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Vertical Healthcare Merger Review After *United States v. AT&T, Inc.*

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In the past year, there have been numerous mergers and acquisitions considered and attempted by notable players in the health care sector, from UnitedHealth Group's agreement to purchase dialysis provider DaVita's Medical Group unit for $4.9 billion to Amazon's recent announcement that it would acquire PillPack, an online pharmacy with a nationwide reach. In fact, the value of overall health care sector deals increased to $315.74 billion compared to $154.87 billion during the same period last year,[1] likely driven in part by concerns about industry trends across health care, from pressures to reduce drug costs to the implementation of value-based care, to new disruptions epitomized by the emerging joint health care venture of Amazon, JPMorgan, and Berkshire Hathaway.[2] Many of these transactions are particularly notable in that they are not "horizontal" mergers of direct competitors operating at the same level of the health care supply chain; rather, they are "vertical" transactions, combining firms that operate at different levels of the supply chain, such as insurers and providers, or insurers and pharmacy benefit managers (PBMs).

Some of these vertical acquisitions have been successful, such as Humana's creation of a joint venture with two private equity funds to acquire the home health, hospice, and community care businesses of Kindred, which closed in early July. Other deals continue to be scrutinized by federal antitrust authorities and await approval. Two of the biggest deals under extended antitrust review are CVS Health's (CVS) acquisition of Aetna and Cigna's acquisition of Express Scripts. The likelihood that these deals will be cleared remains an open question following D.C. District Court Judge Richard Leon's rejection of the Department of Justice's (DOJ) challenge to the vertical merger of AT&T and Time Warner in his June 12 opinion in *United States v. AT&T, Inc*.[3]

CVS announced in December of last year that it would acquire Aetna for $69 billion, subsequently drawing the attention of the DOJ, members of Congress, and 28 state Departments of Insurance. The acquisition will combine one of the country's largest pharmacy chains and PBM with a top health insurer, each of which are significant players in concentrated industries. As described by the parties, this deal will transform CVS' 10,000 pharmacy and clinic locations into community-based sites of care where patients can gain lower-cost and more accessible curative and preventative care and health counseling.[4] Moreover, the firms anticipate $750 million in synergies in the second full year of the transaction from streamlining corporate functions and PBM and prescription drug plan (PDP) operations.[5]

In March of this year, Cigna, a competitor of Aetna in the health insurance market, agreed to purchase Express Scripts, one of the remaining independent firms in the PBM market, for $52 billion. This transaction is currently under review by DOJ and some state regulatory bodies. The parties intend to have Express Scripts continue to operate as a Cigna division post-merger, with its current CEO serving as president. Cigna's CEO, David Cordani, emphasized that the acquisition would improve affordability, choice, personalization and quality of care for customers and clients and increase Cigna's alignment with health care professionals.[6] Further, the parties contend that the combined firm will save $600 million, primarily through ensuring administrative efficiencies in Cigna's managed care business and Express Script's PBM operations.

The Cigna-Express Scripts combination has raised similar questions and concerns to the CVS-Aetna transaction, and both have faced criticism from the American Antitrust Institute (AAI) and American Medical Association (AMA). In the AAI's letter to Assistant Attorney General for the DOJ's Antitrust Division, Makan Delrahim, they wrote that both mergers "enhance the ability and/or incentive . . . to behave in ways that harm[] competition at a horizontal level" and could increase the combined firms' incentives to raise rivals' costs or restrict rival firms' access to critical resources, such as restricting CVS PBM services (Caremark) and retail pharmacy services from rival health insurers or foreclosing rival PMBs from access to Aetna subscribers.[7] The AAI also pointed out that the merger raises concerns about potential anticompetitive coordination in two ways. First, the merger may lead to coordination between Aetna and the other health insurers served by CVS' PBM, Caremark, through competitively sensitive information-sharing, implicating Sherman Act Section 1 price fixing or market allocation concerns. Second, the merger may encourage coordination between similarly-aligned, vertically-integrated PBM insurers such as Cigna-Express Scripts or United Healthcare-Optum to prevent market entry by other firms.

The AMA, sharing these criticisms, also cited concerns that foreclosure of Aetna as a PBM customer would significantly diminish the prospect of new entry into the PBM market. As Aetna is the sole Big Five insurer that neither has its long-term PBM supply needs served in-house nor is transitioning to in-house (as in the case of Anthem), their acquisition forecloses a major customer opportunity for would-be PBM competitors. Reduced competition in the health insurance and PBM markets could lead to higher insurance premiums and reduced quality of insurance for downstream customers.[8] Further, the AMA expressed concerns that non-Aetna insurance subscribers could face restricted access to retail pharmacy services, resulting in an increase in drug spending and out-of-pocket costs.[9]

In challenging the vertical merger of AT&T and Time Warner, the DOJ raised several theories of liability, some of which may inform how the agency will analyze CVS-Aetna and Cigna-Express Scripts. The primary issue discussed in the *AT&T* opinion was whether the merger would increase Turner Networks' bargaining leverage when negotiating distribution contracts with AT&T's rivals for "must-have" content, extracting greater prices from rival distributors than it would be capable of absent the merger. The DOJ argued that distributors would then pass on these increased input costs to their subscribers through higher prices.[10] This is a classic antitrust theory of "raising rivals' costs" of inputs or vertical foreclosure of rivals from access to inputs, echoed by the AAI[11] and AMA[12] in their concerns about the pending vertical health care mergers.

In *AT&T*, the court considered this issue one of first impression, pointing out the lack of judicial precedent where the government has successfully used the increased leverage theory to block a proposed vertical merger as a violation of Section 7 of the Clayton Act.[13] The court concluded that the government failed to clear its first burden of showing that the proposed merger would likely increase Turner's bargaining leverage and therefore did not reach the separate legal question of whether any effects resulting from increased leverage would substantially lessen competition under the Clayton Act.[14] Therefore, the legal theory itself remains viable for future use by the antitrust enforcement agencies, but there is a substantial evidentiary burden upon the government to demonstrate not that the merger would put the combined entity in a better bargaining position with upstream and downstream entities, but that the merger would increase the likelihood the combined firm would restrict access to (or increase the price of) the input to rivals.[15]

Tracking Judge Leon's opinion, antitrust authorities may consider three steps in analyzing the likelihood that a vertical merger, in the health care sector or otherwise, will result in foreclosure that is harmful to consumers.

First, the reviewing agency should analyze how profitable a raising rivals' costs or foreclosure theory would be to a merged firm. If the evidence shows that engaging in such behavior would be profitable, the agency is likely to have more cause for concern. Several factors may affect the likelihood of profitable foreclosure strategies, including the level of competition in the upstream market, the merged firm's margins, any capacity constraints in the industry, and the practical ability of firms to direct patients to their affiliate. The *AT&T* court noted several elements relevant in finding that it was unlikely that, post-merger, Turner Network would engage in a content "blackout" with AT&T's rival distributors, most notably, Professor Carl Shapiro's (the government's chief economic expert) concession that withholding Turner content from rival distributors would not be profitable to the merged entity, as it would lose significant advertising and affiliate fee revenues by doing so.[16] The court wrote that it would find the presence or absence of past foreclosure conduct by the merging firms persuasive,[17] as well as an analysis of prior vertical transactions in the industry demonstrating the use of similar strategies,[18] helping the government to translate the incidence of increased bargaining leverage post-merger into the increased prospect of actual input foreclosure.

Second, after demonstrating that a foreclosure strategy is profitable to the merged firm, the agency should evaluate the potential harm that may result from such a strategy. Market context, market concentration, and firms' preexisting relationships with upstream suppliers all may mitigate harms brought on by the merger.

Finally, the court would weigh the procompetitive benefits and efficiencies gained by the transaction against such harm to determine the existence and impact of such harm on end consumers. The *AT&T* court found that vertical mergers are often procompetitive and efficiency-enhancing. Professor Shapiro even predicted that the merger, if consummated, would lead to $352 million in annual cost savings for AT&T's customers.[19] Given the claimed cost savings of $750 million and $600 million by the CVS-Aetna and Cigna-Express Scripts acquisitions, respectively, the government would have to undermine the credibility of the firms' assessments about their deals' efficiencies and/or prove that the deals' harms outweigh their benefits, as achieved through cost-savings by consumers.

While *AT&T* demonstrated that it can be very tough for the government to prove such a case, the theories of liability that they relied upon to challenge the AT&T-Time Warner deal survive this loss and will continue to be used to analyze and potentially challenge future vertical mergers. The first step of the analysis (evaluating the profitability and likelihood of foreclosure strategies) is fact- and data-intensive, so without detailed knowledge of the merging firms and industry, it can be difficult to assess and much less prove how profitable and feasible a foreclosure strategy may be for the merging parties. Still, the government may look to other vertically integrated PBM-health insurer firms (such as United Healthcare-Optum) across the health care sector to analyze whether insurance premiums and quality of and access to care improved following the combination of insurance and PBM businesses. They may also look to allegations that CVS' PBM arm, Caremark, cut pharmaceutical reimbursements paid to community pharmacies in Ohio, New York, Iowa, Arkansas, and New Jersey within months of announcing its merger with Aetna as potential evidence for such a case.[20]

Further, the DOJ may investigate the CVS-Aetna and Cigna-Express Scripts transactions on the basis that both transactions create horizontal overlap in the Medicare Part D business: a traditional theory of harm for horizontal mergers. The AMA anticipates that the CVS-Aetna acquisition will increase premiums due to a substantial increase in the market concentration of 30 of 34 Medicare Part D regional markets.[21] The two merged entities, plus Humana and UnitedHealth, would cover 71% of all Part D enrollees and 86% of stand-alone drug plan enrollees, creating further consolidation of the marketplace for Medicare insurance coverage, according to an analysis by the Kaiser Family Foundation.[22] If it concludes that this consolidation is likely to increase premiums, the government can require the firms to divest Medicare Part D assets before clearing either of the transactions.

The district court's *AT&T* decision did not necessarily make it more difficult for the DOJ to build a case against the CVS-Aetna and Cigna-Express Scripts acquisitions; it did, however, expound upon the burden of proof the government must meet to successfully block a merger under Section 7 of the Clayton Act through an increased bargaining leverage theory of vertical foreclosure. The government will likely consider this burden and engage in a rigorous analysis of the proposed transactions and the industry before deciding to litigate based on this theory again. Antitrust observers will closely monitor the DOJ's appeal of the *AT&T* decision to see if the legal landscape for vertical mergers shifts further.[23] As consolidation and dealmaking in the health care sector continue to increase, antitrust authorities will closely observe and analyze the effects of vertical integration on local pharmacies, hospitals, and patients.

Endnotes

[1] Meg Bryant, *Healthcare M&A Doubles in First Half of 2018*, Healthcare Dive, July 6, 2018, *available at* https://www.healthcaredive.com/news/healthcare-ma-doubles-in-first-half-of-2018/527204.

[2] Sy Mukherjee, *Jamie Dimon Just Revealed Details About the Big Amazon, JPM, Berkshire Health Care Venture*, Fortune, Apr. 5, 2018, *available at* http://fortune.com/2018/04/05/jamie-dimon-amazon-jpm-berkshire-shareholder-letter.

[3] *United States v. AT&T, Inc.*, No. 17-2511 (RJL), 2018 U.S. Dist. LEXIS 100023 (D.D.C. Jun. 12, 2018), *available at* https://www.leagle.com/decision/infdco20180629a52.

[4] Press Release, *Aetna, CVS Health to Acquire Aetna; Combination to Provide Consumers with a Better Experience, Reduced Costs and Improved Access to Health Care Experts in Homes and Communities Across the Country* (Dec. 3, 2017), *available at* https://news.aetna.com/news-releases/cvs-to-acquire-aetna.

[5] Press Release, *CVS Health, CVS Health to Acquire Aetna; Combination to Provide Consumers with a Better Experience, Reduced Costs and Improved Access to Health Care Experts in Homes and Communities Across the Country* (Dec. 3, 2017), *available at* https://cvshealth.com/newsroom/press-releases/cvs-health-acquire-aetna-combination-provide-consumers-better-experience.

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[7] Letter from Diana L. Moss, President, Am. Antitrust Inst., to Makan Delrahim, Asst. Att'y Gen., Antitrust Div. U.S. Dep't of Justice (Mar. 26, 2018), at 3, 6-10, *available at* https://www.antitrustinstitute.org/sites/default/files/CVS-Aetna_AAI%20Letter_3.26.18.pdf.

[8] *Competition in the Pharmaceutical Supply Chain: The Proposed Merger of CVS Health and Aetna: Hearing Before the Subcomm. On Regulatory Reform, Commercial & Antitrust Law of the H. Comm. On the Judiciary*, 115th Cong. (2018) (statement of the Am. Med. Ass'n), at 3, 6-7, *available at* https://s3.amazonaws.com/assets.fiercemarkets.net/public/004-Healthcare/2018-2-17+AMA+Statement+for+the+Record+-+CVS-Aetna+Merger+-+House+Judici....pdf.

[9] Paige Minemyer, *AMA calls on regulators to block CVS-Aetna merger*, Fierce Healthcare, June 19, 2018, *available at* https://www.fiercehealthcare.com/payer/ama-calls-regulators-to-block-cvs-aetna-merger-says-deal-could-hinder-competition-and-hurt.

[10] *AT&T*, 2018 U.S. Dist. LEXIS 100023, at *89-90.

[11] Letter from Diana L. Moss to Makan Delrahim, *supra* note 7, at 6.

[12] *Hearing, supra* note 8, at 6.

[13] *AT&T*, 2018 U.S. Dist. LEXIS 100023, at *91-92.

[14] *AT&T*, 2018 U.S. Dist. LEXIS 100023, at *92-93.

[15] *AT&T*, 2018 U.S. Dist. LEXIS 100023, at *95-97.

[16] *AT&T*, 2018 U.S. Dist. LEXIS 100023, at *95, *153-54.

[17] *AT&T*, 2018 U.S. Dist. LEXIS 100023, at *152-53 ("Indeed, the evidence showed that there has never been, and is likely never going to be, an actual long-term blackout of Turner content.").

[18] *AT&T*, 2018 U.S. Dist. LEXIS 100023, at *132-33, *144.

[19] *AT&T*, 2018 U.S. Dist. LEXIS 100023, at *74.

[20] Marty Schladen & Lucas Sullivan, *CVS cuts pharmacy reimbursements after announcing Aetna merger*, Akron Beacon Journal, June 24, 2018, *available at* https://www.ohio.com/akron/news/breaking-news-news/cvs-cuts-pharmacy-reimbursements-after-announcing-aetna-merger.

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[23] David Shepardson, *Justice Department to appeal approval of AT&T acquisition of Time Warner*, Reuters, July 12, 2018, available at https://www.reuters.com/article/us-time-warner-m-a-at-t/justice-department-to-appeal-approval-of-att-acquisition-of-time-warner-idUSKBN1K234H.