579 (S.D.N.Y. 1999), *aff'd*, 257 F.3d 256 (2d Cir. 2001)). Professor Town's model does not include variables that may account for competitively-

[4] Complaint Counsel also continue misrepresenting the evidence by misquoting PX00153. *Compare* (CCASB at 15 ("we hear from payors we are the most expensive in [O]hio")) *with* (PX00153 at 001("we hear from payors we are *among* the most expensive in [O]hio.") (emphasis added)).

benign reasons for price differences that the joinder will not change. (RX-71(A) at 000077-000080, *in camera.*) The model cannot distinguish between lawful reasons for price differences and differences resulting from the allegedly unlawful transaction. (Guerin-Calvert, Tr. 7502). Courts have rejected economic models in antitrust cases that suffer from this flaw, and the Commission should do the same here. *Concord Boat*, 207 F.3d at 1057.

To address this problem, Respondent's expert added variables to Professor Town's model that the economic literature analyzing hospital mergers, including papers authored by FTC economists, describe to account for some competitively-benign reasons for price differences. (RX-71(A) at 000077-000080, *in camera*; Guerin-Calvert, Tr. 7505-7506, 7510). Complaint Counsel object that this dilutes the model's results, because the added variables are correlated with other explanatory variables already included in the model. (CCASB 18-19). This is curious because Professor Town himself specified variables correlated with each other in his model, for example by including multiple measures of cost. (PX01954 (Guerin-Calvert, Dep.) at 050-051). Similarly, Complaint Counsel's criticism that adding variables correlated with other explanatory variables already included in the model is akin to reducing the sample size of the data and, consequently, the precision and reliability of the model's prediction (CCASB 19, n. 11), is misplaced. That the model's predictions and their precision decrease when additional variables are added does not mean one should impose arbitrary restrictions on the model's specifications as Complaint Counsel would do. Rather, it suggests that the data are insufficient to precisely predict price effects in this case. (Guerin-Calvert, Tr. 7530-7532).

Adding competitively-benign explanatory variables to the model results in a coefficient on the bargaining power variable (and a smaller predicted price effect) statistically indistinguishable from zero; when those variables are added to Professor Town's alternate

specification for his model, the result is a prediction that the joinder will lead to a price *decrease*. (RX-71(A) at 0000081 (Table 9), *in camera*). Although Professor Town presented his alternate specification as evidence of the model's robustness, the fact that two specifications, when modified to include additional variables, generate such divergent results belies this claim. (Guerin-Calvert, Tr. 7168-7169; RX-71(A) at 000078-81, *in camera*). These results, combined with the fact that neither party's experts know of *any* peer-reviewed studies that validate the accuracy of Professor Town's predicted price effects (Town, Tr. 4288-4289; Guerin-Calvert, Tr. 7511-7512), means that his model is not "reliable, probative, and substantial evidence" that any change in bargaining power from the joinder will likely substantially lessen competition.

Second, Complaint Counsel do not attempt to refute Respondent's argument that Professor Town's allocation of his predicted price effects between ProMedica and St. Luke's lacks any basis whatsoever and, therefore, cannot support a finding of liability. *Compare* (CCASB 17-20) *with* (RAB 28-29). Accordingly, the Commission should reject Professor Town's allocated price effect upon which the ALJ erroneously relied to find liability. (ID 169-170).

Instead of addressing their expert's fundamental problems, Complaint Counsel quarrel with the ALJ's conclusion that St. Luke's pre-joinder prices were below competitive levels. (CCASB 19-20). But the authorities Complaint Counsel cite for presuming that pre-transaction prices are competitive do not support their position. *CF Industries v. Surface Transportation Board* dealt with shippers' challenges to the reasonableness of a pipeline's rate increase, not an evaluation of a merger's likely anticompetitive effects. 255 F.3d 816, 818 (D.C. Cir. 2001). Moreover, in finding that the defendant pipeline had market dominance, the D.C. Circuit explicitly noted that the defendant pipeline had provided no evidence it had "priced below

market." 255 F.3d at 824. In contrast, the record here is replete with evidence that MCOs paid St. Luke's below-market and, in some cases, below-cost rates. (IDFOF 529-530, 532-537, 942-947; *see also* RPF 1796-1799, *in camera*). Complaint Counsel's citation to *Long Island Jewish* is similarly unavailing, because the cited pages merely recite cases that have stated "courts have focused on whether the merger would likely cause the merged entity to wield sufficient market power to enable it to profitably increase prices." 983 F. Supp. at 142-43. They say nothing about the appropriate benchmark from which to begin analyzing the likelihood of an anticompetitive price increase. *Id.* Nor is Complaint Counsel's citation to the *Antitrust Law* treatise applicable; it discusses tests for market definition, not how to evaluate whether a merger will result in anticompetitive effects. IIB Phillip Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, ¶ 537b (3d ed. 2007). Regardless, the ALJ's properly supported findings, showing that MCOs had paid St. Luke's below-market and, in some cases, below-cost rates, contradict any presumption that St. Luke's pre-joinder prices were competitive.[5] (IDFOF 529-530, 532-537, 942-947; *see also* RPF 1796-1799, *in camera*).

Third, Complaint Counsel do not refute their own expert's concession that his model cannot accurately predict which hospital patients would choose if their first choice hospital became unavailable or more expensive. (RAB 25) (citing Town, Tr. 4240-4242). This matters because Complaint Counsel's case turns on the alleged closeness of competition between ProMedica and St. Luke's. *See Horizontal Merger Guidelines*, § 6.1. Further, Complaint Counsel's citation to Professor Town's diversion analysis does not salvage his model because

[5] Though they dismiss it as "bizarre" (CCASB 20), Complaint Counsel undeniably bear the burden of showing ProMedica can profitably increase prices above competitive levels for a prolonged period. (ID 166) (citing *Long Island Jewish*, 983 F. Supp. at 142). They fail to meet their burden by neglecting to present evidence that ProMedica could profitably impose Professor Town's predicted price effect. (RAB 29, n.6).

they concede that "*Mercy* is ProMedica's closest substitute under the diversion analysis." (CCASB 12) (emphasis added).

Any of these flaws in Professor Town's model suffice for the Commission to dismiss its results. Taken together, they mean that the model does not amount to "reliable, probative, and substantial evidence," and the Commission must reject it.

C. The ALJ Wrongly Relied on MCO Testimony

1. MCO Testimony is Neither Reliable nor Probative

The ALJ erred by relying on speculative MCO testimony. Courts demand more than testimony regarding current perceptions or mere speculation about future conditions to support a finding of anticompetitive effects. *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 145-46 (D.D.C. 2004); *Oracle*, 331 F. Supp. 2d at 1131; *see also FTC v. Freeman Hosp.*, 69 F.3d 260, 271-72 (8th Cir. 1995). The Commission should discredit MCOs' unsupported testimony because, contrary to Complaint Counsel's assertion (CCASB 21), MCOs did not try to determine what will happen in the Lucas County market for GAC inpatient services, and Complaint Counsel's effort to buttress the MCOs' lack of analysis (CCASB 22-23) is unconvincing.

A cursory review of the record refutes Complaint Counsel's assertion that MCOs gave "detailed testimony" regarding the bases for their concerns about the joinder. (CCASB 21). No MCO studied Lucas County members' patient preferences or analyzed their insureds' willingness to travel for inpatient hospitalization in Lucas County. (Radzialowski, Tr. 637-638, 774; Pirc, Tr. 2262, *in camera*, 2268-2269, 2297-2298, 2303, *in camera*; Pugliese, Tr. 1563; Sheridan, Tr. 6681; Neal, Tr. 2155). Thus, the MCO testimony lacks foundation; it is sheer speculation.

Complaint Counsel implicitly acknowledge that MCOs did no true analysis of the joinder's likely competitive effects because they spend most of their time trying to explain –

unconvincingly – why MCOs' lack of analysis is immaterial. In doing so, however, Complaint Counsel make broad, unsupported assertions and grossly mischaracterize MCO testimony.[6] First, Complaint Counsel assert that MCOs need not study the feasibility of a Mercy-UTMC network because "the answer was obviously no." (CCASB 23). Complaint Counsel's argument that something that has not been tried "obviously" will not work is circular, illogical, and unsupported. (*See* CCASB 23 (citing Radzialowski, Tr. 716, *in camera* {

})). Further, although Complaint Counsel note that "[i]n the ordinary course of business, health plans evaluate which network configurations would be marketable and attractive at which prices" (CCASB 23), no MCO has evaluated the marketability of a UTMC/Mercy network. {)}.

Second, Complaint Counsel suggest that MCOs' testimony is reliable because it corroborates other evidence indicating that St. Luke's prices will increase post-acquisition. (CCASB 22). But it would be ridiculous to expect that St. Luke's prices will hold steady or decrease when the evidence shows that MCOs were paying St. Luke's below-market rates.[7] Indeed, the ALJ found that "St. Luke's likely would have increased rates regardless of the [j]oinder." (ID 169). Further, Complaint Counsel's focus on MCO testimony regarding raising

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[6] Complaint Counsel claim, without citation, that { } was unsuccessful in marketing a Mercy-UTMC-St. Luke's network and that { } would exit Lucas County if it did not reach an agreement with ProMedica post-acquisition. (CCASB 7, 23). In fact, { 's} share stayed consistent without ProMedica in its network, and { } only testified that it had considered exiting the market *prior* to the acquisition and said nothing about what it would do afterwards. {( )}.

[7] Complaint Counsel cites { } testimony that ProMedica's rates were higher than St. Luke's. (CCASB 7). This reveals only that St. Luke's rates were low – not that ProMedica's rates were high – because { } also testified that { } than St. Luke's. {(}.

rates *at St. Luke's* fails to respond to the ALJ's primary concern; that ProMedica may raise rates at ProMedica's legacy hospitals. *Compare* (CCASB 22) *with* (RAB 31; ID 169-170). MCO testimony does not address whether the joinder will enable ProMedica to profitably increase prices above competitive levels for a prolonged period of time and, therefore, is irrelevant. *See Long Island Jewish*, 983 F. Supp. at 142. Moreover, Complaint Counsel's claim that the joinder will permit ProMedica to raise St. Luke's rates 74.1 percent (CCASB 15-16) rings hollow, because MCOs pay ProMedica's legacy hospitals not one, but different rates (Wachsman, Tr. 4912-4914), and ProMedica would have already raised rates at its own hospitals to match its highest rate if it had the market power Complaint Counsel attribute to it.

Finally, Complaint Counsel miss the importance of MCO bias. (CCASB 23). ProMedica owns Paramount, against which MCOs compete for members. Thus, MCOs have an inherent bias against ProMedica. More importantly, MCOs have an interest in continuing to extract low, often below-cost, rates from St. Luke's. (ID 169; RPF 1788-1791, *in camera*, 1793).[8] The testimony of these large MCOs, therefore, is colored by their desire to better their own self-interest. *See Tenet Health Care Corp.*, 186 F.3d at 1054.

2. The ALJ and Complaint Counsel Ignore Real World Evidence Showing Anticompetitive Effects Are Unlikely

The ALJ and Complaint Counsel err by relying on unsubstantiated MCO testimony rather than real world evidence showing that anticompetitive effects from the joinder are unlikely. First, it is undisputed that excess capacity exists in Lucas County, and the population is not

[8] That interest is reflected by { } with St. Luke's, when St. Luke's sought to renegotiate its rates pre-joinder. (RPF 1802-1819, *in camera*).

forecast to grow.[9] (RPF 57-58). This is important because it allows MCOs to craft narrower hospital networks that can still meet members' needs. Complaint Counsel's suggestion that steering will not work because MCOs had been unable to defeat ProMedica's higher pre-joinder prices is based on the faulty premise that ProMedica had higher pre-joinder prices. (*See supra* § I.B.1.)

Second, Complaint Counsel mischaracterize the relevance of physician privileges. (CCASB 25). Physicians do not need to know the prices that hospitals charge for services; most do not. But, as long as physicians have privileges at multiple competing hospitals, MCOs can exclude hospitals from their networks if they fail to agree on rates without disturbing the physician-patient relationship because physicians *do* consider whether a hospital is in their patients' networks when making admission decisions. (RPF 465).

Third, Complaint Counsel inflate the role of bargaining leverage. (CCASB 26). Both parties' experts agree that bargaining leverage is not in and of itself anticompetitive. (Guerin-Calvert, Tr. 7440; Town Tr. 4142-4143). That is because all hospitals and MCOs have bargaining leverage when they enter negotiations. (Guerin-Calvert, Tr. 7445-7446). But Complaint Counsel overreach when they argue that any change in bargaining leverage would be anticompetitive. (CCASB 26). If true, then any merger or acquisition would be anticompetitive if it increased a party's bargaining leverage. The law is clear, however, that only a *substantial* lessening of competition violates Section 7. *See Long Island Jewish*, 983 F. Supp. at 135-36. Complaint Counsel's argument that "the Acquisition increases ProMedica's leverage" fails to show that anticompetitive effects will result. (CCASB 26). Indeed, Professor Town's own

[9] Complaint Counsel cite Dr. Gold's testimony for their argument that UTMC does not have excess capacity, however, the pages cited do not discuss capacity. *Compare* (CCASB 24) *with* (Gold, Tr. 225-26). Regardless, Dr. Gold testified that UTMC's occupancy rate generally is less than 100 percent. (Gold, Tr. 255-256).

model, with appropriate variables, does not support the conclusion that increased bargaining leverage leads to price increases.

Finally, Complaint Counsel's attack on *United States v. Baker Hughes*, 908 F.2d 981 (D.C. Cir. 1991), is unfounded. (CCASB 27). While some cases have distinguished *Baker Hughes*, others have favorably cited its holding that a threat of entry is sufficient. *See FTC v. Lab. Corp. of Am.*, No. 10-1873, 2011 U.S. Dist. LEXIS 20354, at *52 (C.D. Cal. Feb. 22, 2011) (explaining that defendants are not required to present examples of firms poised for future expansion because the threat of entry may be enough to stimulate competition); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1219 n.26 (11th Cir. 1991) (acknowledging that the threat of entry may deter anticompetitive effects, but finding that there was no threat of entry due to restrictions imposed by Georgia's certificate of need law). *Chicago Bridge & Iron Co. N.V. v. FTC* is distinguishable. 534 F.3d 410 (5th Cir. 2008). There, the Fifth Circuit rejected the threat of entry posed by weaker competitors competing on a dissimilar scale to the merging party and, therefore, held they were incapable of adequately replacing lost competition. *Chi. Bridge*, 534 F.3d at 430.

Here, { } is a large health system with hospitals located adjacent to each of ProMedica's legacy hospitals, and is capable of replacing lost competition. (RPF 142-144). { } qualifies as competitor repositioning because it can defeat a post-acquisition price increase by putting approximately { } of St. Luke's billed charges { .} (Guerin-Calvert, Tr. 7390-7392, *in camera*). Further, Complaint Counsel mischaracterize the facts regarding { }. { } exceeded its overall physician recruiting goals annually from 2007 to 2010. ({ }, Tr. 1055-1056). And, pursuant to its {

}. Finally, the evidence shows that { } is a direct competitive response to the joinder. { }.

II. St. Luke's Uncertain Future Viability Undercuts Any Suggestion that the Joinder Will Result in a Substantial Lessening of Competition

Despite Complaint Counsel's attempt to pigeon-hole ProMedica's argument regarding St. Luke's financial weakness as a defense, the Commission must consider St. Luke's weaknesses in assessing the relevant market's competitive dynamics. *See United States v. Int'l Harvester Co.*, 564 F.2d 769, 773-76 (7th Cir. 1977); *Arch Coal*, 329 F. Supp. 2d at 155-57. The ALJ correctly found that St. Luke's future viability as an independent hospital is uncertain. (ID 214, ¶ 19.) It is likely that, absent the joinder, St. Luke's market share would be reduced to zero (if it exited the market) or nearly zero if it made the service cuts that it considered absent the joinder. (RPF 1963-1964, *in camera*; IDFOF 393). The ALJ's competitive analysis mistakenly ignored this evidence.

Complaint Counsel try to undercut the ALJ's conclusion that St. Luke's was "struggling financially as a stand-alone entity during the years leading up to the Joinder and faced significant financial obstacles to going forward as an independent hospital." *Compare* (CCASB 29-33) *with* (ID 186). They cherry-pick the ALJ's findings discussing St. Luke's growth but ignore those findings that led him to reject the position that Complaint Counsel now reassert – that St. Luke's was in the midst of a "successful financial turnaround."[10] (ID 183; *compare* (CCASB 29-33) *with* (IDFOF 955-956 (Complaint Counsel's reliance on EBITDA unreliable), 805-809, 819,

[10] Complaint Counsel's statement that St. Luke's "experienced financial challenges, like virtually every other business" and comparison of St. Luke's to Bear Stearns and Lehman Brothers is inapt. Complaint Counsel ignore ProMedica's benchmarks with comparable hospitals on metrics like operating profit, operating margin, EBITDA, age of plant, private beds, and reimbursement rates, which all show St. Luke's falling behind. (IDFOF 787-789, 792-795, 815, 817-818, 871; RPF 1785-1786, *in camera*, 1788-1790, *in camera*).

831-835 (St. Luke's required millions in capital improvements), 853-857 (St. Luke's faced millions in annual pension contributions), 864 (St. Luke's available cash reserves declined by half from 2007 to the joinder), 868-871 (as of the joinder's closing, St. Luke's had 104 days cash on hand, about half that of similarly-sized hospitals), 875-884, 896-899, 905-906, 910, 914 (independent rating agencies downgraded St. Luke's credit ratings))).

The fatal flaw in Complaint Counsel's argument that St. Luke's was rebounding is that St. Luke's lost money, on average, for each patient that walked through its door. (IDFOF 942-947). Complaint Counsel's attempt to counter this fact is unavailing. Two of the three documents and testimony that Complaint Counsel cite refer to a one-time, infinitesimal margin of $7,112 in August of 2010, which resulted from two large, unusual, and non-recurring additions to St. Luke's operating income. (CCASB 7, 32; PX00170 at 001; PX01062 at 003; RCCPF 988). The third document Complaint Counsel cite refers only to MCOs' reimbursement as a percentage of Medicare's reimbursement, and does not account for losses from Medicaid or any costs associated with serving Medicare, Medicaid, or commercial patients. *Compare* (PX00157 at 012, *in camera*) *with* (IDFOF 372-375, *in camera*) *and* (RX-56 at 000010-11, *in camera*). In short, St. Luke's was not in the midst of a successful turnaround at the time of the joinder. (*See, e.g.*, RCCPF 988).

Complaint Counsel also fail to rebut evidence that St. Luke's financial condition would render it "competitively insignificant in the future." (RAB 38-40). For example, Complaint Counsel claim that St. Luke's board abandoned the idea of service cuts, but neglect to add that the reason was because St. Luke's decided *instead* to join with another hospital. (CCASB 36-37;

RAB 40; IDFOF 393-395).[11] Moreover, Complaint Counsel's financial expert's conclusion that St. Luke's could have been profitable without cutting services or employees is flawed because, among other things, it relies on EBITDA, which the ALJ found does not necessarily indicate financial strength, overstates future revenue, and understates expenses and capital needs. (ID 183; RCCPF 1082-1084).

Complaint Counsel's remaining arguments are similarly flawed. The reiteration that St. Luke's could pay off its outstanding debt ignores the fact that doing so would have worsened St. Luke's financial condition. (RAB 39). Similarly, Complaint Counsel's bond expert's "analysis" that St. Luke's could have borrowed money to cover its debts, simply because other hospitals with the same credit rating did so, is meaningless because Mr. Brick did no independent analysis of those hospitals' comparability to St. Luke's or whether it made economic sense for St. Luke's to do so – a glaring omission given that St. Luke's operating margin and EBITDA were below that of similarly rated hospitals. (Brick, Tr. 3526-3528; IDFOF 785-789.). Finally, Complaint Counsel's suggestion that St. Luke's was only doing a little belt-tightening ignores the fact that St. Luke's cut its capital expenditures { } in 2009 and could not sustain its employee cost-cutting measures. (RX-56 at 000024, *in camera*; Johnston, Tr. 5329; Den Uyl, Tr. 6468, *in camera*; *see also* RRBR 75-77). Absent the joinder, St. Luke's would either have had to close its doors or severely cut services, undercutting any conclusion that the joinder will result in a substantial lessening of competition.

[11] St. Luke's attempt to push MCOs for higher rates, which Complaint Counsel raise as another alternative, was unsuccessful. (IDFOF 544-549). St. Luke's also investigated affiliating with other entities but either they were not interested or St. Luke's determined an affiliation was not in its or the community's best interest. (IDFOF 424-425; RPF 827-840).

III. The ALJ's Determination that ProMedica's Proposed Remedy Would Nullify Any Anticompetitive Effects of the Joinder Should Have Dictated the Remedy

Even if the joinder violates Section 7, the ALJ chose the wrong remedy. Divestiture is not an "automatic sanction, mechanically invoked in merger cases." *In re Retail Credit Co.*, No. 8920, 1978 FTC LEXIS 246, at *260 (July 7, 1978). Instead of formulaically ordering divestiture, the Commission's primary focus in crafting a remedy is redressing any ill effects of the illegal conduct. *In re Ekco Prods. Co.*, No. 8122, 1964 FTC LEXIS 115, at *122 (June 30, 1964); *In re Diamond Alkali,* No. 8572, 1967 FTC LEXIS 44, at *87, 89-90 (Oct. 2, 1967). Complaint Counsel do not refute this standard, but dismiss it as outdated. (CCASB 40). Nevertheless, it remains good law, and divestiture is not always the best remedy.

Here, the ALJ's determination that ProMedica's proposed remedy "would restore ProMedica's bargaining power to its pre-Joinder state and preserve St. Luke's as a competitive constraint" and "preserve St. Luke's viability, to the benefit of consumers" (ID 207) establishes ProMedica's proposal as appropriate because it cures any anticompetitive effects and is tailored to address St. Luke's unique situation. Complaint Counsel do not contest the ALJ's finding; instead, they try to shoehorn this case into the facts of *Evanston*, No. 9315, 2007 FTC LEXIS 210. (CCASB 39-42). *Evanston* did not, however, set the standard for applying alternative remedies. Further, the ALJ's finding demonstrates that an *Evanston*-style remedy applies here even though the facts are not identical to *Evanston.*[12] (ID 207). Thus, the Commission should enter ProMedica's proposed order.[13]

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[12] Complaint Counsel's suggestion that the community benefits are overstated because St. Luke's was well positioned and had sufficient funds to implement EHR, once again misrepresents the record. (RCCPF 885, 1079, 1080-1081 (stating that while St. Luke's "expected" to implement EHR, in reality, St. Luke's was not in a position to fund its capital needs, including EHR, on its own)).

[13] Complaint Counsel concede that the parties can unwind the joinder and spin-off St. Luke's as an independent entity. (CCASB 42; Closing Argument, Tr. 85-86). Accordingly, ProMedica requests that, if the Commission

(continued...)

CONCLUSION

The Initial Decision suffers from critical errors that Complaint Counsel's Answering Brief cannot cure. Complaint Counsel have not shown, by a preponderance of the evidence, that the ProMedica/St. Luke's joinder will enable ProMedica to profitably raise prices above competitive levels for a prolonged period. ProMedica and St. Luke's were not close competitors, Complaint Counsel's economic expert's analyses were fatally flawed, MCOs' testimony was unsupported and biased, and St. Luke's future as an independent hospital was uncertain at best, thereby diminishing its future competitive significance.

ProMedica, therefore, urges the Commission to reverse the Initial Decision and dismiss the Complaint with prejudice. Alternatively, ProMedica requests that the Commission adopt ProMedica's proposed remedy, which would eliminate the risk of anticompetitive effects, while ensuring St. Luke's will continue as a viable community hospital.

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denies ProMedica's alternative remedy, it amend the ALJ's order to state specifically that ProMedica may unwind the joinder.

This the 26th of January, 2012.

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CERTIFICATE OF SERVICE

I, Christine Devlin, hereby certify that I served a true and correct copy of the foregoing Respondent's Reply in Support of its Appeal Brief, Public Version, upon the following individuals by hand on January 26, 2012.

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