EPSTEIN BECKER GREEN
Health Care & Life Sciences
CLIENT ALERT

Health Care Industry Vertical Transactions: Expect Intensified Antitrust Reviews Despite Recent Government Setback

By Stuart M. Gerson, E. John Steren, Patricia M. Wagner, and Olivia Seraphim

July 2018

While federal officials have stated their intent to persist in questioning vertical relationships that they hypothesize cause downstream economic effects on product flow and prices, a recent loss by the Department of Justice ("DOJ") in district court in the highly publicized case of *United States v. AT&T and Time Warner*[1] underscores the challenges that enforcement agencies face in pursuing vertical activity. But rather than abandon their evolving antitrust theories as to vertical relationships, federal enforcers seem committed to their current tack and will likely modify and amplify their economic arguments in challenging future vertical arrangements. Given the significant number of pending and predicted vertical transactions in the health care industry, that space may prove to be a convenient testing ground for new enforcement actions.

This Client Alert provides a brief review of the recent decision in the *AT&T/Time Warner* case and illustrates the concerns that remain.

United States v. AT&T and Time Warner

DOJ filed its complaint on November 20, 2017, urging the U.S. District Court for the District of Columbia to enjoin AT&T and DirecTV from acquiring Time Warner. DOJ alleged that the transaction would lessen competition in violation of section 7 of the Clayton Act, 15 U.S.C. § 18. Much of DOJ's argument rested on the assertion that the merged company would have increased leverage against competitors and could force the raising of prices by controlling access to downstream video content resulting from the positioning of Time Warner's Network, which includes TNT, CNN, and HBO and holds the rights to popular cable television programs, such as *Game of Thrones, NCAA March Madness,* and the *PGA Championship*.

[1] *United States v. AT&T and Time Warner,* No. 17-cv-02511 (D.D.C. June 12, 2018), *available at* https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2017cv2511-146.

Section 7 of the Clayton Act prohibits mergers (whether horizontal or vertical) that are likely to substantially lessen competition in any defined market. In analyzing claims under section 7, courts employ a burden-shifting approach. As the District Court explained, "[T]he Government first must establish its prima facie case by 1) identifying the relevant product and geographic market and 2) showing that the proposed merger is likely to 'substantially lessen competition' in that market." If the government satisfies this burden, then the burden shifts to "defendants to 'provide sufficient evidence that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition.'" This can be done with evidence that "post-merger efficiencies will outweigh the merger's anticompetitive effects." If the defendants can rebut the government's prima facie case, then "the burden of producing additional evidence of anticompetitive effects shifts to the [government], and merges with the ultimate burden of persuasion, which remains with the [government] at all times."

In its complaint and at trial, DOJ alleged that the proposed merger would violate section 7 because (1) the merged company would have the power to raise the prices that competing video distributors pay for the popular TV network package controlled by Time Warner's Network, and that those cost increases would be directly passed on to consumers; (2) the merger "would enable the merged company to impede disruptive competition from online video distributors," such as Netflix and Amazon Prime, and that "the merged firm would have the incentive and ability to charge more" for Turner's popular shows in order to "impede entrants" into the online video distribution market that would threaten its high profit margins; and (3) the merged entity would prevent rival distributors from using HBO as a promotional tool to attract customers.

The District Court accepted the proposition that vertical mergers "'are not invariably innocuous,' but instead can generate competitive harm '[i]n certain circumstances.'" However, the court concluded that the government had not "met its [ultimate] burden of proof of establishing, through 'case-specific evidence,' that the merger of AT&T and Time Warner … is likely to substantially lessen competition…." In making this determination, the District Court cited the government's own expert testimony that supported the proposition that the merger would result in significant cost savings to consumers due to the elimination of what is referred to as "double marginalization," which occurs when profit margins at different levels of distribution are stacked upon one another.

In addition, the District Court, in rejecting the DOJ's contention of likely harm to competition, (1) determined that internal business documents generated by lower-level employees did not express the beliefs or views of higher-level decision makers and were not representative of how the merged entity would operate; (2) discounted, as inherently biased, competitor testimony regarding the likely impact on their costs of AT&T's control over a significant programming input; (3) concluded that it would not be profitable to withhold programming from Time Warner in a fashion that would extract higher prices; (4) determined that there was no supportable economic analysis of a potential increase in prices due to the merger; and (5) found no reasonable incentive for the parties to utilize their new position to foreclose competition.

Courts are empowered only to decide the cases that are presented to them. In the instant case, observers generally conceded that the government had not put on a strong case. In particular, DOJ primarily relied upon a single expert, whose views were derived from a single analytical study. When the expert, who was countered by a battery of competing economists, was confronted with the fact that the study upon which he relied had been modified without his being informed, his testimony lost a great deal of its force. The bottom line, however, is that, while the result might smart, DOJ's Antitrust Division left the court knowing that this type of dispute is justiciable and that the agency can meet its pleading and proof burdens with a better-focused presentation in the future.

Forward-Looking Views of the Federal Enforcement Agencies

Given this high-profile loss, it might be reasonable to assume that government enforcers would be reluctant to wade back into this water. But that would be out of character. Recall that the string of defeated challenges to horizontal hospital transactions gave birth to a new economic theory—namely, willingness to pay and related economic modeling instrumental to the federal enforcement agencies' success as of late.

In a speech delivered earlier this year, Bruce Hoffman, the Director of the Federal Trade Commission's Bureau of Competition, disclosed that the federal enforcement agencies have each challenged approximately one vertical merger a year since 2000, and several investigations were ongoing. Despite acknowledging that a majority of vertical mergers are beneficial because they "reduce cost and increase the intensity of interbrand competition," Mr. Hoffman stated that not all vertical transactions are "benign." He specifically identified three areas of concern with vertical transactions. First, a vertical merger could deter new entry to the extent that it requires a two-stage entry, i.e., entry at both levels of the vertical transaction.

Second, vertical transactions may result in anticompetitive foreclosure raising rivals' costs or making it more difficult for new entry. This is among the concerns raised in Statement 9 of the *Statements of Antitrust Enforcement Policy in Health Care* relating to vertical transactions in multiprovider health care networks. Dominant networks with exclusive arrangements may make it difficult for new networks to form.

Finally, Mr. Hoffman noted that vertical transactions may lead to anticompetitive behavior due to information sharing about a rival. The example given was the vertical integration of an upstream manufacturer with a downstream distributor. The manufacturer may not know much about its rival's costs and prices, but the downstream distributor might and could use that information to make it more difficult to compete at the manufacturer level, and facilitate collusion among manufacturers.

There are several pending mergers involving large health insurers and, given recent and proposed changes in health care payment methodologies, the health care space could offer government enforcers and private plaintiffs alike fertile ground to challenge vertical arrangements. The foregoing discussion suggests how this might be done and, while the government might be licking its wounds today, a wounded animal poses an aggressive threat to those who enter the jungle.

* * *

This Client Alert was authored by **Stuart M. Gerson, E. John Steren, Patricia M. Wagner,** *and* **Olivia Seraphim.** *For additional information about the issues discussed in this Client Alert, please contact one of the authors or the Epstein Becker Green attorney who regularly handles your legal matters.*