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# New Vertical Merger Guidance Could Implicate Healthcare M&A

On January 10, 2020, the *U.S. Department of Justice* (DOJ) and the *Federal Trade Commission* (FTC) jointly published draft guidelines clarifying antitrust enforcement policies relating to vertical mergers.[1] The guideline changes, which are rare, reflect the "*accumulation of experience at the Agencies*"[2] and provide insight and guidance concerning vertical merger antitrust enforcement policy. The new guidelines supersede the *1984 Merger Guidelines,*[3] which are now withdrawn in their entirety.[4]

Federal antitrust agencies define vertical mergers as mergers that combine firms that operate at different stages of the supply chain.[5] An example of a vertical merger could be a retailer acquiring the manufacturer of the products it sells (an "*upstream*" vertical merger) or a manufacturer acquiring the firm that sells it parts (a "*downstream*" vertical merger).[6] Two recent vertical merger transactions in healthcare are those of *CVS Health* with *Aetna*, and *Cigna* with *Express Scripts*.[7] Vertical mergers can be appealing to many firms because it may allow for increased savings in costs gained through increased production (i.e., *economies of scale*).[8] Moreover, firms may be enticed by a vertical merger because it may result in a greater control over supply costs or downstream prices increasing profit margins.[9] Healthcare organizations can be particularly attracted to vertical mergers as a solution to changing reimbursement models and increased demand for integrated delivery systems.[10] In healthcare, the perceived efficiency gains of vertical mergers are twofold: (1) increased profits and (2) improved quality of healthcare for patients.[11]

The DOJ/FTC vertical merger guidelines focused on five areas of potential adverse competitive effects: *related products, market share, unilateral competitive effects, coordinated competitive effects,* and *efficiencies*.[12] Each are discussed below.

*Related Products*

The guidelines state that federal regulators will be employing a market definition of "*related products*" when analyzing vertical mergers.[13] When identifying competitive concerns in a *relevant market,*[14] agencies will be specifying the *related products* in the market.[15] *Related products* are products or services supplied by a merged firm that are vertically related to products or services in the *relevant market* and affect competition in the *relevant market*.[16] The guidelines proceed to give examples of *related products*, such as "*an input, a means of distribution, or access to a set of customers*."[17] These broad examples indicate that federal regulators will analyze a wide array of related products in the *relevant market*.

*Market Share*

The guidelines identify the market share threshold required for increased federal antitrust scrutiny of a vertical merger. Regulators are unlikely to challenge vertical mergers where the parties have less than 20% market share in the *relevant market*.[18] Further, a challenge is unlikely in cases where the parties' *related products* are used in less than 20% of the *relevant market*.[19] However, there may be exceptions to this *safe harbor*, such as in circumstances where the *relevant product's "share of use in the relevant market is rapidly growing*."[20] Finally, the guidelines clarify that simply having a 20% market share or more does not alone indicate an inference that the vertical merger will likely lessen competition because more factors must be analyzed.[21] As previously noted in the *Horizontal Merger Guidelines*,[22] market share merely provides a way to identify mergers that *may* raise competitive concerns.[23]

*Unilateral Competitive Effects*

Parts of the draft vertical merger guidelines rely heavily on the 2010 *Horizontal Merger Guidelines*.[24] For example, evidence of adverse competitive effects in vertical mergers adopt many of the types of evidence described in Section 2.1 of the *Horizontal Merger Guidelines*, such as "*actual effects observed in consummated mergers, direct comparisons based on experience, and evidence about the disruptive role of a merging party*."[25] Moreover, regulators will use the same types of documentation used in a horizontal merger analysis to prove adverse competitive effects in vertical mergers.[26]

Regulators identify two ways in which a vertically merged firm's control of a *related product* may adversely impact competition in the *relevant market*. First, a vertical merger may foreclose a competitor from accessing a *related product* or raise the rival's cost of the *related product* to a point where consumers of the *related product* are harmed.[27] The merged firm could also refuse to supply the rival with the related products altogether resulting in "*foreclosure*."[28] Alternatively, a vertical


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merger may increase the ability of the merged firm to decrease the quality of its rivals' products or services.[29] Second, the merged firm's control of a *relevant product* could allow the firm access to competitively sensitive information of *downstream* competitors, which may allow the merged firm to moderate its competitive response to rival's competitive actions to preempt or react quickly to procompetitive business actions.[30] These actions may adversely impact competition because rivals may see less competitive value in taking procompetitive actions, or the rivals may refrain from doing business with the merged firm out of fear competitively sensitive business information will be used adversely.[31] These effects may result in rivals becoming less effective competitors because they may lack competitive pricing options from other trading partners.[32]

*Coordinated Competitive Effects*

Regulators identify the possibility for a vertical merger to allow anticompetitive behaviors such as overt or tacit coordination by competitors to eliminate or competitively harm upstart "*maverick*" firms.[33] Vertically merging parties could harm the ability of a non-merging *maverick* in the *relevant market* from effectively competing against the merged firm and increase the likelihood of coordination between the merged firm and other rivals.[34] The change in market structure and access to confidential information may allow for tacit agreements among market participants, detecting cheating in the agreements, and then punishing firms who cheat.[35] These illegal agreements[36] result in locking out *maverick* firms from effectively competing.[37]

*Efficiencies*

The draft guidelines state that regulators will analyze if the perceived efficiencies from a proposed vertical merger will result in lower prices to downstream consumers.[38] Further, the guidelines recognize efficiencies such as combining economic functions and eliminating the need for contracting functions, which may create unnecessary costs that may ultimately be passed along to downstream consumers.[39] Finally, regulators state that approaches to evaluating efficiencies will be drawn from the *Horizontal Merger Guidelines*.[40]

*Healthcare Missing*

Despite being the first update to the *1984 Merger Guidelines* in 34 years, the draft guidelines are surprisingly short and do not expound on a number of questions from antitrust experts relating to vertical merger antitrust enforcement. Significantly, there are no references to healthcare or any examples of vertical mergers in healthcare. The draft contains no discussion of the standards that agencies will utilize to evaluate the ability of merging firms to cut off the supply of downstream products to rivals. This is significant to healthcare because vertically merging healthcare organizations may make it more difficult or costly for competitors to obtain physician services. The omission of any reference to healthcare is surprising given the FTC's involvement in the healthcare industry over the past year, including: (1) its 2019 intervention in the vertical merger of *UnitedHealthGroup's* acquisition of *DaVita Medical Group*;[41] and, (2) the Eighth Circuit's 2019 ruling in favor of the FTC when it blocked the proposed acquisition of *Mid Dakota Clinic* by *Sanford Health*.[42] Finally, the guidelines do not mention any potential remedies. Due to the nature of vertical deals not containing any overlapping products, the only potential remedy that exists other than an injunction would be behavioral remedies administered by a federal court.

Healthcare providers continue to view vertical mergers as perceived increased efficiency solutions; however, the evidence of such results is scarce and ambiguous.[43] Moreover, the evidence that does exist indicates that hospital acquisition of physician practices has minimal impact on increasing care quality.[44] In addition, increased market concentration is strongly associated with reduced patient satisfaction scores.[45] Finally, it has been established that there is a significant increase in spending on healthcare services when they are delivered in hospital-owned settings versus the physician office setting.[46] Merger activity in healthcare may threaten competition in local markets, which may force regulators to focus on vertical mergers to ensure high quality and affordable costs for healthcare consumers.

Despite these potential red flags, vertical integration in healthcare has, nevertheless, continued, and even accelerated, with hospital-acquired medical practices increasing from 35,700 in 2012 to 80,000 in January 2018.[47] Antitrust law appears to still be playing catch-up to healthcare's new economic realities. Vertical mergers are still largely perceived as inherently efficient, with the harm to competition outweighed by the gained efficiency. However, research indicates that this perception may hold true as regards the healthcare industry. The recently proposed guidelines offer a more comprehensive vertical merger antitrust analysis, but it is still unclear if these updates will ultimately result in increased antitrust enforcement of vertical mergers.


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