Update: D.C. Circuit Court of Appeals Upholds Decision Blocking Anthem-Cigna Merger

On April 28, the District of Columbia Circuit Court of Appeals issued its decision upholding an order blocking the proposed merger of health insurers Anthem and Cigna.

In the 2-1 decision, the Circuit Court ultimately agreed with the District Court's decision that Anthem did not show the "extraordinary efficiencies necessary to offset the conceded anticompetitive effects of the merger." Anthem has now filed a Petition for Certiorari with the United States Supreme Court. Below, we summarize the Circuit Court decision that Anthem is asking the Supreme Court to reconsider, and highlight the most interesting and significant aspects of the case.

1. **Legal Status of the "Efficiencies Defense"**

The issue on appeal was whether Anthem demonstrated that the merger would create efficiencies that offset the anticompetitive harms of the merger. The Circuit Court's discussion of the legal question about the breadth of the "efficiencies defense" is perhaps the most interesting and significant part of the decision.

Several circuit courts, including the D.C. Circuit, have held that evidence of verifiable, merger-specific efficiencies can rebut a presumption that a merger is unlawful. However, courts have not settled the question of whether efficiencies can provide a total defense to a merger that otherwise violates Section 7. The most recent Supreme Court case that touched on the issue was *FTC v. Proctor &amp|Gamble Co.*, 386 U.S. 568 (1967). There, the Supreme Court blocked a merger under Section 7 without considering whether efficiencies would provide a viable defense. The Court stated that "[p]ossible economies cannot be used as a defense to illegality." Justice Harlan disagreed in his concurrence, stating that the he "accept[ed] the idea that economies could be used to defend a merger." The

majority opinion here declined to answer whether the efficiencies defense is available for mergers that violate Section 7. Instead, the Circuit Court assumed that efficiencies could provide a total defense, but found that Anthem failed to show the evidence needed for that defense to prevail.

2. **Discussion of Medical Cost Savings Efficiencies Anthem Presented**

The D.C. Circuit found the evidence of medical cost savings offered by Anthem to be neither merger-specific nor sufficiently verifiable to offset the likely competitive harms of the merger. The Circuit Court agreed on both of those points.

Merger Specific?

Anthem argued that the merger would allow the company to sell a product that combined the best of Anthem and Cigna. The product would have Cigna's wellness programs and customer-facing features, but with Anthem's provider rates. The district court found that neither the product or lower rates were merger specific efficiencies. The Circuit Court agreed that the product was not merger specific, but concluded that the merger would generate cost savings. As to the product, the Circuit Court said that Anthem is at fault for its inability to create a product like Cigna's. The Circuit Court believed nothing inherently stopped Anthem from creating a product like Cigna's. The Court suggested if Anthem tried harder or properly realigned its goals, it could realistically offer a Cigna-like product on its own.

The Circuit Court did conclude that the district court erred in finding that the merger cost savings Anthem put forth were not merger specific. The district court had found that the provider rates used in Anthem's evidence had already been secured independently by each insurer. The Circuit Court pointed out that even the government conceded that only by merging could the existing Cigna product be sold at Anthem's lower rates, secured by Anthem's volume-based discounts. This error was, however, ultimately harmless because even if the medical cost savings were merger specific, the Court still found them not sufficiently verifiable.

Verifiable?

The Circuit Court agreed with the District Court that intervening business factors were likely to interfere with Anthem's plan to secure medical cost savings. The Circuit Court mainly focused on verifiability problems with two parts of Anthem's plan to generate merger cost savings – invoking an affiliate clause in Anthem's provider contracts and renegotiating provider rates.

If Anthem invokes widespread use of its affiliate clause, it would undermine its own contractual "Best Efforts" obligations. Under its "Best Efforts" clause, 80% of Anthem's revenue must derive from Blue-branded plans. Merging with Cigna would immediately put Anthem in violation of that clause. And if Anthem invokes the affiliate clause, it would reduce any incentive for Cigna customers to move to Anthem branded products because Cigna plans would get the same provider rates as Anthem plans. In addition, once provider contracts expire and the affiliate clauses no longer are in play, providers could aggressively renegotiate rates. While Anthem's volume gives it significant bargaining power, large hospital networks also have significant negotiating leverage. Anthem's should not assume that it would secure lower provider rates in renegotiations. Finally, the Circuit Court questioned whether Anthem would pass any medical cost savings to consumers. The evidence at trial, including Anthem's own internal documents, sufficiently undermined Anthem's claim that it would pass 98% of the savings to consumers.

In short, Anthem did not convince the Circuit Court that the merger would produce the promised savings for consumers. As the majority opinion stated, "[i]f merging companies could defeat a Clayton Act challenge merely by offering expert testimony of fantastical cost savings, Section 7 would be dead letter." After providing its analysis of Anthem's efficiencies, the majority opinion explained the problems it found in the Dissent's argument. One interesting critique raised was that the dissent assumed that prices are the sole focus of antitrust analysis, which ignores the fact that "lower prices . . . may be transitory" because in highly concentrated markets "companies have a greater ability to retain for themselves input savings rather than pass them on to consumers."

We will continue to keep you posted about the status of the Petition for Certiorari with the United States Supreme Court. If the Supreme Court takes up the case, it will be the first antitrust case heard by the nation's highest court in more than 40

years.

Past Source Blog Updates on the Circuit Court case:

Anthem and Cigna's appeal of a district court decision blocking the insurers' proposed merger is now fully briefed before District of Columbia Circuit Court of Appeal. Below, we highlight some of the key take-aways from the parties' and *amicus* briefs. A link to all of these briefs is provided at the end of this post. You can also listen to a recording of the oral arguments in the case, which the D.C. Circuit heard on March 24th, here.

In its brief, Anthem argues that the district court should have considered the purported medical cost savings when considering the procompetitive effects of the merger. Anthem argues that these savings outweigh the anticompetitive harms the government alleges. The points that Anthem raises in support of this argument are as follows:

- The District Court improperly rejected a "consumer welfare standard";
- The merger will lower provider rates, which will in turn benefit consumers by reducing the cost of consumer medical claims;
- The District Court "contradicted its own product definition," which led it to dismiss valid efficiencies;
- The District Court improperly concluded that any medical cost savings here are not merger-specific efficiencies;
- Anthem had multiple sources to verify the alleged medical cost savings;
- The merger will not harm providers;
- The District Court ignored savings the merger would generate in Richmond, Virginia

The United States and state parties respond in their brief that the evidence in the record overwhelmingly demonstrates that the merger would increase prices for consumers and stifle progress on value-based payment reforms aimed at lowering overall healthcare spending. Anthem's reply brief argues that in fact, Anthem has

more value-based contracts than Cigna. Cigna has deferred to Anthem's arguments in the case. As you may recall, Cigna wants to end the merger, and in separate litigation the two insurers are accusing each other of breaching their merger contract.

There have also been several *amicus* briefs filed in the case. The American Hospital Association, a hospital organization that represents thousands of providers, argues in its brief that the merger will be a "significant blow" to hospitals' goal of generating medical cost savings through value-based payment reforms. The hospital association says that reducing the number of big insurers in the market from four to three will stifle innovation aimed at reducing overall healthcare costs. The brief also emphasizes the unlikeliness that the merger will end in Anthem adopting the value-based payment programs Cigna has developed, given the contentious relationship between the two insures.

Below, we have accumulated all the party briefs, as well as the *amicus* briefs in the case. We will keep you updated on the case as it progresses!

Party briefs:

- Anthem's brief
- United States and state governments' brief
- Anthem reply brief

***Amicus* briefs (all in support of the United States and state governments):**

- Antitrust Economists &amp|Business Professors brief
- American Antitrust Institute et al. brief
- American Hospital Association brief
- American Medical Association and the Medical Society for the District of Columbia brief
- Professors brief

Oral Argument recording (3/24/17)

Past Source Blog Updates on the District Court case:

The much anticipated order in the Anthem-Cigna merger trial has arrived! The District Court blocked the deal, citing concerns about the merger's effect on competition in the market for insurance sold to national accounts. Below, we highlight the most interesting aspects of the case and discuss the key issues involved in the order. The court issued a summary of its full opinion in the order released February 8. The full opinion is currently under seal, but will be released soon. The court is currently considering the parties' arguments about whether any portions of the full opinion should remain permanently sealed. We will post the full opinion as soon as it is available.

The Court's decision focused on the merger's effect on the sale of insurance to national accounts – employer groups with more than 5,000 employees – in fourteen states. The court accepted the product market of "national accounts" because DOJ presented testimony and other evidence establishing that the insurance industry treats this category of accounts as a distinct market. The court also accepted DOJ's geographic market definition, which included 14 states.

After reviewing product and geographic market definitions, the Court stated that the merger created a presumptively unlawful level of concentration in that market under the Horizontal Merger Guidelines. The Court went on to discuss the likely effects of this high market concentration, including increased prices, reduced consumer choice, and diminished incentives for insurer innovation. The Court also spent some time explaining the bid solicitation process in the national accounts market. It highlighted this process to demonstrate that employers consider a number of factors when choosing which insurers' bid to accept. Even though Anthem generally offers the lowest prices, Anthem and Cigna compete on other factors of the sale, such as quality of coverage and size of networks.

The insurers attempted to rebut the presumption that the merger was unlawful by presenting evidence that new insurers would enter the market and create competition. The Court flatly rejected this claim based on the difficulty of building robust provider networks. Further, the Court said that even if insurers with small

networks enter the market, these “niche” products do not appeal to large national employer accounts. The insurers failed to convince the Court that national employers could “slice” their accounts and offer products with small networks to different employees. Employers rarely choose this option because it is expensive and administratively burdensome. Finally, the Court dismissed the insurer’s argument that third-party administrators and provider-sponsored plans generate competition in the market. These organizations either work with or funnel business to Anthem and Cigna, and thus do not actually curb the impact of market concentration.

In their final attempt to save the merger, the insurers tried to show that the merger would create efficiencies. The insurers focused on two: the power to negotiate lower provider rates and the ability to sell Cigna’s value-based products at Anthem’s low prices. The court found neither sufficient, because the offered efficiencies were neither merger-specific (i.e. an efficiency that could only be created by the merger) nor verifiable.

The Court said the lower provider rates were not merger specific because the calculations cited in the case did not depend on an increase in the number of patients on the insurer’s plans. In addition, while the merger might bring lower provider rates to the insurers, this savings did not constitute a true efficiency. The insurers focused on how these savings would lower healthcare spending overall. The Court said it would be unprecedented and inappropriate to find a merger efficiency based on “complex policy decisions about the overall allocation of health care dollars in the United States.” Nothing in the case established that combining patient pools would actually lower total hospital costs or improve quality of care. In short, there was no evidence that giving insurers greater power to bargain with providers would actually help consumers.

The insurers also failed to convince the court that the merger would offer consumers a unique and improved product. The Court said that nothing prevented Anthem from expanding its value-based offerings, or improving its product in other Cigna-like ways. The Court believed that consumers should continue to have the choice between Anthem, which negotiates larger discounts with providers, and Cigna, which provides value-based care. The insurers failed to demonstrate that the benefits of combining those two features into one entity outweighed the merger’s

harms to the market.

The Court also highlighted the "elephant in the courtroom" – conflicts between the insurers themselves. The insurers disagreed about projections on future savings created by the merger. Cigna refused to sign Anthem's Findings of Fact and Conclusion of Law, and even cross-examined the defense's own expert witnesses about savings projections. The Court seemed shocked by these "remarkable circumstances," which demonstrated fundamental strife between the insurers about strategies following the merger. Thus, the insures dispute raised "serious concerns" about whether the "rosy vision" offered by the insurers would ever materialize.

While DOJ argued that the merger had unlawful anticompetitive effects in two additional markets: national accounts across the entire United States and large group (more than 100 employee) accounts in 35 regions, the court did not need to reach these arguments. Instead, it blocked the merger based on the national accounts market in fourteen states alone.

On February 9, Anthem filed a notice of its intent to appeal the decision to the Court of Appeals for the District of Columbia. Cigna officially ended the merger agreement on February 14, and said it will seek almost $13 billion in damages from Anthem in addition to the $1.8 billion break up fee stipulated in the merger contract.

We will continue to follow Anthem's appeal of the decision and post updates about the case as it moves forward.

Past Source Blog Updates on the Trial:

The antitrust trial in *United States v. Anthem Inc. and Cigna Corp.* began in the federal District Court for the District of Columbia on November 21, in which the Department of Justice challenged Anthem and Cigna's $54 billion merger. DOJ, along with seven plaintiff states, filed a complaint against the insurers in July, alleging that their merger violates federal antitrust laws by substantially lessening competition in the sale of health insurance on public exchanges and the purchase of healthcare services. In DOJ's pre-trial brief, filed on November 10, the government claimed it would show at trial that "the merger is likely to have serious anti-

competitive effects in dozens of markets . . . harming consumers and healthcare providers alike." In Anthem's pretrial brief, the insurer argues that the merger will create lower provider reimbursement rates, which will in turn benefit "everyday Americans" because their employers will pay less for health insurance.

After opening statements (DOJ's is available here), in the first weeks of the trial, the court heard arguments on how to define the relevant geographic market for large multi-state employer health insurance plans and how to consider competition in those markets. One key issue was whether Anthem, which operates under a license with the Blue Cross Blue Shield Association in 14 states, competes with other plans in the Blue Cross Blue Shield Association. Anthem and Cigna argued that Anthem is independent from other associate plans, and that the associate plans compete with one another, in an effort to show that after the merger there would still be robust competition in the national insurance market. DOJ countered that Blue Cross Blue Shield Association limits how its associate plans compete with one another, and presented evidence showing that the plans in the association often even work together to attract business.

Another issue to keep an eye on is how Anthem and Cigna have accused each other of breaching the terms of their own merger agreement. DOJ has argued that this conflict indicates that the companies would have difficulty working together to create efficiencies and consumer savings post-merger. Anthem and Cigna lost their discovery motion to keep information about this conflict out of the case. Although evidence of such conflict has not yet come up in the trial, many of the proceedings in the first week have been closed to the public, leading some to speculate that the closed proceedings have focused on infighting between the would-be partners.

Up next is testimony from both parties' expert economists on the potential effects of the merger on competition in the national health insurance markets. We will continue to provide updates as the trial moves forward. For more information on the trial so far, we recommend a useful analysis published this week by Politico Pro (subscription required). The government's major case filings are available on the DOJ page for the case.

The Anthem-Cigna trial is the first of two trials involving big insurance mergers. Up

next for DOJ is its trial in the case against Aetna's proposed $37 billion acquisition of Humana starting on December 5. We will also be following that case and providing updates!