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MERGERS AND ACQUISITIONS

Anthem/Cigna Decision Latest Example of Skepticism About Whether Mergers Can Benefit Consumers



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Merging competitors face a significant burden to show their contemplated merger would benefit consumers, as federal antitrust regulators have met with success in arguing that the parties can't prove that a transaction's benefits would actually be passed on to consumers. Recent court opinions regarding the proposed merger of Anthem Inc. and Cigna Corp. are the latest illustrations of the difficulties facing attorneys seeking to prove the ''efficiencies'' of a proposed merger.

'Efficiencies' Weren't Shown On April 28, 2017, the U.S. Court of Appeals for the District of Columbia Circuit upheld the decision by the U.S. District Court for the District of Columbia in February that granted the Department of Justice's, request for an injunction blocking Anthem's proposed $54 billion acquisition of Cigna. The DOJ also successfully challenged Aetna's proposed $37 billion acquisition of Humana in February, and the parties abandoned that transaction.

Although the district court's lengthy opinion in Anthem/Cigna addressed a number of interesting antitrust and health care issues, including how to define the relevant markets, competition in the sale of health insurance to ''large group'' employers, and the fight between Anthem and Cigna over the merger agreement, the main focus of the appeal was whether the district court erred in concluding that Anthem failed to show that the merger would create substantial efficiencies sufficient to offset the alleged anticompetitive effects of the merger.

Legal Framework Courts and antitrust enforcement agencies evaluate a merger according to a number of factors—including, for example, the market shares of the merging companies, whether the companies are ''close competitors,'' and barriers to entry—to determine whether the transaction would ''substantially lessen competition'' under the Clayton Act. This analytical framework is laid out in the DOJ and Federal Trade Commission's ''Horizontal Merger Guidelines,'' which, though not technically law, explain how the agencies evaluate mergers. The sources for this analysis include the documents and data from the merging companies and competitors, the views of customers, and rigorous econometric modeling of the merger's possible effects.

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Another key factor is efficiencies. Merging companies typically begin their defense of the merger by describing all the ''good'' things the merger will do, such as generate synergies and cost savings, and in the case of health-care mergers, improve clinical quality, all of which the companies claim will be passed on to consumers. According to the Horizontal Merger Guidelines, even if a merger would reduce competition, it could still theoretically pass muster under the antitrust laws if it would create substantial efficiencies that would benefit consumers.

It is not enough for merging companies to show all of the good things the merger would do, however. They must demonstrate that the efficiencies are ''merger-specific,'' meaning they could not be accomplished without the merger, and ''verifiable,'' meaning they likely would occur. This is a difficult task for parties in all mergers, as courts and DOJ and FTC staff tend to view these claims skeptically, and it has been made more difficult by recent health care merger decisions, particularly the D.C. Circuit Court's decision in Anthem/Cigna.

The District Court Decision In Anthem/Cigna, the parties claimed their merger would create billions of dollars in efficiencies. They argued that national account customers alone would save over $2 billion in medical expenditures because Cigna members would access Anthem's more favorable discounts with providers. Anthem also argued that the deal would generate substantial general and administrative cost savings.

The district court dismissed these claims in an opinion authored by Judge Amy Jackson. First, Judge Jackson disagreed with the parties' arguments that potential provider discounts are merger-specific, because the companies would not have to merge for customers to access lower rates. Instead, customers could access them by simply switching to the other company.

In addition, Anthem failed to show there was anything about the ''mere combination of the insurers' two pools of patients that would enable doctors or hospitals to treat patients more expeditiously or at a lower cost.'' The parties did not claim that the medical cost savings would be accomplished by streamlining the parties' operations or that any new products would result from the combination of the parties' resources or expertise. According to Judge Jackson, ''The promised reduction in customers' total medical costs does not result from either company doing anything better, or from the carriers' or the providers' operating more efficiently, and there has been no showing that the merger will result in increased output or enhanced quality at the same cost.''

Finally, Judge Jackson was skeptical that any savings would be passed on to consumers because Anthem's documents showed the company intended to capture the savings itself. Specifically, the documents listed ''pass all savings onto customers'' as one of seven potential options, and therefore the court held that there was little, if any, certainty that consumers would actually benefit from the savings.

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The Circuit Court Decision In a 2-1 decision authored by Judge Judith Rogers, the D.C. Circuit held the district court ''did not abuse its discretion in enjoining the merger based on Anthem's failure to show the kind of extraordinary efficiencies necessary to offset the conceded anticompetitive effect of the merger. . .'' The court first pointed out that the government overwhelmingly met its burden in establishing that the merger would create a highly concentrated market and that Anthem's appeal hinged on the district court's treatment of its efficiencies defense. The court declined to take a position as to whether an efficiencies defense is available at all, stating, ''The court should leave for another day whether efficiencies can be an ultimate defense to Section 7 illegality,'' and it rejected Anthem's argument that parties need not prove that efficiencies are verifiable and merger-specific, citing precedent from the D.C. Circuit, as well as the Horizontal Merger Guidelines.

The D.C. Circuit held that the lower court was correct in rejecting Anthem's argument regarding merger specificity. Anthem argued that the merger would allow it to create new, innovative products and lower costs, but the district court properly found that Anthem's inability to create better programs on its own stemmed from a ''no frills culture'' or ''flawed marketing strategies'' rather than any inherent difficulties that the merger would overcome.

The court also agreed with the district court's skepticism that Anthem could actually achieve lower provider rates and other cost savings, thereby failing to show the efficiencies are verifiable or likely to occur. First, such lower rates would have to be renegotiated, which would require persuading large health systems to agree to lower rates. Furthermore, Anthem likely already achieved ''whatever economies of scale are available,'' and therefore adding Cigna would not create additional, meaningful cost savings.

Implications Judges in other recent health-care merger decisions (for example, the Penn State Hershey Medical Center/PinnacleHealth System merger) have articulated views similar to those in the district and circuit court opinions in Anthem/Cigna, finding that merging parties have not been able to validate their efficiency claims. And, notwithstanding Judge Brett M. Kavanaugh's dissenting opinion in Anthem/Cigna, there is skepticism in the courts and agencies regarding the efficiencies defense in general.

At bottom, merging competitors face a significant burden, and an emboldened DOJ and FTC, to show their contemplated merger would benefit consumers.

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So how can merging parties establish a successful efficiencies defense? In the health-care context, parties cannot simply point to whichever party does something better (e.g., higher quality scores, lower purchasing costs) and argue that the lower performing party would achieve these improvements as a result of the merger.

Rather, the parties should demonstrate with substantial evidence (i.e., documents and data) that the merger is necessary to achieve the claimed efficiencies and that the efficiencies are likely to occur. For example, if a high quality hospital is acquiring a hospital with lower quality, it would be compelling if the buyer could point to concrete examples of how it had improved quality at hospitals it had previously acquired.

Having a detailed implementation plan with specific financial and quality metrics could also be persuasive to a court or agency. At bottom, if a transaction raises competitive concerns, parties should plan their efficiencies arguments early and be able to substantiate their claims with documents and data.

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The authors were involved in the Anthem/Cigna and Aetna/Humana merger litigations on behalf of provider clients.