

Going Vertical: The Hospital-Health Insurer Merger

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In today's health care reform environment, "efficient health care delivery," "stemming soaring health care costs," and "improving outcomes" are just a few of the many often-stated goals. The proper role of antitrust enforcement in achieving these goals remains a hot topic of debate. Consolidation through mergers and other forms of integration are not new in the health care industry, but interest in such transactions as potential tools, or obstacles, for health care reform continues to grow. The analysis of competition in health care mergers has typically focused on horizontal mergers, such as hospital mergers, health insurance company mergers, pharmacy benefit plan mergers, or physician practice group mergers. Vertical mergers, such as mergers between hospitals and health insurers, however, have not been extensively studied or investigated. While economic theory indecisively suggests that vertical integration can be either efficiency enhancing or anticompetitive, we may now have a live experiment in Allegheny County, Pennsylvania in which to examine the competitive effects—and impact on the health care reform goals—of a hospital-health insurer merger.

In a closely watched case in 2010, the U.S. Court of Appeals for the Third Circuit reinstated a Pittsburgh hospital's antitrust lawsuit against a competing hospital and the area's largest health insurer. *West Penn Allegheny Health System, Inc. v. UPMC; Highmark, Inc.*, 627 F.3d 85 (3d Cir. 2010). Now the relationship between the two hospitals and the health insurer has taken a new twist with the acquisition of the plaintiff hospital by the defendant health insurer.

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Allegheny County Health Care

Grown from the acquisition of several independent hospitals in the 1990s, the University of Pittsburgh Medical Center (UPMC) is the region's largest hospital system with 20 hospitals and an operating income of \$240 million in 2010. Its closest competitor, West Penn Allegheny Health System (West Penn), was formed in 2000 from the merger of several financially distressed medical providers. Today, West Penn is failing financially, as reflected by its \$92 million operating loss in 2010.

Highmark, Inc. (Highmark) was formed in 1996 through the consolidation of two Blue Cross and Blue Shield Association licensees in Pennsylvania and is now the largest health insurer in Allegheny County with an operating income of \$675 million in 2010. Highmark funded the formation of West Penn in 2000 with a \$125 million loan. Highmark's closest competitor in the Pittsburgh area is UPMC Health Plan, Inc., a subsidiary of UPMC.

In 2009, West Penn filed an antitrust lawsuit against UPMC and Highmark alleging a "mutual protection" conspiracy—i.e., that the defendants had conspired to eliminate competition in their respective markets in order to create a "super monopoly"—in violation of Sections 1 and 2 of the Sherman Act. West Penn claimed that, in 2002, UPMC and Highmark reached an agreement under which UPMC agreed to use its power in the provider market to prevent Highmark's competitors from gaining market share, and, in return, Highmark agreed to help weaken West Penn. The District Court dismissed the case. 2009 WL 3601600 (W.D. Pa., 2009).

In 2010, the Third Circuit reinstated West Penn's case, finding that West Penn had sufficiently alleged direct evidence of an agreement between UPMC and Highmark to protect each other from rivals. The Third Circuit cited West Penn's allegations that Highmark refused to refinance its loan to West Penn out of fear of retaliation from UPMC. Similarly, the court noted

that West Penn further alleged that Highmark would not increase its reimbursement rates to market levels for West Penn, also out of fear of retaliation from UPMC.

The remanded case is still pending against UPMC in the District Court. West Penn dismissed its case against Highmark when the insurer agreed to purchase West Penn.

Experiment in Vertical Integration

The Pittsburgh region appears to be a prime candidate for testing the costs and benefits of a vertical merger between a health insurer and a hospital. It is clear that the status quo does not work; the region's largest hospitals and health insurers are engaged in an ongoing legal battle, the second largest hospital system is on the brink of financial ruin, and, according to research by the Allegheny Conference, health care costs in Pittsburgh are substantially higher than in similar markets, relative to the quality of care.

In June 2011, Highmark announced a \$475 million deal to acquire financially failing West Penn. The deal is pending state regulatory approval. While the antitrust lawsuit between West Penn and UPMC continues, former co-defendants UPMC and Highmark are now apparent rivals in the health care provider market.

When Highmark announced its intent to acquire West Penn in 2011, contract renewal negotiations regarding payor rates between Highmark and UPMC began to break down. At the time, a spokesperson for UPMC stated that “[h]aving announced its intention to compete with UPMC as a provider, there cannot be any reasonable prospect for a contract renewal between Highmark and UPMC.” The contract, set to expire on June 30, 2012, affects people with individual Highmark insurance policies and those with group policies through an employer.

State lawmakers sought a legislative resolution to the dispute, and the Pennsylvania Insurance Department considered ways to delay the June 2012 deadline to give more time for a possible resolution between the parties and to provide employers and consumers adequate time to consider alternative health care options. Governor Tom Corbett also brokered a mediation between the parties. In December 2011, Highmark and UPMC reached a temporary contract agreement under which Highmark customers can continue receiving in-network rates at UPMC hospitals and from UPMC physicians through June 30, 2013.

Efficiency-Enhancing or Anticompetitive

Federal and state agencies, as well as the courts, have been actively considering the potential anticompetitive effects of the vertical integration. In promoting the acquisition to state regulators, Highmark has said that it is acquiring West Penn to preserve competition by bolstering the failing West Penn as the only competitor to UPMC. Nonetheless, the U.S. Department of Justice Antitrust Division (DOJ) opened an investigation into whether the proposed acquisition may violate the antitrust laws. The transaction was not reportable under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended; therefore, the DOJ's investigation suggest some level of heightened interest in, and scrutiny of, the deal by the antitrust agency. In the ongoing lawsuit between West Penn and UPMC, the District Court also raised potential antitrust concerns when it ordered the affiliation agreement between Highmark and West Penn to be made public with limited redactions. 2012 WL 512681 (W.D.Pa., 2012) In its order, the District Court noted that "[i]f UPMC continues its contractual relationship with Highmark, then arguably Highmark would be in control of, in whole or in part, or at least influence, pricing at the two dominant hospital systems in this regions, potentially leading to

further antitrust concerns.” State regulators are continuing their review of the transaction, which they anticipate concluding later in 2012.

On April 10, 2012, the DOJ announced its decision to close its investigation, stating that “the affiliation agreement [between Highmark and West Penn] likely will not reduce competition in the markets for hospital, physician or health insurance services.” The DOJ concluded that potential anticompetitive effects from the vertical agreement were not likely for several reasons. First, because the hospital market in the region is highly concentrated, there is not likely to be another hospital system with which Highmark can partner and vertically integrate. Second, West Penn was not likely to independently promote entry, or expansion, of another health insurer for the region. Further, West Penn’s need to increase its patient volume remains an incentive for it to offer competitive rates to other health insurers. Finally, the affiliation agreement is not likely to facilitate horizontal collusion between health plans because other health insurers are actively trying to enter the market and win market share from Highmark.

As this health care drama continues to play out in Allegheny County, there is little doubt that animosity continues between the players. In West Penn’s attempt to continue its antitrust lawsuit against UPMC, it is seeking to file an amended complaint alleging that UPMC engaged in predatory practices that lead to West Penn’s financial demise. During the course of the ongoing public relations campaign waged by both Highmark and UPMC to obtain public and lawmaker favor, Highmark sued UPMC for alleged false advertising. Additionally, Highmark refused to sign a one-year contract for UPMC’s newest hospital that will open in July 2012, arguing that it would prefer to obtain a long-term contract with UPMC. Most recently, there are reports that Highmark is actively recruiting physicians to affiliate with West Penn to strengthen its ability to compete in the hospital service market with UPMC.

Beyond these strained relationship between the parties, the DOJ noted several new market developments in its investigation. For example, national health insurers recently obtained more competitive contracts with UPMC, likely increasing the competition in the region's health insurance market. Additionally, the capital contribution from Highmark to West Penn is hoped to improve competition in the region's hospital market. Thus, the DOJ's conclusion was that this vertical merger is likely to be efficiency enhancing. Time, however, will tell. Ultimately, will this prove to be competition at its best or at its worst?

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