AHLA PG Briefing

UnitedHealth-DaVita and Trends in Vertical Merger Enforcement

Antitrust Practice Group • July 11, 2019

Jeny Maier and Adam Cella • Axinn Veltrop & Harkrider LLP

American Health Lawyers Association

1620 Eye Street, NW
6th Floor
Washington, DC 20006-4010
www.healthlawyers.org
info@healthlawyers.org

Printed in the U.S.A.

On June 19, UnitedHealth Group Incorporated (UnitedHealth Group) and DaVita, Inc. (DaVita) agreed to two separate consent agreements to resolve antitrust concerns about UnitedHealth Group's $4.3 billion acquisition of DaVita's DaVita Medical Group (DMG) (the Acquisition). Both the Federal Trade Commission (FTC) and the Colorado Attorney General (Colorado AG) filed complaints alleging that the Acquisition would harm competition.

Both complaints alleged concerns related to managed care provider organizations that provide physician and other health care services (MCPOs) and Medicare Advantage (MA). UnitedHealth Group operates two wholly owned subsidiaries relevant to the Acquisition: UnitedHealthcare, which sells MA and other insurance plans; and Optum, a health services business that operates MCPOs. Davita's DMG also operates MCPOs.

The transaction and the two settlements provide insights into U.S. antitrust merger enforcement in three areas: (1) the horizontal and vertical aspects of the merger analysis and basis for enforcement action in this case; (2) the separate action taken by the Colorado AG; and (3) the open disagreement about vertical merger enforcement policy among the FTC Commissioners.

The Horizontal and Vertical Relationships Between UnitedHealthcare, Optum, and DMG

UnitedHealthcare is an insurance company that offers MA plans. These companies are known as Medicare Advantage Organizations (MAOs). MAOs use MCPOs such as Optum and DMG to construct and manage their plans. This creates a horizontal relationship (i.e., as direct competitors) between the two MCPOs (Optum and DMG) and a vertical relationship (i.e., at different levels of the supply chain) between UnitedHealthcare and the MCPOs.

The Economics of MA

MA plans provide Medicare-eligible individuals a market-based alternative to the Medicare program (Original Medicare) offered by the government. MAOs provide these plans to employer groups and individual consumers. Individuals choose MA plans because Original Medicare may not provide the same benefits and services as an MA plan (e.g., vision, dental, hearing or fitness benefits and a cap on out-of-pocket costs).

The government pays an MAO a predetermined amount of money for each member it enrolls. This amount is determined by bids submitted by the MAO. Government regulations require the bid to reflect the anticipated total health care costs its members will incur, administrative costs, and desired profit margin. The bid amount is paid regardless of the actual costs to insure the member. The government will not, however, pay more than the "benchmark," which is a measurement based on the cost of providing Original Medicare to the average enrollee in that member's county. The benchmark can be adjusted depending on the plan's quality, called the Star Rating. A higher rating increases the benchmark amount.

The government also pays the MAO a portion of the difference between the benchmark and the bid if the bid is below the benchmark. These "rebates" must be reinvested into the MA plan to lower out-of-pocket costs or enrich member benefits. MAOs must charge its members a difference between the bid and the benchmark if the bid is above the benchmark.

This system is designed to incentivize low bids because MA plans with additional premiums are less desirable to individual seniors than plans without premiums.

The Economics of MCPOs

MCPOs employ, or affiliate with, a number of health care providers. These groups lower health care costs through coordination of a patient's care. MCPOs offer MAOs a broad set of providers that independently manage an MA network by coordinating care, managing health care utilization, and containing costs for a covered patient population.

The providers in an MCPO include individual physicians and specialists, physician groups, hospitals, and outpatient clinics. MCPOs often additionally employ a variety of support personnel (e.g., social workers, nurses, care coordinators, and utilization managers) and develop information technology systems dedicated to managing care utilization and monitoring patient care.

MCPOs are necessary inputs for MAOs to provide competitive MA plans. MAOs face a significant chance of increased costs and decreased quality without the patient management provided by a highly functioning MCPO. The availability of MCPOs therefore affects an MA plan's ability to compete for members because prospective members want MA plans with high-quality networks and competitive premiums.

States Show a Willingness to Act Even Where the Feds Do Not

The FTC and Department of Justice (DOJ) are the most visible antitrust enforcement authorities in the United States, with large staffs of lawyers and economists analyzing proposed transactions and enforcing the antitrust laws. The two agencies typically divide responsibility for reviewing mergers based on industry expertise. In recent years, however, and particularly in the health care industry, state enforcers have taken an increasingly prominent role in merger enforcement. Through this case, as well as in the recent Beth Israel-Lahey merger—and even the pending T-Mobile-Sprint merger in the telecommunications industry—it appears that state attorneys general may be looking to raise their profile and authority in merger enforcement and not simply follow along with the FTC or DOJ's enforcement choices.

FTC Complaint and Settlement

In this case, the FTC alleged that the Acquisition would harm competition in the Las Vegas area in two product markets: (1) MCPO services sold to MA insurers and (2) MA plans sold to individual MA members. The FTC's complaint alleged that the Acquisition would result in both horizontal and vertical competitive effects.

Horizontal Effects: The FTC alleged horizontal anticompetitive effects through the elimination of price and non-price competition between Optum and DMG in MCPO services sold to MAOs. DMG and Optum operate the two largest MCPOs in the Las Vegas area, covering more than 80% of MA members in this area. The decrease in competition would lead to increased prices for MAOs and decreased incentives to compete on quality of services.

Vertical Effects: The FTC also alleged vertical anticompetitive effects arguing that if it controlled DMG's MCPO, UnitedHealth Group would control a significant input for MAOs trying to offer MA plans. This would potentially give UnitedHealth Group the ability and incentive to negotiate higher rates from rival MAOs for access to DMG's MCPO (or even deny a rival's access altogether), and instead favor its own MAO, UnitedHealthcare. This increased cost to rival MAOs would force these rivals to make higher bids to the government. The government would ultimately make higher payments and seniors would incur higher cost-sharing (e.g., through co-pays and premiums) and decreased quality and benefits.

The merging parties and the FTC reached a consent agreement to allow the Acquisition to proceed, which required UnitedHealth Group to divest the overlapping DMG assets in the Las Vegas area. Along with the agreement to divest the DMG assets, UnitedHealth Group also agreed to additional provisions designed to ensure that the divested business can operate competitively going forward. According to the FTC, the divestiture will resolve their horizontal and vertical concerns and preserve the competition that exists today in the Las Vegas area.

Colorado Attorney General Complaint and Settlement

The Colorado AG filed its own complaint when the FTC declined to seek remedies relating to the Acquisition's impact on Colorado consumers. The Colorado AG's complaint only pertained to vertical concerns that the Acquisition would give UnitedHealth Group the incentive and ability to raise the cost of MCPOs for MAOs, thereby harming competition for MA plans sold to individual MA members in the Colorado Springs area.

According to the Colorado AG's complaint, DMG—one of the leading MCPOs in the Colorado Springs area—is critical to MAOs because of its (1) proven record to effectively manage care and reduce costs and (2) significant number of affiliated primary care physicians and specialists.

The Acquisition additionally concerned the Colorado AG because of UnitedHealthcare's exclusive MA relationship with Centura, a large provider with two hospitals in Colorado Springs. UnitedHealth Group, through its exclusive agreements and post-acquisition control of MCPOs, could consequently increase the cost for rival MAOs to access DMG's services or withhold access to DMG's services after the Acquisition. These kinds of cost increases would reduce the ability of rival MAOs to compete effectively with UnitedHealthcare.

The merging parties and the Colorado AG reached a consent agreement, which included the following remedies:

1. UnitedHealth Group agreed not to enforce its current exclusive agreement, or enter into any new exclusive agreements, with Centura for MA hospital services in the Colorado Springs area until 2024; and

2. The merged firm agreed that it will not refuse to renew any MA health plan effective prior to the end of 2019 and any plan where the contract exclusively covers MA enrollees that would be effective prior to the end of the 2020 plan year.

The Colorado AG's consent agreement contains only so-called "behavioral" or "conduct" remedies, as opposed to the FTC's consent agreement, which contained both structural (i.e., divestiture) and behavioral remedies. Behavioral remedies, however, are common in transactions with purely vertical competitive concerns, although current DOJ leadership has publicly stated its skepticism of behavioral remedies and a very strong preference for structural (i.e., divestiture) remedies.[1]

The action by the Colorado AG here is noteworthy, as it appears to be evidence of an emerging trend in which state attorneys general have been taking independent enforcement action in mergers and other antitrust cases in circumstances where the federal antitrust agencies have not acted. For example, in addition to this case, the Massachusetts Attorney General recently took action and secured relief in the recent Beth Israel-Lahey Health merger, where the FTC closed its investigation of the same transaction.[2] In the Beth Israel case, the Massachusetts Attorney General secured a consent decree providing for pricing constraints effective for seven years. The FTC, for its part, characterized the merger as a "close call" and decided to close its investigation in light of the parties' settlement with the state. Several state attorneys general also recently filed suit seeking to enjoin the merger of T-Mobile and Sprint when the DOJ has yet to take action on the merger.[3] And the Washington State Attorney General's office has been aggressively pursuing enforcement actions against fast food chains for employee "no-poach" provisions in franchise agreements, whereas the DOJ has indicated that it believes these provisions should be evaluated under the more flexible Rule of Reason.[4]

---

[1] The Director of the FTC's Bureau of Competition, D. Bruce Hoffman, also has publicly stated that the FTC first looks to structural remedies for most vertical mergers, but if structural remedies cannot be achieved without sacrificing the efficiencies that motivate the merger, then it will look at conduct remedies.

[2] See Press Release, *AG Healey Reaches Settlement With Beth Israel, Lahey Health Over Proposed Merger* (Nov. 29, 2018), https://www.mass.gov/news/ag-healey-reaches-settlement-with-beth-israel-lahey-health-over-proposed-merger; Statement of the Federal Trade Commission Concerning the Proposed Affiliation of CareGroup, Inc.; Lahey Health System, Inc.; Seacoast Regional Health System, Inc.; BIDCO Hospital, LLC; amd BIDCO Physician LLC, FTC File No. 171-0118 (Nov. 29, 2018), https://www.ftc.gov/system/files/documents/closing_letters/nid/1710118_bidmc_commission_closing_statement.pdf.

[3] Press Release, *Attorney General James' Multistate Lawsuit To Block T-Mobile And Sprint Megamerger Gains Additional Support From Attorneys General Across The Nation,* (June 21, 2019), https://ag.ny.gov/press-release/attorney-general-james-multistate-lawsuit-block-t-mobile-and-sprint-megamerger-gains*; see also* Complaint, State of New York v. T-Mobile, (June 11, 2019) https://ag.ny.gov/sites/default/files/6.11.19_new_york_attorney_general_james_moves_to_block_t-mobile_and_sprint_megamerger.pdf.

[4] *See, e.g.*, Corrected Statement of Interest of the United States of America, *Stigar v. Dough Dough; Richmond v. Bergey Pullman; Harris v. CJ Star* (E.D. Wash Mar. 8, 2019) (No. 2:18-cv-00244-SAB; No. 2:18-cv-00244-SAB; No. 2:18-cv-00244-SAB).

The FTC Commissioners' Debate: Should They "Roll the Dice" on Vertical Mergers?

The FTC Commissioners voted unanimously to accept the consent order in this case providing for relief in Las Vegas. Commissioners Chopra and Slaughter, the two Democrat Commissioners, issued a joint statement commenting on the scope of the consent agreement, while Commissioners Phillips and Wilson, the two Republican Commissioners, issued a separate joint statement responding to their colleagues. Chairman Simons was recused from the matter.

The Democratic Commissioners

Commissioners Rebecca Slaughter and Rohit Chopra wrote separately to note that they disagreed with the decision not to pursue an enforcement action in Colorado. Commission enforcement action in Colorado on a purely vertical theory of harm would have borne significant litigation risks, since vertical mergers are often viewed as generating procompetitive benefits, and because the government recently lost the first purely vertical merger enforcement case brought in decades—the DOJ's challenge to AT&T's acquisition of Time Warner. According to Slaughter and Chopra, however, any litigation risk from bringing a purely vertical case was worth taking. The Democrats' statement encouraged state attorneys general to "actively enforce the antitrust laws to protect their residents from harmful mergers and anticompetitive practices."[5]

The Republican Commissioners

Commissioners Christine Wilson and Noah Phillips wrote a statement in response to their Democratic colleagues. The Republican Commissioners did not "rule out the possibility" that vertical mergers can harm competition under a theory of raising rivals'

[5] Joint Statement of Commissioners Slaughter and Chopra Concerning UnitedHealth Group and DaVita, In the Matter of UnitedHealth Group and DaVita (June 19, 2019) (No. C-4677), https://www.ftc.gov/system/files/documents/public_statements/1529359/181_0057_united_davita_statement_of_cmmrs_s_and_c.pdf.

costs, but explained that they concluded that the evidence in Colorado was ambiguous and insufficient to convince a federal judge that the Acquisition was likely, on balance, to harm Colorado consumers.[6] Wilson and Phillips further highlighted that, in the face of underdeveloped case law on vertical mergers, the risk of an adverse decision in this case (if the Commission had proceeded with enforcement action in Colorado) was too much to take on, as an adverse decision could impact FTC enforcement in later cases that may present clearer harm.

Implications of the Commissioners' Statements

The dueling statements reflect the differing perspectives held by the Republican and Democratic Commissioners on vertical merger enforcement; in particular, the statements reflect their divergent views on the evidence necessary to proceed on a vertical theory of harm in cases where the vertical integration may also bring procompetitive benefits.

The Republican Commissioners did not rule out the possibility of future vertical merger enforcement, where the evidence supports it. The complaint relating to the Las Vegas area that all four Commissioners voted to issue contained allegations of vertical harms similar to those alleged by the Colorado AG. Nonetheless, the Republican Commissioners' statement demonstrated caution in putting purely vertical claims to the test. The Republican statement contains only one footnote, citing *AT&T*, providing a powerful reminder of what happened when the DOJ attempted to block a vertical merger. The DOJ's decision to seek a remedy in the recent CVS-Aetna merger only with respect to the horizontal aspects of the deal (i.e., the overlap in the parties' individual prescription drug plan businesses), but not with respect to the vertical aspects

[6] Joint Statement of Commissioners Phillips and Wilson Concerning UnitedHealth Group and DaVita, In the Matter of UnitedHealth Group and DaVita (June 19, 2019) (No. C-4677), https://www.ftc.gov/system/files/documents/public_statements/1529366/181_0057_united_davita_statement_of_cmmrs_p_and_w.pdf.

of the deal, arguably also reflects a more cautious approach to vertical merger enforcement.[7]

This case is only the most recent engagement in an ongoing policy dialogue among the current FTC commissioners on how aggressively to pursue vertical merger enforcement. For example, in Staples's acquisition of Essendant earlier this year, the Commission voted 3-2 to allow the deal to clear, subject to a consent decree providing for information firewalls, with Commissioners Chopra and Slaughter dissenting. Slaughter's dissenting statement suggested that her colleagues were too permissive when it comes to vertical mergers, and the Republican majority pushed back, defending their decisions as being based on the evidence in the particular case.[8] The five Commissioners similarly split their votes 3-2 and issued separate statements on the approval of the consent decree allowing Fresenius's acquisition of NxStage to close

---

[7] The DOJ's proposed consent decree in the CVS-Aetna case is currently under review by Judge Richard Leon (coincidentally, the same judge as in the DOJ's challenge to AT&T-Time Warner), pursuant to the Tunney Act, to determine whether the proposed relief is in the public interest. Unusually, several third parties have been granted leave to intervene in the Tunney Act proceeding and have raised concerns about the scope of the DOJ's proposed consent decree. Judge Leon recently held a two-day hearing in which complaining third parties presented witness testimony suggesting that the DOJ's proposed relief is not in the public interest because it does not address the parties' claimed vertical competitive concerns.

[8] *Compare* Statement of Chairman Simons, Commissioner Phillips, and Commissioner Wilson, In the Matter of Sycamore Partners II, L.P., Staples, Inc. and Essendant Inc. (Jan. 28, 2019) (No. 181-0180) ("Commissioner Slaughter's dissent raises a series of generalized concerns about merger enforcement, and in particular, vertical merger enforcement. . . . the dissent seems to suggest that our decision in this case is part of a decades-long, bipartisan pattern of faulty analysis, improper assumptions, unreliable predictions, underweighting evidence of anticompetitive effect, and overweighting evidence of efficiencies. . . . There is no dispute that vertical mergers can harm competition in several ways . . . we agree that where there is credible evidence, the Commission should obtain relief that will eliminate the relevant harm . . . The decision in this case embodies that view."), https://www.ftc.gov/system/files/documents/public_statements/1448328/181_0180_staples_essendant_majority_statement_1-28-19.pdf *and* Statement of Commissioner Wilson, In the Matter of Sycamore Partners II, L.P., Staples, Inc. and Essendant Inc. (Jan. 28, 2019) (No. 181-0180) ("It is folly to think that the Commission unilaterally can 'fix' this perceived problem simply by being more aggressive. As the decision of the federal district court in the AT&T-Time Warner case makes clear, the antitrust agencies do not have the last word, and aggressive agency enforcement may well backfire by creating binding precedents that constrain future challenges to problematic deals."), https://www.ftc.gov/system/files/documents/public_statements/1448307/181_0180_staples_essendant_wilson_statement.pdf; *with* Statement of Commissioner Slaughter, In the Matter of Sycamore Partners II, L.P., Staples, Inc. and Essendant Inc. (Jan. 28, 2019) (No. 181-0180) ("I am particularly concerned that the current approach to vertical integration has led to substantial under-enforcement. . . . In particular, I am concerned that our conclusions depend on unreliable assumptions and predictions about how a vertically integrated firm will conduct itself and are too credulous about claimed procompetitive benefits unique to vertical integration."), https://www.ftc.gov/system/files/documents/public_statements/1448321/181_0180_staples_essendant_slaughter_statement.pdf.

without addressing vertical concerns. Until more case law develops on vertical merger cases, or the FTC and DOJ are able to agree on new vertical merger guidelines, it appears that this ongoing policy debate will continue.

*   *   *

The debates over vertical merger enforcement are far from over. Even if the FTC or DOJ decide to bring more vertical merger challenges in the near future, federal courts could nevertheless find that the government lacks the requisite evidence to enjoin these mergers. In the meantime, state attorneys general may continue to file lawsuits to enjoin mergers—horizontal or vertical—that potentially harm their residents when the federal enforcers do not act.