California Attorney General Imposes Conditions of Price Cap and Prohibition of Anticompetitive Practices on Cross-Market Acquisition in Northern California

California is one of the leading states in healthcare antitrust enforcement. Following the footsteps of former California Attorney General Xavier Becerra, who led the antitrust lawsuit against northern California hospital giant Sutter Health, the new attorney general Rob Bonta continues to exercise the AG's expansive authority with aggressive enforcement actions in the California provider market. Earlier in the summer, the AG's office settled a lawsuit filed by Cedars-Sinai Health System and Huntington Memorial Hospital, with revised competitive impact conditions on the cross-market affiliation in Southern California to address potential harms to competition (read more on The Source Blog). This month, we examine a proposed cross-market transaction in Northern California, on which the AG also imposed conditions to preserve market competition.

In February, Acadia Healthcare Company, a private equity backed for-profit corporation, proposed to acquire the nonprofit psychiatric hospital Adventist Health Vallejo. Acadia Healthcare is a behavioral health system that operates 227 behavioral health facilities nationally, including the 80-bed San Jose Behavioral Health (SJBH) in Santa Clara County of Northern California. Adventist Health Vallejo (Adventist Vallejo), also located in the San Francisco Bay Area, is an acute psychiatric in-patient hospital in Solano County.

Pursuant to California law, the attorney general has merger review authority of nonprofit hospital transactions in the state. The AG reviews such proposed mergers based on criteria that includes whether the merger will serve the public interest and its potential effects on the availability or accessibility of health care services to the affected community.[1]

According to the Competitive and Quality Impact Report commissioned by the AG's office, the proposed merger of Acadia Healthcare (which owns SJBH) and Adventist Vallejo would negatively impact competition in the market for acute psychiatric services in the region. Notably, the expert analysis concluded the proposed merger posed limited horizontal competition concerns, as SJBH and Adventist Vallejo are 76 miles (about 1 hour and 20 minutes) apart and not considered direct competitors. Nonetheless, the report highlighted potential "cross-market" effects, pointing to empirical evidence that hospital prices are higher for hospitals involved in cross-market mergers or are part of a cross-market system.[2] The economic analysis further found that both SJBH and Adventist Vallejo have market power and their common ownership under Acadia would likely result in cross-market effects, allowing Acadia to leverage both hospitals to increases prices for acute psychiatric services in Northern California.

As a result, the AG imposed several competitive impact conditions on the sale based on the recommendations from the report to address competition, quality, and access concerns from the proposed acquisition. The conditions imposed are remarkably similar to those imposed in the affiliation of Cedar-Sinai and Huntington Memorial in Southern California, including price caps and bans on anticompetitive contract terms. Specifically, the competitive impact conditions include:

1. Annual price increases of no more than 6% for commercial

payers and 2.8% for Medi-Cal (for 5 years, with option to extend for 3 years);

2. Prohibition of all-or-nothing contracting for hospital services that requires the payer to contract with all (or a group) of its hospitals rather than individual hospitals (for 10 years);
3. Prohibition of penalizing a payer for contracting with individual hospitals, or setting significantly higher than existing contract prices or out-of-network fees for any or all of Acadia's hospitals (for 10 years);
4. Prohibition of interference with narrow, tiered, or steering commercial products or value-based benefit designs (for 10 years); and
5. Imposition of an independent monitor to ensure compliance with the competitive impact conditions for 10 years.

Given the recent conditional approval of Cedars-Sinai/Huntington and Acadia/Adventist Vallejo, California is signaling the increasing willingness to go after non-horizontal provider consolidation which may be cross-market in nature and could serve as a model to state and federal agencies in their enforcement guidelines.

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[1] Cal. Corp. Code §§ 5914 et seq.

[2] *See* Jaime S. King & Erin Fuse Brown, The Anti-Competitive Potential of Cross-Market Mergers in Health Care, 11 ST. LOUIS U. J. HEALTH L. & POL'Y 43 (2018); Dafny, Ho and Lee, The Price Effects of Cross-Market Mergers: Theory and Evidence from the Hospital Industry, RAND Journal of Economics (April 2019); Matthew S. Lewis & Kevin E. Pflum, Hospital systems and bargaining power: evidence from out-of-market acquisitions, Rand Journal of Economics (August 2017).