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Brief Insight

Health Care Perspective: The FTC and DOJ's Long-Awaited Enforcement Guidelines for Vertical Mergers

David R. Brenneman, Ryan Kantor, Zachary M. Johns, and Bernard W. Archbold

The health care industry has recently seen a number of high profile mergers between companies that compete in different sections of the health care ecosystem: insurers have merged with providers, pharmacies have merged with insurers, and insurers have merged with pharmacy benefit managers (PBMs). Meanwhile, hospital groups have acquired physician practices over the last decade at an accelerating rate; for instance, in 2011 less than 25% of specialist practices and less than 30% of primary care physician practices were owned by a hospital group.[1] By 2018, hospital systems owned 45% of specialist practices and 48% of primary care physician practices.[2] Given the financial stress many members of the health care industry are under as a result of COVID-19, further consolidation is likely.[3]

David R. Brenneman et al., *Health Care Perspective: The FTC and DOJ's Long-Awaited Enforcement Guidelines for Vertical Mergers*, J. Health and Life Sci. L., Oct. 2020 at 2. Published by the American Health Law Association, www.americanhealthlaw.org/journal.

1 Thomas L. Greaney & Richard M. Scheffler, *The Proposed Vertical Merger Guidelines and Health Care: Little Guidance and Dubious Economics,* Health Aff. Blog (Apr. 17, 2020), https://www.healthaffairs.org/do/10.1377/hblog20200413.223050/full/.

2 *Id.*

3 Jeff Overley, *FTC Attys Talk COVID-19's Impact On Hospital M&A Oversight,* Law360 (May 22, 2020, 6:48 PM), https://www.law360.com/competition/articles/1275378/ftc-attys-talk-covid-19-s-impact-on-hospital-m-a-oversight?nl_pk=46241d26-43c5-431b-a2c5-ad1d50482955&utm_source=newsletter&utm_medium=email&utm_campaign=competition (interviewing Mark Seidman and Melissa Hill, Co-Deputy Assistant Directors, Merger IV, Bureau of Competition, Federal Trade Commission).

With vertical integration in the health care sector showing no signs of slowing down, it is important for health care professionals considering such transactions to become familiar with the Federal Trade Commission (FTC) and Department of Justice's ((DOJ) and together ("Agencies")) newly released Vertical Merger Guidelines ("Guidelines") issued on June 30, 2020. The Guidelines, which replace DOJ's long outdated 1984 Non-Horizontal Merger Guidelines, were updated to memorialize the Agencies' current methodology for analyzing vertical mergers.[4]

The Guidelines cover vertical mergers, which include business combinations between companies in different segments of the supply chain. In the health care industry, this can include combinations among insurers, hospitals, pharmacies, or PBMs, as well as hospital and physician group combinations and mergers among health care companies and companies that support health care via software and platforms. The Guidelines stress that vertical mergers often result in procompetitive benefits and are less often problematic than horizontal mergers (i.e., mergers between competitors), but also state that they can be anticompetitive under certain circumstances. In particular, a vertical merger may harm competition where (i) the combined company has the ability and incentive to foreclose its rivals or raise its rivals' costs, (ii) the combined company will have access to its rivals' competitively sensitive information as a result of the merger, or (iii) the merger enables coordinated interactions among competitors.

ANTITRUST RISKS IF THE MERGED ENTITY HAS THE ABILITY AND INCENTIVE TO FORECLOSE RIVALS OR RAISE THEIR COST

When companies merge vertically, the resulting entity may own its rivals' input supplier(s) or its rivals' downstream outlet for selling its products. Here are two examples:

- *Example 1*—Foreclosure: An insurance company ("Insurance Company") might acquire a single or multi-specialty physician group ("Physician Group") that, pre-merger, contracted with the Insurance Company's competitors to offer them discounted in-network rates. This transaction may be anticompetitive if the Insurance Company, post-merger, has (i) the ability to exclude the Physician Group (or facilities that are part of it) from its competitors' insurance networks and (ii) the incentive to do so, perhaps because a substantial number of employers who purchase insurance plans for their employees view the Insurance Company's plans as the next best option to gain access to the Physician Group. This is known as "foreclosure," and it is particularly problematic where the Physician Group includes "must-have" doctors or facilities without which a regional insurance network is untenable or highly unattractive to employers.

4 *See generally* U.S. Dep't of Justice, Non-Horizontal Merger Guidelines (1984), https://www.justice.gov/atr/page/file/1175141/download?splash=1.

- *Example 2*—Raising Rivals' Costs: The Insurance Company again acquires the Physician Group, but rather than excluding the Physician Group from its competitors' networks, it requires them to demand higher reimbursement rates. This raises the cost for the Insurance Company's rivals to build viable insurance networks and may result in the Insurance Company winning customer accounts from employers.

The Guidelines state that unless the merged company has the ability *and* the incentive to foreclose their rivals' access to inputs or outlets, or offer them worse price or non-price terms, the merger will rarely warrant close antitrust scrutiny from the Agencies.[5] The Guidelines also note that a vertical merger is unlikely to result in harm to competition when the merged company's rivals can switch to alternative suppliers at the same cost and quality.[6] Implicitly, this means that if there are few alternatives available, or if the available alternatives have capacity constraints, or are of lesser quality or higher cost, the transaction may receive scrutiny.

VERTICAL ISSUES REGARDING HEALTH CARE MERGERS WITH TECH COMPANIES

While the vertical merger examples above illustrate mergers between traditional health care companies, the methodology for scrutinizing such mergers set forth in the Guidelines will also apply to health care companies merging with tech companies. As the health care industry increasingly becomes dependent on tech platforms, software, analytics, and AI, some health care participants have replaced their in-house technological capabilities with independent third-party vendors. Others have entered into partnerships and joint ventures with larger technology companies to create new health care products.

In either case, like health care, the technology industry has faced significant scrutiny of late, and the Agencies will undoubtedly analyze such transactions carefully using the framework set forth in the Guidelines. Typically, in these health care/technology transactions, the focus will be on whether the merged firm will have both the ability and incentive to foreclose other health care participants from its newly acquired platform, software, artificial intelligence or asset (including data). While this will frequently depend on the parties' respective market shares, if the tech product is nascent, there may also be questions regarding whether other health care and/or tech firms will be able to innovate a competing product.

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5 U.S. Dep't of Justice & Fed. Trade Comm'n, Vertical Merger Guidelines § 4(a)(1)–(2) (2020), https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf [hereinafter Vertical Merger Guidelines].

6 *Id.* § 4(a)(1).

OTHER FORMS OF ANTICOMPETITIVE HARM

Another possible form of anticompetitive harm that could result from a vertical transaction is the merged firm gaining access to a pre-merger rival's competitively sensitive information. For instance, in Example 1 on page 3, if the Physician Group continues to be included in rival insurers' plans, it would get access to reimbursement rate information or innovative new approaches that could improperly advantage its Insurance Company parent. The Insurance Company could use knowledge of reimbursement rates at the Physician Group to inform negotiations with other providers. In the alternative, the Insurance Company could tell the Physician Group the reimbursement rates that it is paying the Physician Group's rivals. That information could lead to the Physician Group demanding higher rates from other insurers.

With this informational advantage, the merged firm may compete less aggressively than it did pre-merger and may reduce its rival's incentive to compete aggressively or implement procompetitive changes.[7] A rival also may change suppliers to avoid sharing competitively sensitive information with a competitor, but this may force the rival to use an inferior means of supply or pay higher prices, which could reduce quality and competition.[8] As described below, instituting firewalls between the merged companies that prohibit information exchanges can be a practical way to reduce or eliminate these antitrust risks.

The Agencies also expressed concern that, in some circumstances, vertical mergers may help facilitate collusion among market participants. A vertical merger could lead to the elimination of an aggressive company that currently is preventing coordination among competitors in the market. In addition, a vertical merger could allow for easier detection of "cheating" on collusive agreements.

PROCOMPETITIVE BENEFITS MIGHT OUTWEIGH ANTICOMPETITIVE HARM

The Guidelines make it clear that vertical mergers often result in procompetitive benefits, such as the ability to eliminate double marginalization or increase efficiency. In simplest terms, elimination of double marginalization means cutting out the intermediary. Using Example 1 above, the Insurance Company is able to lower the reimbursement rates its health plans pay for covered treatments at the Physician Group's facilities because it will receive the treatments at cost rather than cost plus a margin. The Insurance Company in turn can market plans to employers at a lower price because only the Insurance Company's margin is added to its costs when pricing insurance policies. Because its expenses are lower, the Insurance Company could reduce its members' premiums while earning the same return as beforehand.

7 *Id.* § 4(b).
8 *Id.*

Other efficiencies the Agencies consider are the elimination of transaction costs, streamlining production, improved distribution or inventory management, and the creation of innovative products.[9]

The Guidelines make it clear that the Agencies will weigh the procompetitive benefits with any risk of anticompetitive harm. Therefore, the Agencies may even approve vertical mergers between companies that have meaningful market shares if they can prove that the benefits of the merger outweigh the possibility of harm.

FOUR TIPS FOR HEALTH CARE COMPANIES CONSIDERING VERTICAL MERGERS

Health care companies can take four steps to reduce their risk of a prolonged investigation or an enforcement action as a result of a vertical transaction.

- *Document Creation:* The parties should take care to identify the anticipated merger-specific synergies, including cost synergies and any revenue synergies via cross-selling opportunities. Where the elimination of double marginalization is likely, parties should describe how reduced input costs would lead to lower prices for consumers. Parties should be mindful of how they describe the impact of their combination on competition in the marketplace. Parties should assume the FTC or DOJ will review transaction-related documents during the merger review process and will be on the lookout for "buzz" words or phrases, like that the combination "will kill the competition" or "raise rates once the deal goes through."
- *Information Firewalls:* The parties should be conscious about the risks of competitively sensitive information flowing between vertical business segments. To avoid this, the post-merger entity should consider implementing internal firewalls that prevent a rival's competitively sensitive information (i.e., information about current or future prices, cost data, output levels, or capacity) from being viewed by the company's employees charged with competing against the rival.
- *Compliance/Gun Jumping:* The parties should ensure they do not begin integrating the services they provide prior to closing. Even in a vertical transaction where the parties are not direct competitors, antitrust gun jumping violations are possible.
- *Consult with Antitrust Counsel Early in the Planning Process:* The antitrust analysis of vertical mergers can be highly complex. Early engagement with antitrust counsel can result in troubleshooting potential issues, reducing the risk of attention from the antitrust agencies.

9 *Id.*

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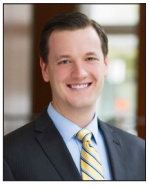

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