

Client Alert

Anthem-Cigna Merger Blocked by Appeals Court and the Utility of Efficiencies in Mergers Going Forward

May 8, 2017

Last week the U.S. Court of Appeals for the District of Columbia Circuit affirmed the district court's issuance of a permanent injunction, effectively blocking the merger of Anthem and Cigna. While the D.C. Circuit ultimately rejected Anthem's arguments on factual grounds, it also went out of its way to question the legal foundations of the efficiency defense. On Friday, May 5, Anthem announced it will ask for Supreme Court review of the D.C. Circuit's decision, making this case important for antitrust practitioners and companies defending their deals before the agencies and courts.

Summary of *United States v. Anthem, Inc.*

On July 21, 2016, the United States, 11 states and the District of Columbia (collectively, the "government") sued to enjoin the merger of Anthem and Cigna (collectively, "Anthem"), alleging that the merger would substantially lessen competition in violation of the Clayton Act in the markets for the sale of health insurance to national accounts and to large group employers in 35 local markets, as well as for the purchase of services from healthcare providers.

Following a six-week bench trial, the district court permanently enjoined the merger, holding that the combination of the second- and third-largest sellers of health insurance to national accounts and large group employers in the U.S. was likely to result in substantial anticompetitive effects.

The district court utilized the *Baker Hughes* three-part, burden-shifting framework to look at the merger's impact on competition. First, the government carried its initial burden to establish that the transaction would likely result in anticompetitive effects. The district court found that the government satisfied its burden by showing that the merger would increase the Herfindahl-Hirschman Index (HHI) by 537 to 3000, well beyond the Department of Justice and Federal Trade Commission's Horizontal Merger Guidelines' thresholds. The burden then shifted to Anthem to produce evidence rebutting that presumption. Anthem produced evidence demonstrating that Cigna was not its primary competitor for national accounts, that the sophistication of national customers would thwart attempts to increase price, new entrants would constrain pricing, and the combined company would be more likely to innovate. The district court found that Anthem had provided sufficient evidence to rebut the government's prima facie case. The burden shifted back to the government, which ultimately carried their burden to show that the reduction in the number of health insurance carriers in the defined markets was anticompetitive.

Anthem put forth an efficiencies defense, arguing that the combined company would realize \$2.4 billion in medical cost savings through, among others, the straight pass-through of its rates to Cigna consumers and its

ability to renegotiate provider rates to the best of the merging parties' rates, and argued that those savings would outweigh any potential harm. The court rejected the defense, finding that Anthem's claimed efficiencies were neither merger-specific nor verifiable, and may not have been cognizable. The district court enjoined the merger based on the government's proof that the reduction of competition violated Section 7 of the Clayton Act.

On appeal, Anthem focused solely on the district court's rejection of its efficiencies defense.

A divided three-judge panel upheld the district court's decision to enjoin the merger, finding no abuse of discretion in the lower court's determination that Anthem "fail[ed] to show the kind of extraordinary efficiencies necessary to offset the conceded anticompetitive effect of the merger in the fourteen Anthem states: the loss of Cigna, an innovative competitor in a highly concentrated market."

Of note, the majority opinion openly questioned whether an efficiencies defense exists under antitrust common law in light of the *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967). There, the Supreme Court enjoined a merger without considering evidence that the combined company could purchase advertising at a lower rate, holding that "[p]ossible economies cannot be used as a defense to illegality." The D.C. Circuit, along with the Eighth and Eleventh circuits, have previously recognized the use of an efficiencies evidence to rebut a prima facie case, but they have not gone so far as to recognize such evidence as an ultimate defense to a Section 7 illegality claim. Based on the expedited nature of the appeal, the D.C. Circuit declined to determine whether an efficiencies defense could save an otherwise illegal merger.

The D.C. Circuit, however, then proceeded to review the efficiencies evidence on the assumption that it could be a defense under the *Baker Hughes* "totality of the circumstances" approach because Anthem had failed to show that the district court had clearly erred in rejecting an efficiencies defense. The D.C. Circuit utilized the horizontal merger guidelines and determined that the district court did not err when it rejected Anthem's efficiencies evidence as not merger-specific and not verifiable.

With respect to merger-specificity, Anthem argued that the combined company would allow Anthem to create a new product offering incorporating both Cigna's attractive programs and Anthem's lower rates. The evidence showed that the reality differed from Anthem's promise; in the short term, Anthem would simply offer Cigna customers Anthem pre-existing products, which was essentially the same thing as Anthem selling its own product to those customers (in contrast to a true Cigna product at Anthem rates, which would be merger-specific). Anthem alone could do the same thing by offering more effective marketing or an improved product. As such, the D.C. Circuit upheld the district court's conclusion that this evidence was not merger-specific.

Anthem also maintained that the \$2.4 billion in projected post-merger savings had been verified by two independent sources, and should therefore be credited. The D.C. Circuit examined the claimed savings and called them "fantastical," finding that the "projections fall to pieces in a stiff breeze." Anthem had identified three mechanisms by which it would achieve the savings: rebranding, affiliate clauses in its provider agreements, and renegotiated provider contracts. The D.C. Circuit found the notion of total or nearly total pass-through savings too speculative, given the uncertainty around whether providers would sign on to such affiliate clauses or renegotiate the contracts at lower rates, as well as the time it would take to achieve any medical savings.

Even if pass-through savings were achieved, the Court found it reasonable to expect that the providers would respond to the lower rates by reducing the quality of the Cigna products, which were “high touch” and focused on improving health and lowering utilization. The Anthem strategy could actually siphon business away from Cigna and thereby diminish Cigna’s capacity to further innovate within its collaborative provider model by making it less attractive to providers; “that threat to innovation is anticompetitive in its own right.” As such, the D.C. Circuit upheld the district court’s conclusion that the practical business realities effectively made these savings unverifiable.

The D.C. Circuit upheld the permanent injunction, finding that the district court reasonably determined that Anthem had failed to show the “extraordinary efficiencies” needed to constrain the likely price increases and the threat to innovation in this highly concentrated market. Anthem’s argument that the district court failed to balance the merger’s likely benefits against its potential harm “rings hollow” in light of the evidence.

The Utility of Efficiencies in Mergers Going Forward – What Does *United States v. Anthem, Inc.* Mean for Your Transaction?

At first glance, the D.C. Circuit seems to be calling into question the use of efficiencies evidence in merger analyses. However, a careful reading reveals that the D.C. Circuit opted not to answer that question, and instead rested its ultimate holding on a factual analysis of the *type* of efficiencies evidence presented. That approach falls in line with numerous other opinions that have skirted answering the ultimate legal question of whether efficiencies evidence can provide a *defense* to a Section 7 illegality claim.

United States v. Anthem, Inc. does, however, provide an important reminder: consider when and how to present efficiencies evidence. Well-supported and well-constructed efficiencies evidence may allow you to not only proceed with your transaction, but permit your transaction to move forward without ever stepping foot into a courtroom.

For instance, the enforcement agencies – unlike the courts – have a longstanding commitment to efficiencies evidence and the *Merger Guidelines* should help decipher what they are looking for. It may be best and most persuasive to provide efficiencies evidence clearly and from the start of a potentially challenging transaction. If you are already entrenched in litigation, note that courts are struggling with the appropriate level of deference to grant efficiencies evidence and they have never – not once – ruled that an efficiencies defense exists. It may be best to present such evidence early, as part of rebuttable evidence and again, look to the *Merger Guidelines* for a framework of how best to construct it.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Shawn R. Johnson

Partner – Washington, D.C.

Phone: +1.202.624.2624

Email: srjohnson@crowell.com