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Timing and Hold Separate Agreements in Mergers: When to Fold, Hold or Call

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Merging hospitals, physicians, and other health care entities who are investigated by the Federal Trade Commission, Department of Justice Antitrust Division, or a state Attorney General typically face a dilemma relatively early in the investigation: whether to agree to the government's request to delay closing the transaction and hold separate until the government's investigation is completed (and thus risk the transaction falling apart due to the potentially long delay in completing the investigation and obtaining clearance), or to decline the request and move towards consummating the transaction (and potentially risk an immediate legal challenge and request for preliminary relief enjoining closing or subsequent dissolution or divestiture, or at a minimum, creating a more adversarial relationship with the investigating agency). Historically, merging parties have perceived litigation with the government as the greater risk, and almost uniformly selected the former option and agreed to the government's request. Four recent health care mergers illustrate these risks and the considerations that may go into this decision, and perhaps signal a change from this historical risk-assessment.

A "hold-separate" or "timing" agreement is a device employed by government antitrust enforcement agencies in which the merging parties are asked to agree not to consummate their proposed transaction or further consolidate their operations until a certain period of time, typically 30 days, elapses after the parties certify compliance with the agency's subpoena for documents regarding the transaction. The purpose of such agreements is to allow the government to complete its investigation before the parties are too far along in integrating their operations, so that if the government ultimately decides to challenge the merger it is not faced with the difficult task of "unscrambling the eggs" to remedy an already-consummated transaction.

The Mergers

1. ProMedica-St. Luke's Hospital Merger

ProMedica Health System and St. Luke's Hospital, located in Toledo, Ohio, agreed to merge in May 2010. Although the FTC opened an investigation into the acquisition in

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July 2010, the parties closed the transaction and began integrating St. Luke's into ProMedica in September. The integration was subject to a hold-separate agreement, however, which prevented the parties from consummating certain key elements of the merger. Specifically, the agreement prohibited ProMedica from terminating any of St. Luke's health plan contracts, altering any service lines offered by St. Luke's, or terminating any St. Luke's employees.

After an apparently contentious document discovery process, ProMedica refused to extend the hold-separate agreement and, in January 2011, the FTC initiated an administrative proceeding seeking divestiture of all assets acquired by ProMedica and the restoration of "two separate, viable and independent businesses." At the same time, the FTC filed an action in Ohio federal court seeking a temporary restraining order and preliminary injunction to extend the hold-separate agreement through the end of the administrative proceeding. On March 29, 2011, the federal court granted the FTC's request for a preliminary injunction. Although the transaction was already consummated in part, the order extended the hold-separate agreement, pending the outcome of a hearing before an administrative law judge that began on May, 31, 2011.

Based on these findings, the court concluded that the FTC had carried its relatively easy burden for obtaining injunctive relief under section 13(b) of the FTC Act. The standard for obtaining injunctive relief under section 13(b) favors the FTC because the Commission does not have to make a showing of irreparable harm, as private litigants must show to obtain injunctive relief. Instead, the FTC need show only a likelihood of success on the merits and that balancing the equities favors injunctive relief. Here, the court concluded that balancing the equities favored a preliminary injunction; however, in order to mitigate the negative impact on the hospitals, the court required the FTC to complete its administrative proceeding by November 30, 2011, at which time the court stated it would revisit its decision "to ensure that all parties are treated fairly and expeditiously."

In this merger, the parties partially consummated the transaction and aggressively resisted the FTC's investigation discovery, but could not seem to decide whether to agree to hold separate or not – first agreeing, then refusing to extend the agreement (prompting the FTC to initiate litigation) and then agreeing again rather than fight the

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FTC's request for a temporary restraining order. Ultimately, the transaction was enjoined pending resolution of the administrative hearing on the merits.

2. LabCorp-Westcliff Medical Labs Merger

In May 2010, Laboratory Corporation of America, or LabCorp, announced it had agreed to purchase the assets of Westcliff, the third largest clinical laboratory in California. The purchase price did not meet the transaction size threshold, thus the merger was not reportable to the federal enforcement agencies under the Hart-Scott-Rodino (HSR) Act. When the FTC learned of the transaction, it issued a civil investigative demand or "CID" (a prelitigation subpoena for documents) to the parties. In a hold-separate agreement, the parties agreed not to consummate the acquisition and complete integration until 30 days after they had certified compliance with the CID. When the parties apparently later declined to agree to any further extension of the hold-separate agreement, in December 2010, the FTC simultaneously filed both an administrative complaint, alleging that the acquisition would violate section 7 of the Clayton Act and section 5 of the FTC Act, and a complaint in federal district court in California, seeking injunctive relief to extend the hold-separate agreement through the completion of the FTC's administrative hearing.

In contrast to the result in the *ProMedica* merger, the district court denied the FTC's requested injunction on February 23, 2011, despite the relaxed standard for the FTC to obtain injunctive relief. The court concluded that the FTC failed to show a likelihood of success on the merits or that the equities balance in favor of injunctive relief. The court found several efficiencies that would result in $2.3 million in annual savings to consumers. The court concluded these reduced costs to consumers are the type of "public interest" most relevant to balancing the equities, and concluded that balancing the equities "strongly favors defendants" in that case.

In addition, the district court emphasized the length of time the injunction would likely remain in place while the administrative proceeding was pending. The court made specific findings about the length of FTC administrative hearings, and found that despite the FTC's reform efforts to streamline the proceedings, "that process remains a long, drawn-out ordeal." The court opined that delay would be particularly inequitable for the defendants given they could not receive compensation for the delay in the event they

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ultimately prevailed on the merits. The court seemed particularly troubled by the "real possibility that a preliminary injunction here would financially devastate or destroy LabWest" (as Westcliff was renamed). Finally, the court found divestiture remained a possibility in the event FTC prevailed on the merits. As a result of all these factors, the equities favoring denial of the injunction "heavily outweighed" any minimal likelihood of success by FTC. The court's refusal to enter a preliminary injunction allowed the parties to consummate the acquisition despite the pending administrative proceedings.

The FTC immediately appealed the decision to the Ninth Circuit and simultaneously requested a stay pending appeal. On February 25, 2011 the district court denied the FTC's request for a stay. The court's order denying the stay reiterated that "the difficulties of divestiture did not outweigh the risks of the injunction." The Ninth Circuit then denied the FTC's request for an injunction pending the appeal of the district court's denial. The FTC voted to withdraw its appeal on March 24, 2011. One FTC commissioner dissented from the FTC majority's decision to withdraw the appeal, in part because she believed the district court had improperly valued the parties' private interests over the "public equities" that injunctive relief by FTC is intended to protect. Similarly, the dissenter noted "pre-integration relief is often far more likely to remedy competitive problems than post-integration divestiture." Subsequently, the FTC postponed, and then dismissed its underlying administrative proceeding on April 22, 2011.

In this case, like *ProMedica*, the parties began to consummate the merger, then initially agreed to hold separate but subsequently refused to extend the agreement. Unlike the *ProMedica* merger, however, the court denied the FTC's request for a preliminary injunction so the parties were free to consummate the transaction. The FTC then dropped its administrative proceeding, perhaps recognizing the difficulty in obtaining divestiture to "unscramble the eggs" at that point even if it were able to prevail on the merits.

3. Providence Health-Spokane Cardiologist Merger

On July 21, 2010, Providence Health & Services announced its intention to acquire two cardiology clinics, Spokane Cardiology and Heart Clinics Northwest, located in Spokane, Washington, in a merger that did not have to be reported to the FTC because

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it did not meet the HSR threshold. Providence planned to acquire the assets of each cardiology practice group and subsequently to employ all, or virtually all, of their affiliated physicians. The FTC and the Washington Attorney General's Office initiated an investigation of the transactions in August, 2010. After FTC staff expressed serious concerns to the parties regarding possible anticompetitive effects of the transactions that could increase health care costs in the Spokane area, in violation of section 7 of the Clayton Act, Providence Health & Services abandoned its plans to acquire the clinics in mid-February 2011. Subsequently, the FTC voted to close its investigation.

Here, the parties cooperated with the FTC's investigation, including agreeing to hold separate, but ultimately after a protracted investigation, which the parties apparently did not perceive was close to concluding and was undoubtedly quite expensive, they abandoned the transaction.

4. Northeast Health, St. Peter's Health Care Services and Seton Health Hospital Merger

Northeast Health, St. Peter's Health Care Services and Seton Health, three general acute care hospital systems in Albany, New York, entered into a formal affiliation agreement in June 2010. Shortly thereafter, the FTC issued CIDs for documents, and the parties executed a timing agreement on June 24, under which they agreed not to consummate the merger until 30 days after they certified compliance with the CIDs. The parties completed production in response to the CIDs in March, 2011.

On April 27, 2011, the FTC issued letters to the parties stating it completed its review and decided not to challenge the merger. The FTC stated that, "[U]pon further review of this matter, it now appears that no further action is warranted by the Commission at this time. Accordingly, the investigation is closed." In this merger, the parties followed the "historical practice" and agreed to hold separate, and also cooperated with the FTC's investigation, and in the end were able to consummate their transaction and proceed with integrating their organizations.

Discussion

So, in light of these four examples, what is the best choice for merging hospitals, physicians, or other health care entities when confronted with a request by the

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government to agree to hold separate pending the government's investigation? The answer will be different for each transaction and each set of parties but, as these examples demonstrate, will ultimately depend on the parties' willingness to take risk and appetite for litigation. There are risks with pursuing either option, however, and a number of factors to be considered.

The choices and their resulting risks are fairly clear. If the merging parties choose to take what has typically been perceived as the "safe" route and to agree to the government's request to delay closing the transaction and hold separate until the government's investigation is completed, they run the risk of the merger falling apart during the potentially long and indefinite period while the investigation is pending. During that time, the transaction may lose momentum, employees may defect, and competitors may take advantage of the merging parties' uncertain future, all resulting in potentially significant negative consequences for the merging parties themselves, as the court recognized in LabCorp. And there is no guarantee that the government will approve the merger at the close of its investigation even if the parties agree to hold separate.

If the parties choose to decline the request and move towards consummating the transaction, they potentially risk an immediate legal challenge and request for a temporary restraining order and preliminary injunction preventing consummation of the merger. Even if the government does not seek, or loses its request for, preliminary injunctive relief, it still may prevail in its proceeding on the merits and then seek dissolution of the merger and/or divestiture of some of the acquired assets. Indeed, when the parties decline the request to hold separate and the government elects not to seek an immediate injunction prohibiting closure, it typically sends an "at-risk" letter which informs the parties of the risk of an adverse decision on the merits and dissolution if they proceed with the merger before the investigation is complete. At a minimum, refusing the request is likely to create a more adversarial relationship with the investigating agency, which may have cost and sometimes even substantive ramifications.

The factors underpinning these choices and risks are more subtle. Refusing to agree to hold separate increases the likelihood of litigating a preliminary injunction, but does it

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decrease or increase the likelihood of being able to consummate the merger, which is the primary objective in the first place? Certainly, litigation is disruptive, creates negative publicity (particularly for nonprofit and charitable organizations), and is expensive and time-consuming. But is it more expensive and more protracted than agreeing to hold separate?

First, cost is always a consideration in determining any litigation strategy. In this situation, perhaps surprisingly, it is not necessarily more costly to refuse to hold separate and risk litigation. Whether or not the parties agree to delay consummating the merger or the government seeks an injunction, the government's investigation of the merits will continue and the parties will incur the costs related to the investigation, most significantly, the cost of collecting, processing and producing documents. In this era of electronic records, a document production is easily the most expensive facet of an investigation (or litigation, short of the actual trial). The parties also likely will need to retain an economist to perform a market analysis, and incur other costs to prepare their affirmative "defense" of the merger during the investigation. Moreover, the government too faces resource and cost considerations, as the LabCorp decision demonstrates. And even if the parties hold separate, if the government ultimately challenges the merger on the merits at the close of its investigation, these litigation costs will still exist. Thus much of the cost will be incurred regardless of whether the parties hold separate and whether the government seeks preliminary injunctive relief.

Similarly, time is another factor with less-than-obvious ramifications. Agreeing to hold separate with the thought that this will avoid litigation over injunctive relief and expedite the process towards final clearance is perhaps just the opposite of what will happen in actual practice. In fact, it is somewhat more likely that refusing to hold separate will force the government's hand, including seeking a preliminary injunction, and accelerate the ultimate result (for better or for worse). Government investigations can be quite protracted, typically lasting more than six months and sometimes more than a year, and as the result in the Providence Health cardiology merger demonstrates, this indeterminate delay (combined with the cost and uncertain outcome) can itself be fatal to the transaction. Time has tactical and strategic effects as well — when the parties agree to hold separate the government has more leverage in its investigation and related discovery requests because the parties feel time pressure to comply with

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requests in order to hopefully expedite the agency's conclusion and obtain clearance to close. Conversely, refusing to hold separate and (assuming it is not enjoined) consummating the transaction may ameliorate the parties' sense of urgency.

A third factor is the impact of the hold-separate decision on the broader relationship between the merging parties and the investigating agency staff. The best practice almost universally is to cooperate with the government in its investigation. Resisting the government's discovery requests is expensive, generally fruitless, and likely will cause delay. Will refusing to hold separate also have a negative impact on the relationship? In the ProMedica merger, it appears the parties attempted to force the FTC's hand by resisting document discovery and simultaneously refusing to extend the hold-separate agreement, but then ultimately capitulated and agreed to continue holding separate rather than fight the temporary restraining order, with the final result that the merger was enjoined pending resolution of the administrative proceeding. It would seem that refusing to hold separate by itself, however, while marginally increasing the adversarial nature of the relationship between the merging parties and agency, can be handled in a transparent and open way, combined with cooperation in the discovery process, so that any such negative impact is minimized. Of course, as in the Albany hospital merger, the parties may cooperate in all aspects of the investigation, including agreeing to hold separate, and be permitted to merge in the end.

The size of the transaction and the merging parties is another factor. While at first blush it might seem that a smaller transaction, especially if it is not reportable under the HSR thresholds, is less likely to be investigated in the first place, this suggestion is belied by the examples given, in which none of the four transactions was reportable and yet each was investigated. Size does matter for the hold-separate decision, however. A non-reportable transaction is more likely to have already closed, or be well on the way to doing so, before attracting the attention of the government and this may influence the parties' decision to refuse to hold separate. Also, smaller transactions, such as those involving physician groups, may be more likely to unwind on their own due to the delay and cost resulting from the investigation because there is less institutional commitment to the merger. Similarly, already-consummated, smaller mergers likely are easier for the courts to unwind through dissolution or divestiture than larger, more complex transactions after a decision on the merits that the merger is unlawful. Conversely, the

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government may be more likely to seek a preliminary injunction in the first place to prevent consummation of larger mergers.

This highlights what is perhaps the biggest risk and factor to be considered in deciding whether to hold separate or not — will the government seek, and the court order, the merger to be dissolved or assets to be divested after the substantive proceedings? As the court and dissenting Commissioner in *LabCorp* recognized, it can be very difficult to "unscramble the eggs" and pre-integration injunctive relief is often easier and more likely to address the competitive problems than post-integration divestiture. But attempting to predict and relying on the FTC or court's reluctance to force dissolution or divestiture is a huge risk for merging parties who decide to proceed and consummate the transaction, because the negative consequences from such drastic relief could extend far beyond simply undoing the merger to also include damaging the individual parties in their separate operations.

The conflicting decisions in ProMedica and *LabCorp* show that it is very difficult to prospectively predict how a court will balance the equities and choose the government or parties' side in determining whether to enjoin the transaction pending resolution of the proceedings on the merits (much less predict how the court or FTC will resolve the substantive issues). Rather than leaving this decision to the courts, merging parties may be better served by proactively identifying the specific factors they face, and their tolerance for accepting the risks of agreeing versus those raised by refusing to hold separate, and making an informed decision rather than merely a hurried reaction when the government requests such an agreement. While it may not change the end result, the parties may be able to influence the process based on their particular circumstances.

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