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Editor's Report

In this edition of the *Chronicle*, we are pleased to offer five original articles covering a range of antitrust issues relating to the health care and pharmaceutical industries:

- In our first article, Douglas Litvack, of Jones Day, and Peter Herrick, of Simpson Thacher & Bartlett LLP, discuss the recent Ninth Circuit Court of Appeals decision in *St. Alphonsus Medical Center v. St. Luke's Health System*, with a particular focus on the Court's treatment of the defendants' efficiencies defense. (p. 2)

- In our second article, Jennifer Ansberry discusses the antitrust risks of price transparency in the health care sector. (p. 9)

- In our third article, Jena Valdetero, of Bryan Cave LLP, discusses lessons learned from the Anthem data breach. (p. 20)

- In our fourth article, Roger D. Blair, from the Department of Economics at the University of Florida, and Christine Piette Durrance, from the Department of Public Policy at the University of North Carolina-Chapel Hill, discuss the economic effects of licensing health care professions. (p. 29)

- In our fifth article, Michael Carrier, a professor at Rutgers Law School, discusses the application of state law to drug patent settlements in the context of the California Supreme Court's *Cipro* case. (p. 35)

As you know, we are always interested in hearing from our Committee members. If there is a topic that you would like to see covered in a Committee program or if you have any other suggestions, please contact the Committee Co-Chairs, Jeff Brennan (jbrennan@mwe.com) or Philip Nelson (nelson.p@east.ei.com).

If you are interested in writing an article for the *Chronicle*, please contact one of the Executive Editors, Leigh Oliver (leigh.oliver@hoganlovells.com), Valentina Rucker (vrucker@wsgr.com), or Amanda Lewis (alewis1@ftc.gov).

Leigh Oliver
Hogan Lovells
Washington, D.C.

Valentina Rucker
Wilson Sonsini Goodrich & Rosati
Washington, D.C.

Amanda Lewis
Federal Trade Commission
Washington, D.C.

The Ninth Circuit's *St. Luke's* Decision and Its Practical Impact on Agency Practice

By Douglas Litvack and Peter Herrick[1]

Introduction

Efficiencies are often the central rationale for a strategic merger. The merging parties and antitrust counsel therefore spend significant time, money, and resources advancing efficiencies arguments in hopes of persuading the Federal Trade Commission or the Department of Justice that the transaction will generate cost savings and enhance competition. Indeed, most transactions are pitched to the antitrust agencies, and even courts, as being procompetitive because they create efficiencies that will be passed on to consumers.

But, for many transactions, it is fair to wonder whether efficiencies arguments will tip the scales in favor of antitrust clearance. While the *Horizontal Merger Guidelines* support efficiencies in merger analysis, agency staff will generally give primacy to competitive effects in its investigation and, ultimately, in its decision of whether to recommend a challenge. Strong efficiencies evidence, however, can play a particularly important role in transactions that fall within the antitrust clearance "grey zone"—i.e., where it is unclear to staff even well into an investigation whether the transaction is likely, or unlikely, to harm competition.

It is in those cases where the Ninth Circuit's recent decision in *St. Alphonsus Medical Center v. St. Luke's Health System* ("*St. Luke's*")[2] may weigh in heavily on the existence and scope of the efficiencies defense. There, the Ninth Circuit imposed a high bar for any efficiencies defense, requiring defendants to show a direct linkage between efficiencies and competition.[3] While the court did not break completely new ground, this requirement reaffirms that merely demonstrating the existence of efficiencies may not be enough. Indeed, it is more important than ever for merging parties to clearly "connect the dots" for staff (and the courts) on how the transaction's efficiencies *enhance* competition in the relevant markets. Moreover, with this decision in hand, agency staff may be further emboldened to challenge cases that fall within the antitrust "grey zone." To be sure, in any future challenges, the FTC and DOJ will rely on the Ninth Circuit's efficiencies analysis to bolster their arguments that the defendants' efficiencies defense should be rejected.

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[1] Douglas Litvack is an associate at Jones Day and a former FTC staff attorney in the Mergers IV Division. He also was a member of the FTC's trial team for its successful challenge of the St. Luke's-Saltzer transaction; Peter Herrick is Counsel at Simpson Thacher & Bartlett LLP and former Senior Trial Counsel at the FTC. He was the FTC's second chair for the *St. Luke's* trial.

[2] The FTC, State of Idaho, and Treasure Valley Hospital were also plaintiffs, while Saltzer Medical Group was also a defendant.

[3] *See Saint Alphonsus Med. Ctr. - Nampa Inc. v. St. Luke's Health Sys., Ltd.*, No. 14-35173, slip op. at 23-27 (9th Cir. Feb. 10, 2015).

Recap of Ninth Circuit's Ruling on Efficiencies

In *St. Luke's*, the Ninth Circuit affirmed the district court's ruling that St. Luke's Health System's acquisition of Saltzer Medical Group—the largest multispecialty physician group in Nampa, Idaho—violated Section 7 of the Clayton Act.[4] In November 2012, St. Luke's competitors (St. Alphonsus Medical Center and Treasure Valley Hospital) filed suit to enjoin the transaction. Then, in March 2013, the FTC and State of Idaho joined the private hospitals' ongoing lawsuit.[5] After 6 months of discovery, 9 expert reports, and an 18-day trial, the district court found that the transaction substantially lessened competition in the adult primary care physician market in Nampa, Idaho.[6]

Generally, at the trial court level, merger cases are analyzed using a burden shifting framework where the plaintiff first must establish a prima facie case that the transaction is anticompetitive, typically relying on market shares and the Herfindahl–Hirschman Index ("HHI") to create a presumption of illegality.[7] If the plaintiff establishes its prima facie case, then the burden shifts to the defendants to offer evidence that the transaction is not anticompetitive.[8] In *St. Luke's*, the HHI in adult primary care services in Nampa was 6,219, with a change of 1,607, creating a strong presumption of anticompetitive harm.[9] These HHI figures exceeded the concentration levels other courts found to be presumptively illegal by a wide margin.[10] In addition, the plaintiffs offered evidence of competitive effects in the relevant market, based primarily on the defendants' own documents and econometric analyses by the FTC and State of Idaho's economic expert.

In response, St. Luke's focused almost entirely on the claimed benefits of the transaction. While St. Luke's disputed the scope of the alleged geographic market, it relied principally on the transaction's efficiencies—which it described as "procompetitive benefits"—to undermine the plaintiffs' case, During the trial, St. Luke's argued that the transaction was a necessary step to create an integrated delivery system that would provide higher-quality and lower-cost care to St. Luke's patients.[11] St. Luke's contended that the only way to achieve these benefits was to employ the Saltzer physicians.[12] Indeed, St. Luke's argued that

[4] The Ninth Circuit also agreed with the district court that St. Luke's acquisition of Saltzer Medical Group violated the Idaho Competition Act. *St. Luke's Health Sys.*, No. 14-35173 slip op. at 7.

[5] Notably, the FTC and State of Idaho did not allege all of the same markets that the private hospital plaintiffs did, focusing instead on one market: adult primary care physician services. *Compare* Gov't Plaintiffs' Compl. *with* Private Plaintiffs Compl.

[6] *See Saint Alphonsus Med. Ctr. – Nampa Inc. v. St. Luke's Health Sys., Ltd.*, No. 12-cv-00560, slip op. at 1 (D. Idaho, Jan. 24, 2014).

[7] *Chicago Bridge & Iron Co v. FTC*, 534 F.3d 410, 423 (5th Cir. 2008).

[8] *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 631 (1974).

[9] *St. Luke's Health Sys.*, No. 14-35173 slip op. at 18.

[10] Under the *2010 DOJ and FTC Horizontal Merger Guidelines* ("Merger Guidelines or Guidelines") § 5, an HHI level above 2500, with a change greater than 100, creates a presumption of illegality. Although the Supreme Court in *Philadelphia National Bank* found a post-merger share of 30 percent to be presumptively illegal, courts generally follow the Merger Guidelines HHI threshold. *See e.g., FTC v. Univ. Health Inc.*, 938 F. 2d 1206, 1211 n.12 (11th Cir. 1991); *FTC v. Cardinal Health*, 12 F. Supp. 2d 34, 53-54 (D.D.C. 1998); *United States v. H&R Block*, 833 F. Supp. 2d 36, 73-74 (2011).

[11] *See* Defendants' Findings of Fact at 19-20, *St. Luke's Health Sys., Ltd.*, No. 12-cv-00560.

[12] *See* Findings of Fact at 19-20, *St. Luke's Health Sys., Ltd.*, No. 12-cv-00560.

employment was necessary to achieve the key components of integrated care, such as sharing a common electronic health record system with physicians and moving away from fee-for-service toward risk-based payments. Yet, while the district court "applauded [St. Luke's] for its efforts to improve the delivery of health care," it found that "there are other ways to achieve [this] effect that do not run afoul of the antitrust laws."[13] In so doing, the court found that St. Luke's efficiencies were not "merger-specific" because evidence did not support St. Luke's claimed need to employ the Saltzer physicians to successfully transition to integrated care.[14] For this reason, the district court rejected St. Luke's efficiencies arguments and ultimately found that St. Luke's failed to rebut the plaintiffs' prima facie case and that the transaction violated Section 7.[15]

On appeal, St. Luke's again argued that the transaction created merger-specific efficiencies (which were improperly ignored or undervalued by the district court) that would offset any potential anticompetitive harm.[16] The Ninth Circuit disagreed, holding that the district court's rejection of St. Luke's efficiencies defense was not clearly erroneous. In so doing, the Ninth Circuit wrote that it is "skeptical about the efficiencies defense in general and about its scope in particular."[17] The Ninth Circuit noted that the Supreme Court has *never* sanctioned an efficiencies defense to merger challenges.[18] And no court has ever found efficiencies were enough to save an otherwise anticompetitive transaction under Section 7 of the Clayton Act.[19] Moreover, the Ninth Circuit noted how difficult it is to predict anticompetitive harm in merger cases and feared that balancing that harm against projected efficiencies would add further complexity and uncertainty to an already tough task.[20]

Rather than give the efficiencies defense the death penalty, however, the Ninth Circuit limited its scope. In theory, a merger would not violate Section 7 of the Clayton Act if verifiable and merger-specific efficiencies outweighed the likely anticompetitive effects.[21] But, according to the Ninth Circuit, "a successful efficiencies defense requires proof that a merger is not, despite the existence of a prima facie case, *anticompetitive*."[22] The Ninth Circuit continued, "because Section 7 of the Clayton Act only prohibits those mergers whose effect 'may be substantially to lessen competition' a defendant may rebut a prima facie case with evidence that the proposed merger will create a more efficient combined entity and thus increase competition."[23] In other words, there must be a *direct* linkage between the efficiencies and the transaction's competitive effects. By way of example, merging parties could perhaps rebut

[13] *Saint Alphonsus Med. Ctr. – Nampa Inc. v. St. Luke's Health Sys., Ltd.*, No. 12-cv-00560, slip op. at 3 (D. Idaho, Jan. 24, 2014).

[14] *Id.*

[15] *Id.*

[16] *See* Appellant's Brief *at* 46-54, *Saint Alphonsus Med. Ctr. – Nampa Inc. v. St. Luke's Health Sys., Ltd.*, No. 14-35173 (Jan. 12, 2014), *available at* https://www.ftc.gov/system/files/documents/cases/140612briefofappellants.pdf.

[17] *St. Luke's Health Sys.*, No. 14-35173 slip op. at 25.

[18] *Id.* at 23.

[19] *Id.* at 24.

[20] *Id.* at 25 (stating "[i]t is difficult enough in §7 cases to predict whether a merger will have future anticompetitive effects without also adding to the judicial balance a prediction of future efficiencies").

[21] *See e.g., FTC v. H.J. Heinz Co.,* 246 F.3d 708, 720 (D.C. Cir. 2001).

[22] *St. Luke's Health Sys.*, No. 14-35173 slip op. at 27 (emphasis added).

[23] *Id.*

potential anticompetitive effects if their combined entity would gain sufficient scale to lower its costs.[24] But, under the Ninth Circuit's *St. Luke's* decision, the more salient question is whether those cost savings are likely to enhance competition. If the parties can make that showing, the efficiencies defense would, in theory, satisfy the Ninth Circuit's test. Notably, this requirement is slightly different, and more stringent, than other courts' requirement that efficiencies must be passed on to consumers to be credited.[25]

St. Luke's efficiencies defense fell short of the Ninth Circuit's standard. Critically, St. Luke's evidence at trial focused on the transaction's benefits (which the trial court largely accepted), not on how those benefits would *enhance* competition in the relevant market.[26] While these efficiencies could be helpful, the trial court—and ultimately the Ninth Circuit—were not persuaded that they would be sufficient to offset the potential competitive harm caused by the merger. In addition, the Ninth Circuit appeared to reject the notion that the patient care benefits that St. Luke's claimed would be generated by the transaction could offset concerns about higher prices for healthcare services, noting that "[i]t is not enough to show that the merger would allow St. Luke's to better serve patients."[27]

As recognized by the Ninth Circuit, its view on efficiencies focuses more on competition than courts in other circuits. Other circuits do not specifically require defendants in a Section 7 case to establish a connection between the efficiencies and competitive harm. In the Sixth Circuit's recent decision in *ProMedica Health System v. FTC*, for example, the court acknowledged that a defendant may rebut a showing of anticompetitive harm by proving the "merger will create efficiencies that enhance consumer welfare."[28] Likewise, the D.C., Seventh, and Eleventh Circuits also recognize that merger-specific benefits can theoretically save an otherwise anticompetitive transaction.[29] And, notably, the Eighth Circuit reversed the district court's decision in *FTC v. Tenet Health Care Corp.* because the trial court failed to consider the defendant's efficiencies claims.[30] Moreover, the majority of trial courts, including the FTC's administrative court, generally consider whether a transaction's consumer benefits outweigh the likelihood of harm.[31]

What the St. Luke's Decision Means for Future Transactions Relying on Efficiencies

Although the Ninth Circuit's articulation of the efficiencies defense may differ from other circuits, it is aligned with the antitrust agencies' views on efficiencies. The FTC and DOJ use the *Horizontal Merger Guidelines* (the "Guidelines") as the framework for their review and investigation of transactions' competitive implications.[32] The Guidelines specifically set

[24] *Id.* at 27.

[25] *See e.g.,* Univ. Health Inc., 938 F. 2d at 1223; *Rockford Mem. Corp.*, 717 F. Supp. at 1289.

[26] *See* Defendants' Findings of Fact at 7-58, *St. Luke's Health Sys., Ltd.*, No. 12-cv-00560.

[27] *St. Luke's Health Sys.*, No. 14-35173 slip op at 28.

[28] 749 F.3d 559, 571 (6th Cir. 2014).

[29] *See H.J. Heinz*, 246 F.3d at 720; *FTC v. Univ. Health*, 938 F.2d 1222-24 (11th Cir. 1991); *United States v. Rockford Mem.*, 898 F.2d 1278 (7th Cir. 1990).

[30] 186 F.3d 1045, 1054 (8th Cir. 1999)

[31] *See e.g., United States v. H&R Block*, 833 F. Supp. 2d. at 52 (D.D.C. 2011); *In re ProMedica Health Sys., Inc.*, No. 9346 2012 WL 1155392 (F.T.C. Mar. 28, 2012); *In re Evanston Nw. HealthCare Corp.*, No. 9315, 2007 FTC LEXIS 210 (F.T.C. Aug. 6, 2007).

[32] *See* Merger Guidelines § 1 (stating "[t]hese Guidelines outline the principal analytical techniques, practices, and the enforcement policy of the Department of Justice and

forth the factors the agencies consider when investigating a transaction's legality under the antitrust laws. Among other things, the antitrust agencies consider whether the merger generates efficiencies that would offset the merger's potential competitive harm.[33] Indeed, the Guidelines recognize that "a primary benefit of mergers . . . is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service or new products."[34] However, according to the Guidelines, efficiencies almost never justify a merger to monopoly or near monopoly.[35] Rather, efficiencies tend to justify a merger where there is potential for *small* competitive harm—in other words those mergers that fall within the antitrust "grey zone."[36]

Like the Ninth Circuit, the antitrust agencies are often skeptical about the efficiencies defense.[37] Indeed, their doubts are apparent from the Guidelines' efficiencies section opening line: "[c]ompetition usually spurs firms to achieve efficiencies internally."[38] Yet, DOJ and FTC leadership continually reiterate the importance of efficiencies in their merger analysis, echoing the Guidelines' suggestion that mergers creating competitive harm could be justified by efficiencies.[39] A quick look at the past, however, reveals that the antitrust agencies have raised, not lowered, the efficiencies bar. Starting in 1997, the Guidelines were revised to tighten the reins on the defense.[40] Perhaps the biggest change was placing the efficiencies burden of proof on the merging parties, not agency staff. This burden shift (that holds today) required parties to "substantiate efficiencies claims" so the staff could confirm the likelihood and magnitude of each claim and determine whether a transaction's benefits outweighed its potential harm.[41] Today, the Guidelines reject outright this pure consumer welfare balancing test approach, stating "the Agencies will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies."[42] Instead, the antitrust agencies employ a sliding scale approach where parties must show greater degrees of efficiencies, as the magnitude of the competitive harm increases.[43] That is one reason why

Federal Trade Commission (the "Agencies") with respect to mergers and acquisitions . . . under the federal antitrust laws).

[33] Merger Guidelines § 10 (stating "the Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive").

[34] *Id.*

[35] *Id* (emphasis added).

[36] *See id*.

[37] The courts and agencies believe that competition is paramount. Under this thinking, protecting competition is far more beneficial to consumers than promoting efficiencies through consolidation.

[38] Merger Guidelines § 10.

[39] *See e.g.,* Deborah Feinstein, Antitrust Enforcement in Healthcare: Proscription, no Prescription, Fifth National Accountable Care Organization Summit – Washington, D.C. (June 19, 2014), *available at* https://www.ftc.gov/system/files/documents/public_statements/409481/140619_aco_speech.pdf.

[40] *Compare* 1992 DOJ and FTC Horizontal Merger Guidelines § 4 *with* 1997 DOJ and FTC Horizontal Merger Guidelines § 4.

[41] 1997 DOJ and FTC Horizontal Merger Guidelines § 4. Prior to 1997, agency staff was required to internally assess potential transaction efficiencies. *See* 1992 DOJ and FTC Horizontal Merger Guidelines.

[42] Merger Guidelines § 10.

[43] *Id*. The Guidelines specifically state that "[t]he greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to consumers, for the

efficiencies rarely, if ever, overcome agency staff concerns about transactions that are likely to create significant competitive harm.

Although the Ninth Circuit decision is not a sea change in efficiencies analysis, it likely will encourage agency staff to review efficiencies claims with even more skepticism —assuming the decision holds.[44] Going forward, agency staff may focus even more on competitive effects, while giving less weight to efficiencies absent compelling evidence to the contrary. Most of the transactions the agencies review closely, and particularly those subject to a Second Request, present at least some risk of lessening competition, while creating varying levels of efficiencies. Historically, for those transactions that are likely to significantly reduce competition (e.g., mergers to duopoly or monopoly), staff often spends a great deal of time and energy understanding and focusing on likely competitive effects, with secondary emphasis on efficiencies claims. In those cases, efficiencies have little chance of outweighing likely competitive effects, unless the merging parties make a convincing evidentiary showing, such as using past analogous experiences to show that the present transaction will generate enormous consumer benefits.[45] Post-*St. Luke's*, it is safe to assume that this tendency will only become more pronounced.

The other likely consequence of the Ninth Circuit decision is that the agencies will rely on it to further raise the bar on the efficiencies defense in litigation. In litigation cases, including *St. Luke's*, the agencies use the favorable case law to give the court good reason to reject the efficiencies defense. For example, the FTC repeatedly relies on the *ProMedica* district court for the proposition that efficiencies do not save anticompetitive transactions.[46] There, the court stated that "[n]o court in a 13(b) proceeding, or otherwise, has found efficiencies sufficient to rescue an otherwise illegal merger."[47] Since then, the agencies have cited that proposition in court briefings despite its apparent conflict with the agencies' own Guidelines.[48] With the recent Ninth Circuit decision, the agencies have yet another case that can help them narrow the scope of the efficiencies defense and question whether it even exists. If the agencies can continue to stockpile these efficiencies wins, it may over time make the defense practically non-existent as a litigation defense. In addition, the decision might make future agency merger challenges more likely, especially where parties rely heavily on efficiencies. The agencies routinely use their prior litigation experiences to assess the litigation risk associated with challenging

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Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market." *Id.*

[44] Because St. Luke's has not exhausted all of its appeals, the decision is not final. In fact, on March 26, 2015, St. Luke's and Saltzer petitioned the Ninth Circuit for panel rehearing and rehearing en banc to reverse the Ninth Circuit's decision.

[45] For example, prior to the Saltzer transaction, St. Luke's completed about 30 other physician practice group acquisitions but could not show empirically that those past transactions improved quality or lowered costs. *See* Plaintiffs' Findings of Fact at 89, *Saint Alphonsus Med. Ctr. – Nampa Inc. v. St. Luke's Health Sys., Ltd.*, No. 12-cv-00560 (D. Idaho, Jan. 24, 2014).

[46] Plaintiffs' Pre-Trial Brief at 19, *Saint Alphonsus Med. Ctr. – Nampa Inc. v. St. Luke's Health Sys., Ltd.*, No. 12-cv-00560, *available at* https://www.ftc.gov/system/files/documents/cases/130910stlukepretrialmemo.pdf.

[47] 2011 WL 1219281 at *57.

[48] Merger Guidelines § 10 unequivocally conveys that efficiencies can save an otherwise anticompetitive transaction (stating "[t]he Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm customers . . .").

future transactions. Like a private litigant, if the agencies face a likelihood of losing, then they may be less inclined to spend time, resources, and money challenging that transaction. By tipping the scales against the efficiencies defense, the Ninth Circuit's *St. Luke's* decision likely will lower the agencies' future litigation risk, empowering them to challenge even more transactions.

The efficiencies defense is not dead. Still, in advocacy before the agencies post-*St. Luke's*, the merging parties are most likely to get traction on efficiencies if they show a direct link between efficiencies and staff's areas of competitive concern. It also is imperative for the efficiencies to be analyzed and considered as part of the merging parties' decision to do the transaction. In *St. Luke's*, the defendants hypothetically could have satisfied this burden in two ways. First, defendants could have presented empirical evidence showing that St. Luke's numerous past physician practice group acquisitions led to higher-quality or lower-cost physician services. In fact, the FTC (using health plans claims data) performed that analysis and found St. Luke's past physician acquisitions resulted in either no change in costs or higher costs.[49] Second, defendants—prior to entering into the transaction—could have engaged an independent expert consultant to assess the potential cost-saving and quality-improvement opportunities. The consultant would have identified and quantified the magnitude of the transaction-specific cost savings, while also detailing how quality would improve for primary care services in Nampa. After this rigorous assessment, the defendants could then have proceeded with the transaction with some further evidence that it likely would improve quality and lower costs. By executing these two strategies, the defendants may have shown a connection between efficiencies and the area of concern (i.e., adult primary care services in Nampa). But, as the *St. Luke's* case shows, the efficiencies defense only works with the right set of facts and circumstances.

Conclusion

Given these impediments to a successful efficiencies defense, merging parties should focus not only on efficiencies, but also on evidence that the transaction will not produce competitive harm in the first place. Indeed, in light of *St. Luke's*, these need not—and perhaps should not—be considered entirely separate exercises. Needless to say, merging parties should focus early in their analysis on finding and demonstrating the linkage between their purported efficiencies and competition. With appropriate attention to this link, efficiencies could be outcome determinative in those grey zone antitrust cases.

[49] Plaintiffs' Pre-Trial Brief at 21, *St. Luke's Health Sys., Ltd.*, No. 12-cv-00560, *available at* https://www.ftc.gov/system/files/documents/cases/130910stlukepretrialmemo.pdf.