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Huntington Hospital/Cedars-Sinai Health System v. California DOJ

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On March 30, 2021, Huntington Hospital (Huntington) and Cedars-Sinai Health System (Cedars-Sinai) filed a first of its kind lawsuit in Los Angeles County Superior Court against the California Department of Justice (California DOJ) and the Attorney General of California challenging restrictions and conditions imposed on the parties' proposed affiliation. The case involves a novel use of California Corporations Code §§ 5920 to invoke antitrust concerns, remedies, and notable economic theories, all of which are worthy of observation and study by all health care practitioners.

Executive Summary

Huntington and Cedars-Sinai, both located in Los Angeles County, have sued the California Attorney General for imposing competition restrictions on the hospitals as part of a conditional approval of their affiliation agreement. The conditions include a requirement that the hospitals negotiate with insurance plans through separate firewalled teams, a price cap on hospital services, and a requirement that the hospitals submit to mandatory final offer arbitration. The arbitration condition would apply if insurance providers determine that they are subject to terms that the hospitals would not have imposed but for the affiliation. The hospitals contend that the Attorney General lacks the authority to impose such conditions under California Corporations Code § 5920; that the affiliation does not create competitive concerns; and that even if it did, that the Attorney General could address all potential concerns with a prohibition on "all-or-nothing" bargaining. Both plaintiff and defendant have retained and submitted competing expert reports. Both experts agree that the hospitals do not directly compete but disagree on whether cross-market effects could lead to a price agreement under the agreement. The state's expert asserts that the cross-market effects could lead to a price increase under theories of traditional tying, common customer, and change in control but the hospitals' expert disputes the application of these theories in this transaction.

The Affiliation and § 5920

In July 2020, Huntington and Cedars-Sinai entered into an Affiliation Agreement intended to broaden their patients' access to more specialists and facilities, enhance clinical best practices, and engineer deeper collaboration on innovative research.[1] The parties also contend that their transaction would create substantial cost savings through joint purchasing and the combination of administrative and back-end infrastructure (such as a shared electronic medical records systems).[2] Although the Federal Trade Commission (FTC) did not block the transaction or impose any conditions, then-Attorney General of California Xavier Becerra conditionally approved the affiliation subject to the imposition of competitive impact conditions among other conditions.

California Corporations Code § 5920 requires the Attorney General's consent for the affiliation to proceed. The statute requires such consent for the sale or transfer of assets or control from one nonprofit company involved in health services to another similar company. Section 5917 provides a non-exclusive list of factors that the Attorney

General should consider in deciding whether to grant his consent. The plaintiffs contend that none of the factors specifically mention competition or antitrust concerns, but the Southern District of California has described the factors as "span[ning] an expansive range of considerations, from the terms of the agreement to antitrust concerns and the public interest."[3] In the complaint, Huntington and Cedars-Sinai argue that aside from violating their Due Process rights by failing to share materials on which the Attorney General based his decision, that the Attorney General lacked authority to require competitive impact conditions at all.[4] In support of their position, the hospitals also contend that the legislature enacted the statute only to "ensure that nonprofit healthcare providers remain true to their philanthropic mission" and that, had the legislature intended to give the Attorney General antitrust enforcement authority through the statute, it would have done so "with unmistakable clarity."[5] Alternatively, the hospitals contend that if the statute's grant of authority is broad enough to allow consideration of "any factors" including antitrust factors, then it is an unconstitutional delegation of policymaking authority to the Attorney General.[6]

Challenged Competitive Conditions

The challenging hospitals did not dispute several requirements imposed by then-Attorney General Becerra such as agreeing to maintain certain service levels. Even so, the Attorney General's Order also imposed three competitive impact conditions that Huntington and Cedars-Sinai must agree to accept in order to consummate their proposed affiliation. First, the conditional approval required the parties to separate their teams of negotiators for entering contracts with health insurance payers and prohibited these teams from sharing any information about contracting activity with each other. Second, the conditional approval imposed a price cap on the total reimbursement that Huntington could receive from any managed care contract entered into or renewed after December 4, 2020. Third, the conditional approval required the parties to submit to "baseball style" or final offer arbitration whenever a health insurance payer claimed that the parties imposed a condition in an agreement that they would not have imposed without the affiliation. Each requirement is discussed in turn.

Separate Negotiating Teams

Under the separate negotiations and firewall requirement, the California DOJ requires the parties to establish separate and fire-walled Huntington and Cedars-Sinai negotiating teams that would negotiate the terms of any contracts with insurance payers unless such payers voluntarily consented to a joint negotiation. If the payers did consent to a joint negotiation, they could negotiate with a joint negotiation team that would exist separately and be firewalled from the Huntington and Cedars-Sinai negotiating teams.

Although a California Attorney General has never imposed such a separate negotiation requirement under California Corporations Code §§ 5920, prior hospital affiliations have seen these conditions imposed to address competition concerns. For example, in *In Re Evanston Northwestern Healthcare Corp.*, the FTC found that the extraordinary circumstances presented by the case justified a behavioral remedy for already merged hospitals to conduct negotiations separately with health insurances payers as they had before the merger to restore competitive conditions.[7] The Commission stressed, however, that the imposed condition was unique to the facts of that case including post-consummation improvements made to the merged hospitals.[8]

Price Caps

The price cap condition requires Huntington, but not Cedars-Sinai, to tie increasing prices over a one-year period to the amount of the increase of the U.S. Bureau of Labor Statistics' seasonally adjusted CPI for Hospital Services in U.S. Cities. This index tracks pricing increases for a basket of pre-determined inpatient hospital services and Huntington would have to ensure that its prices for the same basket of inpatient hospital services do not increase by more than the index. The price cap condition provides a floor of a 4% price increase for Huntington even if the index increased by a lesser amount. If Huntington's actual price increase exceeded the increase in the index,

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Huntington would have to reimburse the payers. On the other hand, if Huntington's increase were lower than the increase in the index, Huntington would be able to "bank" the difference towards a future increase. For example, if Huntington had increased total inpatient services prices by 5% in the year following the affiliation, but the index increased by 6%, thereby allowing for 6% cap on Huntington's price increase, Huntington could then apply this 1% difference on top of the next year's index-based cap as next year's increase.

Like the separate negotiating condition, there is past precedent for imposing a price cap condition on hospital transactions even though California Corporations Code § 5920 has never specifically been used to impose such a condition. In a proposed transaction under which a variety of Massachusetts health care providers and organizations came together to form Beth Israel Lahey Health, Inc. (BILH), the Massachusetts Attorney General entered an assurance of discontinuance with BILH that required an agreement to a seven-year price cap among other conditions to allow the merger. The terms of the price cap required BILH to keep any price increases below the state's Health Care Cost Growth benchmark set at the time of the agreement at 3.1%.

Mandatory Arbitration

Finally, under the mandatory arbitration condition, payers who believed the hospitals charged them on terms that would not have occurred but for the affiliation could first submit such disagreements to mediation and then, if the parties failed to agree after the mediation, commit to a binding arbitration proceeding. The arbitration would bind the parties and the arbitrator would conduct it as final offer arbitration in which both the payers and Huntington/Cedars-Sinai would submit proposed prices and terms and the arbitrator would have to choose between them. Insurance companies and hospitals generally include mandatory arbitration provisions to adjudicate contract terms that are part of their managed care agreements, but in this case, mandatory arbitration would apply in the absence of an agreement on pricing to reach a pricing agreement in the first place.

Competitive Analysis

Aside from their opposition to imposing competition conditions under § 5920 in general, the hospitals also disagree with the Attorney General's analysis of competitive effects of the affiliation and required remedies. Both the Attorney General's expert and the hospitals' experts agree that Huntington Hospital and Cedars Sinai do not directly compete for many patients and for the most part serve different areas. The experts, however, disagree on whether the affiliation can have cross-market effects even though the hospitals serve different customers.

Both parties to the lawsuit agree that Huntington and Cedars-Sinai have very little overlap in the areas in which they serve, or the geographic market. In other words, if either of the hospitals raised prices, the other hospital would be unlikely to recoup losses by picking up some of the lost customers. The Attorney General's expert, however, argues that the hospitals could still engage in anticompetitive actions under theories of tying, common customers, and change in control.

Tying occurs when a firm with market power, or the ability to profitably raise prices above a competitive level, seeks to exert that power in another market where it does not have market power by bundling its products together. The Attorney General argues that the hospitals do have market power and could exert such power by bundling the hospitals together and requiring insurance payers to purchase services from both. The hospitals' expert, however, disputes that there could be any unused market power that the hospitals could exert through tying and notes that the hospitals had proposed not to engage in such "all-or-nothing" contracting as a remedy to any prospective problems.

The Attorney General's common customers theory posits that even though the hospitals serve different locations, health insurance plans are loath to have network-coverage holes in areas where they sell insurance products. If the hospitals have market power in their given areas, this could allow them to bundle their services together for higher prices at one or both hospitals than each hospital could have negotiated individually. The hospitals respond that this is not a separate theory and instead just a rationale for how a tying theory could work. The hospitals argue that they each have several other competitors in their respective geographic areas and plans can and do forego both hospitals in favor of competitors. The hospitals also contend that their proposal not to engage in "all-or-nothing" contract negotiations with plans would obviate any common customer concern.

Finally, the Attorney General posited a change in control theory. Under this theory, the parties could use the change in control to pursue price increases post-merger based on some latent market power that the hospitals had not yet converted into price increases pre-merger. The Attorney General contends that such effects could materialize for a variety of non-economic reasons such as ties to the community. The Attorney General supports this inference by noting the perception among customers that Cedars-Sinai charges high prices while Huntington's prices may be high but do not seem to be that far above a competitive level for its services. Thus, under this theory, Cedars-Sinai could change Huntington's pricing model to reflect its own, thereby raising prices at Huntington. The hospitals contend that Cedars-Sinai has exerted no such pricing control over hospitals that it has acquired and that Huntington would similarly continue to determine its own prices.

The Attorney General's expert concludes that these potential harms justify the firewalled negotiation provision to prevent any anticompetitive tying by preventing bundling and any change in control price increases, and by preventing the sharing of strategic pricing information in negotiations. He also argues that the price cap could prevent this harm if the firewalled negotiation provision does not. The Attorney General's expert does not discuss the mandatory arbitration condition.

The hospitals' expert responded to these assertions by arguing that even if the Attorney General is right about cross-market effect harms, the parties' proposed prohibition on "all-or-nothing" bargaining would prevent these harms in a less costly manner. He argues that the Attorney General's expert did not consider the increased costs of having to maintain separate negotiation teams with no shared information. He also argues that the price caps could constrain the hospitals' ability to improve facilities and innovate due to an inability to recoup their investments. Finally, the hospitals' expert argues that the mandatory arbitration condition would lead to abuse by insurance payers who could raise it for any price increases because of its imprecise requirement that the hospitals engaged in terms it would not have engaged in but-for the merger.

Conclusion

Since the hospitals' complaint was just filed in March 2021, any final resolution of the dispute will take several months or longer, depending on any motion practice and discovery efforts by the parties. If the hospitals succeed in their challenge, it could signal an end to the California Attorney General's efforts to use § 5920 to limit proposed health care transactions. But if the State of California prevails in the suit, it could mark the beginning of a new era of state Attorneys General using state statutes to impose limitations on proposed mergers and affiliations.

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[1] Verified Petition and Complaint ¶ 4, *Pasadena Hospital Association Ltd. V. Cal. Dep't of Justice*, No. 21STCP00978, (Cal. Super. Ct. Mar. 30, 2021).

[2] *Id.*

[3] *Prime Healthcare Services, Inc. v. Harris*, No. 3:16-cv-00778, 2017 WL 3525169 at *2 (S.D. Cal. Aug. 16, 2017) (citing Cal. Corp. Code § 5917; Cal. Code Regs. tit. 11, § 999.5(f)). The actual conditions then-Attorney General Kamala Harris and her successor Xavier Becerra sought to impose in *Prime Healthcare Services, Inc*, however, involved requirements that "effectively required Prime to operate five hospitals as acute care facilities for ten years and to maintain the majority of current hospital services at each hospital, with the exception of St. Vincent Medical Center, for ten years." *Id.* at *5.

[4] Verified Petition and Complaint ¶¶ 16, 17 *Pasadena Hospital Association Ltd. V. Cal. Dep't of Justice*, No. 21STCP00978, (Cal. Super. Ct. Mar. 30, 2021).

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[5] *Id.* ¶ 16. A bankruptcy court opinion reviewed conditions imposed under Cal. Corp. § 5920 through only the enumerated factors stated in the statute before finding that the conditions were an abuse of discretion but the opinion was later vacated and withdrawn. *In re Verity Health System of California, Inc.,* at *14-15, No. 2:18-bk-20151, 2019 WL 5585007 (C.D. Cal. Bankr. Oct. 23, 2019), *vacated*, 2019 WL 6519342 (C.D. Cal. Bankr. Nov. 13, 2019).
[6] *Id.* ¶ 150-54. The U.S. District Court for the Southern District of California, however, rejected a similar challenge to the statute's broad grant of factors to consider as void for vagueness because the statute did not grant the Attorney General of California limitless discretion and required her to consider the list of nine enumerated factors as well as factors in the enabling regulations, *Prime Healthcare Services, Inc. v. Harris*, 216 F. Supp. 3d 1096, 1125 (S.D. Cal. 2016).
[7] No. 9315 (FTC April 28, 2008).
[8] *Id.* at *11.