LAW360
A LexisNexis® Company
Legal News & Data

DC Circ. Should Be Wary Of Efficiencies Defense In Anthem

Law360, New York (March 21, 2017, 1:23 PM EDT) --

There is an old children's book that warns of what happens when you give a mouse a cookie. The mouse will want a glass of milk, a mirror, nail scissors, and the list goes on. This children's book could easily have been describing merger defendants' efforts to push antitrust policy toward far more permissive standards in merger defenses. A perfect example of this is found in the Anthem Inc. merger case now on appeal in the D.C. Circuit (oral arguments Friday).[1] After the U.S. Department of Justice did an excellent job of proving consumer harm as a result of the proposed merger, Anthem appealed on the theory that they surely would have won the case if only the judge had given far more credit to their efficiencies defense than virtually any other court has in the history of the defense.

David Balto

U.S. District Judge Amy Berman Jackson found that the proposed merger of Anthem and Cigna Corp. would substantially lessen competition in the market for health insurance. This ruling was not challenged by Anthem on appeal. What was challenged was Judge Jackson's findings that Anthem's claimed efficiencies were not cognizable because they weren't merger-specific or verifiable, and might not be efficiencies at all. These efficiencies were mostly based on Anthem's claims that the post-merger company would be able to select the lowest negotiated provider rate from each company and pass those savings on to consumers.

The efficiencies defense represents a more modern antitrust policy, and one that is somewhat underdeveloped in the law and economics. The efficiencies defense was not mentioned in either the original language of Section 7 of the Clayton Act or the amended language from 1950. Indeed, Brown Shoe, the first U.S. Supreme Court case to apply Section 7, affirmed analysis that the merger should be condemned because it enabled the post-merger firm to produce shoes of a better quality or at a lower cost, thus injuring its rivals.[2] The Supreme Court reaffirmed that view five years laterin Federal Trade Commission v. Procter & Gamble.[3] The efficiencies defense was first seriously contemplated in 1968 by the Antitrust Division's own merger guidelines and have been elaborated on ever since in subsequent revisions.

Courts, however, have been extremely wary of using efficiencies to justify a merger that was found to be prima facie unlawful.[4] As professor Herbert Hovenkamp explains, "[t]he decisions that credit claimed efficiencies as justification typically also find that the government failed to make out its prima facie case against the merger. Thus, in those cases

acknowledgement of efficiencies is simply dicta."[5]

The scrutiny of claimed efficiencies by the Anthem district court, and other courts before, is entirely appropriate. Efficiencies are already generally accounted for in the ordinary market concentration standards used for assessing merger illegality. As the Antitrust Division explains, challenges of mergers with efficiencies benefiting consumers should be rare because mergers of "companies operating significantly below the size necessary to achieve significant economies of scale" would not normally create antitrust concerns under current standards of proof.[6] Essentially, mergers at lower market shares are the ones most likely to lead to consumer benefiting cost savings, while at higher market shares the firms are already at efficient scale and/or won't have the competition to motivate them to pass savings on to consumers.

The current merger guidelines then add in an extra layer of defense by providing a framework to account for fact specific efficiencies that might not have been appropriately accounted for under ordinary market concentration standards. However, the merger guidelines caution that "efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great."[7] Therefore, the Antitrust Division, like the courts, are most skeptical of efficiencies when there is already a substantial case for consumer harm if the merger is allowed to proceed.

Going further than the agencies and courts have in recognizing an efficiencies defense, thereby creating a much more permissive merger policy, is entirely inappropriate due to current underenforcement in mergers. As antitrust scholar Hovenkamp states in his current working paper on efficiencies, "[r]ecent empirical literature suggests that merger policy today is under deterrent. That is, current enforcement policy is more likely to permit an antiticompetitive merger than to prohibit a harmless one."[8]

An overly strong efficiencies defense would make markets worse for consumers. The airline industry is a good example of this. Several mergers were permitted in the airlines industry in large part due to claimed efficiencies. However, the results of these mergers shows poor results in the projections of harms versus consumer benefits. In 2013 the American Antitrust Institute released a report comparing the claimed benefits of the airline mergers with real world results.[9] This report showed problems integrating, disconnectivity, and potential merger-induced congestion. These problems came on top of well-reported fare and fee hikes following the mergers. The ease of combining the airline companies was grossly overestimated, which significantly cut into any realized benefits. This is especially instructive in the Anthem case, where evidence was presented that Anthem would be unlikely to realize efficiencies as easily as it claims and that its strategy of using the best discount rates from each company could hurt provider relations and lead to contract renegotiations.

Furthermore, the economics has not developed to the point where we can project the harms and benefits that flow from a merger to the accuracy necessary to ensure that consumers are protected. In his 2009 paper, antitrust law professor and co-director of the Center for Health Law Studies Thomas Greaney lays out the problem with matching sound economic theory to "the multiple levels of uncertainty" involved in predicting efficiencies.[10] Greaney warns that "the problems associated with efficiency evaluations are distinct from and more severe than those encountered in other areas of antitrust inquiry, while also being less susceptible to empirical verification." Greaney concludes that "doctrinal development has failed to isolate critical issues of fact that courts can meaningfully evaluate." Compounding the economics problem are asymmetries of information that enable gaming of the efficiencies defense. Diana Moss identified this in her retrospective study of airline mergers. Moss found that there was a significant shift of efficiencies claims from cost savings to

network benefits that were much harder to verify.[11]

The problems with accurately projecting the benefits and harms stemming from claimed efficiencies is apparent in Anthem. Even if Anthem can realize the claimed cost savings, it may not necessarily result in benefits to consumers. Consumers want high-quality health care at a good price, not necessarily lower reimbursement. Lower reimbursement could lead to lower quality care that would harm consumers. This can put the court in the uncomfortable position of deciding matters of health policy regarding cost versus quality. Additionally, lower reimbursements could lead to much harder to predict negative outcomes – like a decrease in provider innovation.

An overly permissive efficiencies defense is especially harmful in concentrated industries like health insurance. Several studies of past health insurance mergers show a significant problem of underenforcement leading to consumer harm. It has been said "when insurers merge, there's almost always an increase in premiums."[12] Two separate, retrospective economic studies on health insurance mergers found significant premium increases for consumers post-merger. One study found that the 1999 Aetna-Prudential merger resulted in an additional seven percent premium increase in 139 separate markets throughout the United States.[13] Another study found that the 2008 United-Sierra merger resulted in an additional 13.7 percent premium increase in Nevada.[14] There is also economic evidence that a dominant insurer can increase rates 75 percent higher than smaller insurers competing in the same state.[15] Studies show that cost savings from reduced payments from providers are generally not passed on to consumers.[16] There are also studies showing that, conversely, increasing competition leads to lower premiums.[17]

Substantially expanding the efficiencies defense, as Anthem and its supporting amici have requested, would prove disastrous if applied to mergers generally. The District of Columbia is a common venue for the DOJ to file merger injunction cases, therefore it is especially important that the appellate court adopt sound and well-developed merger enforcement policy.

—By David Balto, Law Offices of David A. Balto PLLC

David Balto is a former policy director of the Federal Trade Commission Bureau of Competition and a former antitrust lawyer at the U.S. Department of Justice.

DISCLOSURE: David Balto is counsel of record on behalf of amici curaie American Antitrust Institute, Consumers Union, Consumer Action, Consumer Federation of America, U.S. PIRG, Sergeants Benevolent Association, California Reinvestment Coalition, Connecticut Citizen Action Group and Universal Health Care Foundation of Connecticut in their brief urging the court to uphold the lower court's decision to block the Anthem-Cigna merger. He also runs the Coalition to Protect Patient Choice, which advocates for consumer rights in health insurance and pharmaceutical matters.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] United States v. Anthem, No. 17-5024 (D.C. Cir. filed Feb. 10, 2017)

[2] United States v. Brown Shoe Co., 179 F. Supp. 721, 738 (E.D. Mo. 1959), aff'd 380 U.S.

294 (1962); see also Herbert J. Hovenkamp, Appraising Merger Efficiencies at 5 (January 12, 2017), Geo. Mason L. Rev. (forthcoming), U Iowa Legal Studies Research Paper No. 16-02, available at https://ssrn.com/abstract=2664266.

[3] 386 U.S. 568, 580 (1967) (explaining that although some mergers may result in efficiencies, the Court “"struck the balance in favor of protecting competition").

[4] See, e.g., Saint Alphonsus Medical Center-Nampa, Inc. v. St. Luke's Health sys., Ltd, 2014 WL 407446 (D.Id. Jan. 24, 2014), aff'd, 778 F.3d 775 (9th Cir. 2015).

[5] Hovenkamp, supra at 2.

[6] Antitrust Division, United States Department of Justice, Merger Guidelines I (1968), available at http://www.justice.gov/sites/default/files/atr/legacy/2007/07/11/11247.pdf.

[7] U.S. Dep’t of Justice & Fed. Trade Comm’n, Horizontal Merger Guidelines § 10 (2010), available at http://www.ftc.gov/os/2010/08/100819hmg.pdf.

[8] Hovenkamp, supra at 3.

[9] Diana L. Moss, Delivering the Benefits? Efficiencies and Airline Mergers (November 21, 2013), available at https://ssrn.com/abstract=2547673.

[10] Thomas Greaney, Efficiencies in Merger Analysis: Alchemy in the Age of Empiricism? in Economic Theory and Competition Law at 205, (Josef Drexl, Laurence Idot & Joel Monéger (eds.), Edward Elgar (2009).

[11] Moss, supra at 3-6.

[12] David Lazarus, As Health insurers merge, consumers’ premiums are likely to rise, L.A. TIMES (July 10, 2015 4:00 AM), available at http://www.latimes.com/business/la-fi-lazarus-20150710-column.html.

[13] Leemore Dafny et al., Paying a Premium on Your Premium? Consolidation in the US Health Insurance Industry, 102 Am. Econ. Rev. 1161 (2012).

[14] Guardado et al. The Price Effects of a Large Merger of Health Insurers: A Case Study of United-Sierra, 1(3) HEALTH MANAGEMENT, POL’Y & INNOVATION 1 (2013).

[15] Eugene Wang and Grace Gee, Larger Insurers, Larger Premium Increases: Health insurance issuer competition post-ACA, TECH. SCI. (Aug. 11, 2015), available at http://techscience.org/downloadpdf.php?paper=2015081104.

[16] Evaluating the Impact of Health Insurance Industry Consolidation: Learning from Experience, The Commonwealth Fund (Sep. 20, 2015), available at http://www.commonwealthfund.org/publications/issue-briefs/2015/nov/evaluating-insurance-industry-consolidation.

[17]E.g., Steven Sheingold, Nguyen Nugyen, and Andre Chappel, Competition and Choice in the Health Insurance Marketplaces, 2014-2015: Impact on Premiums, ASPE. Issue Brief (July 27, 2015), available at https://aspe.hhs.gov/sites/default/files/pdf/108466/rpt_MarketplaceCompetition.pdf.

All Content © 2003-2017, Portfolio Media, Inc.