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ANTITRUST

Expert Analysis

Efficiencies Defenses to Merger Challenges

In a thorough opinion evaluating the legality of a health insurance merger under antitrust law, the U.S. Court of Appeals for the District of Columbia Circuit considered whether and when efficiencies may offset competitive concerns. Rejecting arguments that anticipated health care cost reductions should spare Anthem's proposed acquisition of Cigna from an antitrust challenge, a split panel of the D.C. Circuit upheld an injunction blocking the proposed merger because it was likely to lessen competition without offsetting benefits.

Anthem, which is licensed to operate under the Blue Cross Blue Shield brand in 14 states, reached an agreement in July 2015 to merge with Cigna, with which Anthem competes in those 14 states. The U.S. Justice Department, 11 states, and the District of Columbia filed suit to enjoin the merger on the ground that it was likely to substantially lessen competition in at least two markets. Anthem pressed the point that any anticompetitive harm resulting from combining the second and third largest health insurers would be outweighed by the efficiencies generated from lowering fees paid for health care

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services. Unpersuaded, the district court enjoined the merger.

In a 2-1 decision, the appellate court rejected Anthem's argument that the trial court failed to sufficiently weigh the claim that approximately $2 billion in cost saving efficiencies would result from the merger. Anthem had

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asked the U.S. Supreme Court to review the circuit court ruling and take the opportunity to address efficiencies arguments in merger cases, but the merger was called off and the petition was dismissed.

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Health Care Market

The proposed merger involved the second and third largest sellers of medical health insurance to large companies in the United States. Anthem, the second-largest seller, serves approximately 38.6 million medical members and is a member of the Blue Cross Blue Shield Association, a group of 36 health insurance companies licensed to do business under the Blue Cross and/or Blue Shield brands. Anthem holds an exclusive license to the Blue brands in all or part of 14 states (the Anthem states). Anthem has historically been able to leverage its size to negotiate significant discounts from providers.

Cigna, the third-largest seller of health insurance to large companies in the United States, serves approximately 13 million medical members nationwide and in more than 30 countries. Unlike Anthem, Cigna has generally not been able to negotiate steep discounts from providers. Instead, Cigna developed collaborative arrangements with providers, which reduce employees' utilization of expensive medical procedures and promotes wellness through behavioral supports and lifestyle changes. These customized wellness programs offer customers a long-term strategy for lowering health care costs rather than traditional provider discounts.

Lower Court Opinion

The Justice Department and the other government plaintiffs alleged that the merger would substantially lessen competition in violation of §7 of the Clayton Act in the market for the sale of health insurance to national accounts in both the Anthem states and the United States as a whole and in the market for the sale of health insurance to large group employers in 35 local markets. The government also alleged that the merger would lessen competition for the purchase of services from health care providers in the 35 local markets by giving the combined company anticompetitive buyer power.

The district court permanently enjoined the merger on the grounds that it likely would have substantial anticompetitive effects in the market for the sale of health insurance to national accounts in the Anthem states and in the market for the sale of health insurance to large group employers in Richmond, Virginia. *United States v. Anthem, Inc.*, 2017 WL 685563 (D.D.C. Feb. 21, 2017). Employing a three-part burden shifting analysis, the lower court first found that government carried its burden to establish a presumption that the merger likely would result in anticompetitive effects by showing a substantial increase in concentration in a relevant market. Anthem rebutted the presumption with evidence showing that United Healthcare, not Cigna, was Anthem's primary competitor, that customer sophistication and market dynamics would prevent an increase in prices, and that the combined company would be more likely to innovate. The burden then shifted back to the government. The court found that the government carried its burden to show that on balance a reduction in the number of health insurance carriers from four to three was anticompetitive. The district court then rejected Anthem's defense that any anticompetitive effects would be offset by approximately $2 billion in savings for customers generated by the merger because Anthem's claimed efficiencies were not necessarily dependent on the merger and were unverifiable. The trial garnered some attention because the merging parties' disagreements were revealed in open court, leading the district court to observe that in addition to the government's arguments, Cigna "provided compelling testimony undermining the projections of future savings."

On appeal, the D.C. Circuit affirmed, holding that the record did not support Anthem's contention that only through a combination of the two companies would it be possible to offer a product that included Anthem's lower rates and Cigna's customized wellness programs and that the claimed efficiencies were not verifiable. The appeals court also upheld the district court's finding that the merger would substantially lessen competition in the market for large group employers in Richmond, Va., where the combined company would have 64 percent to 78 percent of the market. *United States v. Anthem, Inc.*, 855 F.3d 345 (D.C. Cir. April 28, 2017), cert. dismissed, No. 16-1342, 2017 WL 1807377 (U.S. June 12, 2017).

Anthem's Efficiencies Claims

Anthem did not challenge the lower court's finding that the merger would increase concentration in two relevant markets. Instead, Anthem challenged the lower court's ruling on the grounds that the court improperly declined to consider its efficiencies defense.

The D.C. Circuit determined that the lower court did not err when it rejected Anthem's efficiencies evidence as not merger-specific and not verifiable. First, the court found that Anthem's plan to introduce products incorporating Cigna's customer wellness plans and Anthem's lower rates was not "merger specific." In other words, those savings could be accomplished without the merger. Specifically, the court noted that the record shows that, in the short term, Anthem would simply offer Cigna customers Anthem products, which was the same thing as Anthem selling its product to those customers. In addition, the court noted that Anthem could, if it chose to, offer a product similar to Cigna's on its own.

Second, the D.C. Circuit determined that Anthem's cost-savings plan, which included rebranding, renegotiating provider contracts, and employing affiliate clauses in provider agreements, was speculative given business realities or provider contracting and product development. The court noted that Anthem likely will not be able to persuade providers to extend lower rates to Cigna, as such contracts would force providers to expend extra effort and resources to deliver customized wellness plans without any corresponding increase in value to providers. Further, either party generally may terminate provider contracts with only 90 days' notice, so the affiliate clause would accomplish little if the contract were terminated.

The court questioned whether the cost savings would indeed be passed on to consumers. The majority further noted that even if savings were achieved, it is reasonable to expect that providers would respond to the lower rates by reducing the quality of the Cigna products. This strategy could take business away from Cigna and diminish Cigna's capacity to further innovate its model by making it less attractive to providers.

The D.C. Circuit majority criticized the dissent's "single-minded focus on price" and observed that the main purpose of antitrust policy is to "maximize consumer welfare by encouraging firms to behave competitively," not simply to reduce prices. The majority warned that lower prices may lead to decreased quality and that "any benefit to the consumers' wallets" may be "diminished by the harm to their health." And, as indicated in a concurring opinion, cost-savings accomplished as a result of the exercise of market power—in this case, arguably, the combined company's increased scale as a buyer of health care services—are not cognizable offsetting efficiencies and may indeed constitute an antitrust violation.

After considering the totality of the circumstances, the D.C. Circuit upheld the lower court's determination that Anthem failed to show the kind of "extraordinary efficiencies that would be needed to constrain likely price increases in this highly concentrated market, and to mitigate the threatened loss of innovation."

Viability of Efficiencies Defense

In evaluating Anthem's efficiencies defense, the D.C. Circuit majority opinion questioned whether such a defense exists at all in light of the Supreme Court's decision in *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967). In *Procter & Gamble,* the Supreme Court enjoined a merger without consideration of evidence that the combined company would purchase advertising at a lower rate, stating that "possible economies cannot be used as a defense to illegality." Despite this precedent, which could be read to suggest that efficiencies may not be a cognizable defense, the D.C. Circuit acknowledged that the D.C., Eighth, and Eleventh Circuits have previously recognized the use of efficiencies evidence to rebut a prima facie showing, but questioned whether those precedents recognize efficiencies evidence as an ultimate defense to a §7 claim. While acknowledging this discrepancy in case law, the D.C. Circuit declined to determine where an efficiencies defense could be asserted in an otherwise illegal merger. Instead, the D.C. Circuit evaluated the defense on the assumption that efficiencies evidence could be a defense under the "totality of the circumstances" approach outlined in *U.S. v. Baker Hughes*, 908 F.2d 981, 984-85 (D.C. Cir. 1990).

Anthem relied on this ambiguity in its petition seeking review by the Supreme Court. Specifically, Anthem argued that there was a split among the circuits—the Third and Ninth Circuit have been skeptical of an efficiencies defense, while the Sixth, Eighth, Eleventh, and D.C. Circuits have considered efficiencies in their merger analysis—and that the lower courts' reliance on merger standards articulated by the Supreme Court in the 1960s are outdated in light of current economic understanding. In addition to asking the Supreme Court to rule on whether efficiencies could be a defense to a merger challenge, Anthem asked the court to articulate how such efficiencies considerations should be weighed when determining the net competitive effect of the merger. The merger was abandoned before the Supreme Court decided whether it would review the D.C. Circuit's ruling, leaving the *Anthem* opinion as the latest judicial pronouncement on the topic.

While the courts' interpretations of the law ultimately control (even when they are inconsistent), a significant majority of merger reviews get resolved in an administrative process before the U.S. antitrust agencies (the Department of Justice and the Federal Trade Commission), whose highly sophisticated application of §7 of the Clayton Act acknowledges that efficiencies may offset a merger's likely anticompetitive effects.

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