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# Antitrust Analysis of Vertical Health Care Mergers

The US antitrust agencies' continued focus on transactions in the health care industry has triggered recent high-profile merger investigations and enforcement actions. Companies considering a vertical health care merger should carefully analyze and be prepared to address any antitrust implications to minimize the risk that these issues will impede the merger.



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Vertical mergers in the health care industry are common. Examples of purely or predominantly vertical health care mergers include combinations among:

- Hospitals or health systems and physician groups.
- Insurers and health care providers.
- Insurers and pharmacy benefits management (PBM) companies.

Meanwhile, health care continues to be a major focus of the US antitrust agencies. Health care companies and their counsel should therefore carefully analyze the antitrust implications of vertical mergers that they may be contemplating.

This article explains the US antitrust analysis of vertical mergers in the health care industry. Specifically, it discusses:

- Key terminology.
- Applicable law and enforcement.
- Theories of harm.
- Potential efficiencies.
- Typical remedies.
- Recent merger investigations and enforcement actions.
- Antitrust risk assessment in vertical mergers.

## KEY TERMINOLOGY

Vertical mergers involve merging companies operating at different levels of the supply chain, such as a supplier and a customer or a reseller. The supplier level is referred to as the upstream market, and the customer or reseller level is referred to as the downstream market.

Transactions can have both vertical and horizontal elements, so counsel should evaluate the potential for a transaction to raise both vertical and horizontal competition issues. For example, a merger of two health systems may implicate both horizontal competition issues between the merging systems' hospitals and vertical competition issues involving the combination of their hospitals and physician groups.



Search [Vertical Mergers](#) and [How Antitrust Agencies Analyze M&A](#) for more on vertical and horizontal competition issues.

## APPLICABLE LAW AND ENFORCEMENT

Section 7 of the Clayton Antitrust Act bars mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly" (15 U.S.C. § 18). The analysis of vertical mergers differs from that of horizontal mergers because:

- Horizontal mergers involve companies that operate in the same market and are therefore competitors. A horizontal merger may violate Section 7 by

eliminating the competition between the merging companies.

- Vertical mergers involve companies that operate in different markets (the upstream and downstream markets) and are therefore not competitors in those markets. Although a purely vertical transaction does not eliminate existing competition between the merging companies, it can still violate Section 7 by harming competition in the upstream or downstream market.

The US antitrust agencies, the Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC), enforce federal antitrust law. Each agency's industry expertise determines whether it serves as the lead investigating agency. For example, mergers involving:

- Insurers and electronic health record vendors typically are reviewed by the DOJ.
- Health care providers, pharmacies, PBM companies, medical device manufacturers, and pharmaceuticals typically are reviewed by the FTC.

Vertical health care mergers may span the expertise of both agencies (for example, an insurer/provider merger). In these cases, the industry that is most likely to be harmed by the transaction typically determines the lead agency.

Regardless of the particular segment of the health care industry at issue in a transaction, state attorneys general offices (state AGs) also review vertical health care mergers, under either federal antitrust law or state law. State AGs historically have been active antitrust enforcers in the health care industry, and recently have been even more active. (For more information, search [State Merger Review Checklist](#) on Practical Law.)

## THEORIES OF HARM

Vertical mergers can raise concerns about competitive harm in several ways. The FTC and DOJ consider multiple theories of harm when evaluating the anticompetitive effects of a vertical health care merger, including:

- Input foreclosure or raising rivals' costs.
- Customer foreclosure.
- Reduced likelihood of entry by competitors.
- Elimination of a potential competitor.
- Information sharing and coordination.

## INPUT FORECLOSURE OR RAISING RIVALS' COSTS

The upstream merger partner (that is, the supplier) might harm competition in the downstream market by either:

- Cutting off the supply of a critical input to the competitors of the downstream merger partner (known as input foreclosure).

- Raising the price of the input that it supplies to the competitors of the downstream merger partner (known as raising rivals' costs).

If input foreclosure or raising rivals' costs were feasible and profitable for the merged company, the potential anticompetitive effects include:

- Forcing downstream competitors to exit the market or raise their prices to end customers, making them less competitive to the merged company's downstream business.
- Causing end customers of the downstream competitor to switch their purchases to the merged company's downstream business.
- Allowing the merged company to raise its own downstream prices to end customers.

In the health care context, these concerns might arise, for example, where a dominant provider merges with an insurer. In this case, the provider market is the upstream market and the insurer market is the downstream market. Two key antitrust issues are whether this merger enables the merged company to either:

- Stop the merged provider from participating in competing insurers' networks. This could make the rival insurers' health plan networks significantly less attractive to prospective enrollees, or make their health plans outright unmarketable.
- Raise the reimbursement rates that rival insurers must pay to include the merged provider in their networks. This could force rival insurers to raise the premiums charged to their enrollees, making their prices less competitive with those of the merged company. It could also potentially even allow the merged company to raise its insurance premiums to enrollees.

For this vertical harm to be likely (or even feasible), the merged company must have the ability and incentive to stop contracting with rival insurers or to raise the reimbursement rates that those insurers pay to include the merged provider. Those conditions might not be met if, for example, rival insurers can:

- Continue to offer attractive health plans to their enrollees without the merged provider.
- Switch the providers included in their networks.

If either of these is possible, the attempted foreclosure or price increase could be unprofitable for the merged company, because it might lose more profit from lost insurers with which it contracts than it gains from raising prices on insurers that continue to contract with the merged company.

### **CUSTOMER FORECLOSURE**

The reverse of input foreclosure is customer foreclosure. This theory of harm might arise in a vertical merger that combines a supplier with a powerful customer. The concern is that the merged company's downstream

business will only, or predominantly, buy inputs from the merged company's upstream business, either stopping or significantly reducing purchases from upstream competitors to the merged company, and thereby cut off a critical sales outlet for upstream competitors.

For example, in the health care context, customer foreclosure may arise if a hospital merges with a dominant insurer in a particular market. The merged company might then refuse to include rival hospitals in the merged insurer's network. As a result, rival hospitals would be foreclosed from accessing enrollees of the dominant insurer, driving those patients to seek care from the merged hospital, that is, the only hospital in the dominant insurer's network.

For this vertical harm to be likely (or even feasible), the merged company must have the ability and incentive to stop purchasing from upstream competitors. Those conditions might not be met if, for example:

- Rival hospitals have adequate alternative insurers with which they could contract. In this case, being excluded from the merged company's insurer network would not reduce the rival hospitals' ability to compete with the merged company's hospital for patients. Under these circumstances, the merged company may not want to exclude rival hospitals from its network because its network could become less attractive than the networks of rival insurers that include these rival hospitals.
- There is a particularly attractive or "must have" rival hospital in a certain market. The merged company may not be able (or want) to exclude this rival hospital from its network.

### **REDUCED LIKELIHOOD OF ENTRY BY COMPETITORS**

A vertical merger might create market conditions that discourage a company from entering the upstream or downstream market because, to compete successfully post-merger, the entrant would need to enter at both the upstream and downstream levels. For example, if an insurer/hospital merger led to customer foreclosure by eliminating the ability of a new hospital to contract with the dominant insurer in a particular market, a potential hospital entrant into the market might also have to enter the downstream insurance market to have a sufficient outlet for access to patients. Therefore, the need to enter both the upstream hospital and downstream insurance markets might delay, discourage, or prevent a new hospital from entering the market.

### **ELIMINATION OF A POTENTIAL COMPETITOR**

A vertical merger might prevent a potential competitor from entering either the upstream or the downstream market, particularly if it involves merger partners in adjacent links in the supply chain. In other words, one of the parties to a vertical merger might, in the absence of the transaction, have entered the market of the other

merger partner. Even if actual entry by the merger partner was not imminent, the risk of this entry could have had a constraining effect on the upstream or downstream market, which the merger might eliminate.

In the health care context, this theory of harm could be implicated if, for example, a hospital plans to launch a health insurance plan, but instead merges with an insurer. In this case, the US antitrust agencies could have concerns that the merger would eliminate potential health plan competition.

### INFORMATION SHARING AND COORDINATION

Post-merger information sharing between the merging companies is a potential competitive concern. For example, the upstream business of the merged company could use information from or about its customers, which are downstream competitors to the merged company's downstream business, that it gains from sales made to those downstream competitors, and share that information with the merged company's downstream business to the detriment of downstream competitors.

In an insurer/hospital merger, the merged insurer likely would have competitively sensitive information from and about rival hospitals, and the merged hospital likely would have competitively sensitive information from and about rival insurers. The US antitrust agencies may have concerns about the merged company sharing this information among its component businesses because that could put the merged company's rivals at a competitive disadvantage.

### POTENTIAL EFFICIENCIES

Many antitrust scholars and economists view procompetitive efficiencies as an inherent, or at least a common, aspect of vertical mergers. To lessen anticompetitive concerns, vertical merger efficiencies must be:

- Merger-specific (that is, only achievable through merging and not through some alternative means with equal or lesser anticompetitive effects).
- Verifiable and non-speculative.
- Passed on to customers.
- Greater than any competitive harm.

Efficiencies that are frequently identified and considered in vertical merger analysis include:

- Elimination of double marginalization.
- New and better services and products.
- Aligned incentives.
- Increased incentive to invest.

### ELIMINATION OF DOUBLE MARGINALIZATION

When each company in a supply chain sells downstream, it typically applies a mark-up. Depending on the number of companies in the supply chain, several mark-ups can accumulate by the time a product is sold to the end customer.

Vertical mergers potentially reduce this phenomenon by eliminating one level of mark-up within the supply chain and, therefore, may lower prices for end customers and spur downstream competitors to lower their prices to remain competitive. This efficiency is often referred to as the elimination of double marginalization (EDM) because the upstream merger partner eliminates the margin charged to its downstream merger partner and sells the input at cost.

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In the health care context, EDM could be realized in an insurer/provider merger where, for example, the merged provider charges its insurer partner at cost or reduced rates for services, thereby allowing the merged insurer to reduce premiums (or the rate at which premiums increase) to enrollees.

### NEW AND BETTER SERVICES AND PRODUCTS

By combining complementary areas of expertise or know-how, the merging companies may be able to offer new and better services and products to the end customer post-merger. Likewise, improved communication and coordination (potentially including the sharing of intellectual property) could lead to higher quality services and products for the end customer. It also may lead to better interoperability of products.

In the health care context, these vertical-integration benefits could, for example, result in better, more coordinated care and case management for patients.

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 Search [Making Effective Merger Efficiencies Arguments](#) for more on the role of efficiencies in merger analysis.

### ALIGNED INCENTIVES

By combining, companies may reduce or eliminate disincentives to cooperate and the risk of hold-up in the sales or contracting process. For example, vertical mergers may eliminate potential issues in contracting and licensing between formerly independent companies. Instead, the combined company's incentives are aligned, and it can efficiently allocate resources to each of its components. Therefore, in an insurer/provider merger, the merging companies avoid contracting disputes and inefficiencies, instead achieving greater alignment to engage in population health management, community health programs, and basic patient care.

### INCREASED INCENTIVE TO INVEST

A vertical merger can encourage investment in the merged company because that investment can have a potentially broader impact and help the merged company achieve other efficiencies. For example, Company A or Company B could make a capital investment of \$100 million per year that would increase Company A's profit by \$90 million per year and Company B's profits by \$20 million per year. Pre-merger, it would not make sense for either company to make the investment, but post-merger, it might, given the impact of the investment on both the upstream and downstream components of the merged company.

### REMEDIES

Remedies for anticompetitive mergers are either structural or behavioral:

- Structural remedies include blocking the merger entirely or forcing the merging companies to sell off (that is, divest) particular assets.
- Behavioral remedies permit a deal to proceed, but limit the merging companies' post-merger conduct by, for example:
  - requiring the merged company not to discriminate in its dealings with competitors; or
  - limiting the merged company's ability to share competitively sensitive information among its component businesses, such as through a firewall policy.

For decades, most vertical mergers were cleared without remedies. Those that raised concerns were resolved through consent orders that required behavioral relief. However, there are indications that antitrust scrutiny of vertical mergers is increasing significantly (see below *Recent Merger Investigations and Enforcement Actions*). In addition, the DOJ and FTC recently released a draft of new Vertical Merger Guidelines, which were last updated in 1984. The release of new guidelines reflects the renewed focus on vertical mergers, but the draft does not significantly change the existing analysis of vertical mergers. (See Fed. Trade Comm'n and Dep't of Justice,

Draft Vertical Merger Guidelines (Released for Public Comment) (Jan. 10, 2020), available at [ftc.gov](https://www.ftc.gov).)



Search [Merger Remedies](#) for more on remedies for anticompetitive mergers.

### RECENT MERGER INVESTIGATIONS AND ENFORCEMENT ACTIONS

Recent transactions demonstrate the increased scrutiny of vertical mergers and provide guidance on how the US antitrust agencies evaluate vertical mergers in the health care industry.

#### FRESENIUS/NXSTAGE

Fresenius Medical Care announced its proposed acquisition of NxStage Medical, Inc. for \$2 billion in August 2017. Fresenius is the world's largest provider of dialysis products and services, and it is the largest US operator of outpatient hemodialysis clinics. NxStage develops devices used in in-home dialysis and critical care settings, including in-home hemodialysis machines.

By a 3-2 vote, the FTC approved the deal with certain structural remedies aimed at the horizontal aspects of the merger. The FTC also examined the vertical aspects of the merger, because in-clinic dialysis providers, such as Fresenius, buy in-home dialysis machines, such as those produced by NxStage, to provide these machines to qualified patients. However, the majority concluded that vertical effects were unlikely.

The majority considered the input foreclosure or raising rivals' costs theory of harm. It found that the totality of the evidence suggested that the merged company would continue to sell NxStage in-home hemodialysis machines to in-clinic competitors of Fresenius, and that the merger might increase these sales by combining NxStage's high-quality machines with Fresenius' superior scale and service. As part of this analysis, the majority also said that Fresenius had a strong history of supplying other clinics with dialysis products and that the merger could improve health outcomes for patients by increasing access to in-home hemodialysis machines. In short, the FTC found that vertical harm from input foreclosure or raising rivals' costs was unlikely, but vertical efficiencies were likely.

The majority also examined the customer foreclosure theory of harm. In particular, the FTC assessed whether the merger would make it more difficult for other companies to enter the in-home hemodialysis machine market because Fresenius, which the FTC viewed as one of two large in-clinic hemodialysis providers, would source in-home machines from itself (that is, NxStage), leaving only one large customer to which rival in-home machine makers could sell their products. In rejecting this concern, the FTC majority relied on an

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announcement that one or more companies planned to enter the in-home hemodialysis machine market, which alleviated potential concerns about new entrants needing to enter at both levels of the supply chain (in-home machines and outpatient dialysis clinics).

Fresenius completed its acquisition of NxStage in February 2019.

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 Search [In the Matter of Fresenius Medical Care AG & Co. KGaA and NxStage Medical, Inc. \(consent decree\)](#) in What's Market for more on the Fresenius/NxStage transaction.

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## CVS/AETNA

CVS Health Corp. announced a proposed \$69 billion acquisition of Aetna Inc. in December 2017. CVS is the largest retail pharmacy chain in the US, owns the largest PBM company, and is the second-largest provider of individual prescription drug plans (PDPs). Aetna is the third-largest health insurer and fourth-largest provider of individual PDPs.

Ultimately, the DOJ and five states announced a settlement to clear the transaction subject to a divestiture to resolve a horizontal overlap in the deal (the DOJ alleged that the deal combined two of the largest providers of individual PDPs). No relief was required to resolve any vertical concern.

Notably, several groups complained that the settlement failed to remedy the harm from the transaction and, for the first time ever, a judge held an extensive hearing on the settlement under the Tunney Act. With respect to vertical harm, the complainants argued that the merged company could raise rivals' costs for PBM services, which would harm competition in the insurance market. In particular, they claimed that the merged company could leverage CVS's strength in the PBM market, where it held a 25% share, to raise PBM prices to Aetna's health insurance rivals, which would result in those competing health insurers either:

- Incurring higher PBM costs and becoming less profitable.
- Passing on the higher PBM costs to their members and becoming less competitive with Aetna, which would gain additional members at the expense of rival insurers.

The court ultimately rejected the complainants' raising rivals' costs concerns, finding that insurance rivals to Aetna had sufficient PBM alternatives to CVS's PBM and that CVS's PBM often lost business to these rival PBMs. Moreover, the court stated that CVS would not risk its much bigger PBM business (by raising PBM prices to rival health insurers) to grow Aetna's much smaller health insurance business.

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 Search [Court Approves CVS/Aetna Settlement After Evidentiary Hearing and U.S. v. CVS Corporation and Aetna Inc. \(consent decree\)](#) in What's Market for more on the CVS/Aetna transaction.

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## UNITEDHEALTH/DAVITA

UnitedHealth Group Inc. announced in December 2017 that its subsidiary Optum would acquire DaVita Medical Group. UnitedHealth is one of the largest US health insurers, and, at the time, Optum and DaVita owned primary care and specialty physician practices in several states. There was one key horizontal aspect in the transaction, which was otherwise largely vertical.

In the Las Vegas, Nevada area, the FTC examined horizontal and vertical issues and required a remedy to address both concerns. For the horizontal issue, the FTC alleged the merger would combine Optum's and DaVita's managed care provider organizations (essentially, large multispecialty physician groups), resulting in a combined 80% market share.

For the vertical issue, the FTC had concerns about input foreclosure and raising rivals' costs. In particular, the FTC alleged that the merger, by combining what would be the "must have" Optum-DaVita physician organization with UnitedHealth's leading (over 50% market share) Medicare Advantage (MA) plans in the Las Vegas area, would enable the merged company to foreclose, or raise its provider reimbursement rates to, rival MA plans, thereby lessening competition to provide MA plans to seniors in the area. The FTC also alleged that the merged company could have a greater ability and incentive to raise its own MA rates or reduce UnitedHealth's incentive to improve the quality and benefits of its MA plans.

There was also a purely vertical issue in the Colorado Springs, Colorado area, where UnitedHealth was alleged to be the largest MA insurer and where DaVita owned two physician practices that constituted one of the largest groups in the area. The FTC was divided 2-2 on whether to seek a remedy there, so it imposed no remedy. However, the Colorado AG required behavioral relief to resolve input foreclosure and raising rivals' costs concerns. In a settlement agreement with the Colorado AG, UnitedHealth agreed to allow rival MA plans to contract with the acquired DaVita physician groups through the 2020 plan year, and was further required to relinquish contractual rights to be the exclusive MA plan with a large hospital system in the area.

In June 2019, UnitedHealth completed its acquisition of DaVita for \$4.3 billion.

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 Search [In the Matter of UnitedHealth Group Incorporated, Collaborative Care Holdings, LLC, DaVita Inc., and DaVita Medical Holdings, LLC \(consent decree\)](#) in What's Market for more on the UnitedHealth/DaVita transaction.

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### CIGNA/EXPRESS SCRIPTS

Cigna Corp. announced a proposed \$67 billion acquisition of Express Scripts in March 2018. Cigna is a global health care services company that, among other things, provides health insurance. Express Scripts is a PBM company. Express Scripts and other PBM companies contract with Cigna and other health insurers to manage pharmacy benefits for insurance plan members.

After a six-month investigation, the DOJ announced that it would not challenge the transaction or seek behavioral or structural remedies. In its closing statement (available at [justice.gov](https://www.justice.gov)), the DOJ said it had concluded that the merger was unlikely to:

- Substantially lessen competition in the sale of PBM services (a horizontal concern), because Cigna's PBM business was small and other PBM companies, including two large PBM companies, would remain post-merger.

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The higher the market shares, the more likely there are to be concerns about potential input and customer foreclosure and raising rivals' costs.

- Enable the merged company to increase the cost of Express Scripts' PBM services to Cigna's health insurance rivals, because most rival insurers had sufficient PBM alternatives. Consequently, any attempt by the merged company to increase these costs "likely would result in the merged company losing PBM customers and not result in Cigna's gaining a sufficient volume of additional health insurance business to offset the loss of PBM customers."

Cigna and Express Scripts completed their transaction in December 2018.



Search [Cigna Corporation and Express Scripts Holding Co. \(decision to close\)](#) in What's Market for more on the Cigna/Express Scripts transaction.

### ANTITRUST RISK ASSESSMENT IN VERTICAL MERGERS

To understand the potential for competitive concerns in a vertical merger, health care companies and their counsel should:

- Determine the merging companies' market shares in the upstream and downstream markets. The higher the market shares, the more likely there are to be concerns

about potential input and customer foreclosure and raising rivals' costs.

- Assess the availability of alternative suppliers of the input and alternative outlets for the input (customers) other than the merging companies, as well as customers' and suppliers' ability to switch to alternative suppliers and customers, respectively.
- Review the merging companies' margins and diversions (substitution between competitors) in both markets. The higher the margins of, and diversion from competitors to, the merged company, the greater the incentive may be to foreclose or raise rivals' costs because each additional sale captured by the merged company is more profitable.
- Consider whether either merger partner had plans to enter into the upstream or downstream market of the other merger partner, and evaluate whether other companies are planning to, or could, enter the upstream or downstream markets or both.
- Analyze any similar previous transaction in the industry, and what happened post-merger, to gain insight into the potential ability of the merged company to foreclose or raise rivals' costs.
- Review whether either merger partner does business with and receives confidential, competitively sensitive information from competitors of the other merger partner, such as contracting information, pricing or reimbursement rate information, and (further downstream) customer information. If so, a firewall may be required. 

