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CLIENT MEMORANDUM

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Takeaways from the DOJ's UnitedHealth-Change Healthcare Merger Loss

- The DOJ recently lost its challenge to the UnitedHealth-Change Healthcare merger, a case in which the government raised both horizontal and vertical concerns and objected to the parties' proposed divestiture to a private equity firm.

- This case is significant because it demonstrates that a "fix-it-first" strategy can work and a private equity fund can be an acceptable divestiture buyer, and because the government has once again failed to prove a vertical theory of competitive harm.

Recently, Judge Carl J. Nichols of the United States District Court for the District of Columbia denied the request of the United States Department of Justice (DOJ) and two states to enjoin the proposed merger of UnitedHealth Group and Change Healthcare. Judge Nichols found that the government failed to prove that the transaction, which includes a divestiture proposed by the parties, is likely to substantially lessen competition in violation of Section 7 of the Clayton Act. The $13 billion deal was announced on January 6, 2021.

The Parties and the Transaction. UnitedHealth Group has several lines of business, including commercial health insurance and "first-pass claims editing" software, which is sold through its Optum subsidiary. First-pass claims editing is a process used by insurers to help make determinations as to whether claims should be paid. Change also operates a first-pass claims editing business, as well as an electronic data interchange (EDI) clearinghouse. As the court described, EDI clearinghouses "enable the electronic transmission of claims, remittances, and other information between and among payers [i.e., insurers] and [healthcare] providers." As such, EDI clearinghouses gain access to large amounts of claims data. The merger has both horizontal and vertical aspects: it would combine two first-pass claims editing software providers and it would combine an EDI clearinghouse (Change) with an insurer (UnitedHealth Group).

The Government's Challenge to the Transaction. The government asserted horizontal and vertical theories of harm to competition. The horizontal theory is relatively straightforward. The government argued that the merger would combine two competitors in a market for the sale of first-pass claims editing solutions, resulting in UnitedHealth having more than a 90 percent share of the market. The vertical harms asserted by the government arise from UnitedHealth gaining control over Change's EDI clearinghouse and using that control to disadvantage rival insurers. According to the government, the merger "would give [UnitedHealth] the ability and incentive to use rivals' [claims data] for its own benefit, which in turn would lessen competition in the markets for national accounts and large group commercial health insurance," and, separately, "would give [UnitedHealth] the ability and incentive to withhold innovations and raise rivals' costs to compete in those same markets for national accounts and large group plans."

The Deal Parties' "Fix-It-First" Remedy for Horizontal Concern. To address the horizontal issue, UnitedHealth agreed that it would divest Change's first-pass claims editing business (called ClaimsXten) to TPG, a private equity firm. The government and

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the deal parties disagreed over the proper legal standard to use in evaluating the divestiture. The parties argued that the court should evaluate the entire series of transactions, including the divestiture, as a whole. The government, on the other hand, argued that the court should first evaluate the whole merger (including the ClaimsXten business) and then proceed to evaluate the effect of the divestiture. Because the legal analysis of mergers generally proceeds under a burden-shifting framework, the upshot is that the government's proposed standard would ultimately require the *parties* "to prove that there is *no* competitive harm" instead of requiring the *government* "to prove that there is *substantial* competitive harm."

The court ultimately agreed with the parties to the transaction that the merger and divestiture should be evaluated as a whole, but that "[i]n any event . . . the evidence leads to the same result under either standard": a conclusion "that competition in the post-divestiture market for first-pass claims editing will match, and perhaps even exceed, its current levels."

Evaluation of Private Equity Firm as Divestiture Buyer. The court determined that the divestiture of ClaimsXten to private equity firm TPG "will preserve competition in the market for first-pass claims editing." In particular, the court found that "TPG has the experience necessary to compete effectively in the claims editing market," citing testimony supporting TPG's general growth strategy, including its history of investments in R&D and pursuit of "add-on acquisitions." The court also cited testimony "that TPG earns almost all its profits by growing its businesses and then selling them for more than it paid, which aligns TPG's incentives with the performance of its investments." The court went on to find "that TPG has significant experience with 'carve-out investments,'" referencing the "successful carve-outs" of several high-profile companies. The court also found that "TPG has significant experience in the healthcare industry" and that the "evidence at trial established . . . that TPG intends to invest substantially in the ClaimsXten business." In addition, the court noted that "the scope of the divestiture package includes ClaimsXten's current senior leadership and management team—including some of the same people who elevated ClaimsXten to the top of the claims editing market."

Notably, the court rejected the government's "misplaced" argument that TPG's status as a private equity firm would cause ClaimsXten to be less competitive. To the contrary, the court found that "TPG's incentives are geared toward preserving, and even improving, ClaimsXten's competitive edge." Here, the court cited testimony from a TPG principal that TPG's return on investment would increase as the success of the company increases, and that ClaimsXten may in fact better innovate as a standalone company rather than as a "small division of a big company." Here, the court cited evidence that TPG planned to double R&D spending at the company. The court concluded that "TPG is well-positioned to maintain, and perhaps even improve upon, ClaimsXten's performance in the claims editing market."

The court also found that "the scope of the divestiture is . . . sufficient to preserve competition." Here, the court cited evidence of TPG's due diligence, through which it determined that the divestiture package will be "sufficient to operate ClaimsXten on a standalone basis," and that ClaimsXten's experienced management team "will continue to work with the business post-divestiture."

Vertical Theories. The court rejected the government's vertical theories of harm. First, the court found that the government did not satisfactorily prove that the merged company's incremental access to rival insurers' data as a result of the merger would reduce innovation in the market and therefore be likely to substantially lessen competition. After observing that UnitedHealth's Optum subsidiary already has access to much data and that the government did not offer evidence of the quantity or value of additional data Optum would gain access to, the court went on to find that "United's incentives to protect external customers' data outweigh its incentives to 'misuse' that data." Here, the court reasoned that "Optum currently pursues a multi-payer business strategy," "the success of that strategy turns on payers and providers trusting that their data will be protected," "Optum has strong incentives to preserve these relationships," and "doing so requires maintaining customers' trust that their data and [competitively sensitive information] will not fall into the hands" of UnitedHealth's insurance unit. The court also cited evidence of Optum's practice of not sharing payer data with UnitedHealth's insurance unit, citing the existence of information firewalls within UnitedHealth, provisions regarding data sharing in the company's customer contracts, and the company's adherence to these firewalls and contracts. Finally, the court found that the government failed to introduce evidence from UnitedHealth's rival insurers that they would reduce innovation because of the merger.

The court went on to reject the government's theory that UnitedHealth would withhold so-called "integrated platforms" from its insurer rivals, thereby driving up their costs. (As described by the court, integrated platforms are "EDI-related innovations" that "are intended to reduce administrative waste and speed up payment to providers.") Here, the court found that integrated platforms are "'concepts,' *not* actual products." Regardless, according to the court, "the evidence did not establish" that UnitedHealth would be likely to withhold such products from its rivals, citing evidence that "it currently markets all of its payment integrity products to [its] biggest rivals." Ultimately, the court credited UnitedHealth executives' testimony that the company would continue to do business with other insurers over the government expert's "independent weighing of costs and benefits."

Significance. The outcome in this case is significant for several reasons.

First, the opinion sets forth a legal framework for evaluating transactions where the parties themselves propose a remedy for competitive concerns. Notably, the framework identified by the court in this case is more favorable to the deal parties than the government, ultimately requiring the government to show that even with a proposed divestiture the deal likely poses "*substantial* competitive harm." This is of particular significance given the Antitrust Division's current stated approach of being less amenable to settling and more willing to litigate merger cases.

Second, the court's findings with respect to the suitability of TPG (a private equity firm) as a divestiture buyer are especially notable in light of the DOJ Antitrust Division's aversion to private equity. In April, the current head of the Antitrust Division said that "too often partial divestitures ship assets to buyers like private equity firms who are incapable or uninterested in using them to their full potential." Later he said: "Very often settlement divestitures [involve] private equity firms [often] motivated by either reducing costs at a company, which will make it less competitive, or squeezing out value by concentrating [the] industry in a roll-up." These statements stand in contrast with the court's findings about the transaction at issue here. The statements also contrast with the Antitrust Division's Merger Remedies Manual, published toward the end of the prior administration and now withdrawn, which stated that "in some cases a private equity purchaser may be [a] preferred" purchaser of divestiture assets. Notably, the court favorably cited the manual's discussion of private equity several times in its opinion. The upshot is that companies divesting assets and private equity firms considering buying assets to be divested can take note of the numerous lines of evidence supporting the court's finding that the divestiture will be sufficient to preserve competition.

Third, the court's findings with respect to the government's vertical theories of competitive harm are notable both because of the government's increasing willingness to challenge vertical deals and because, with this case, the government has now lost both of the vertical merger challenges it has brought in recent years (the other being the DOJ's challenge to AT&T's acquisition of Time Warner in 2018). To be sure, several vertical deals were abandoned by the parties in the face of government challenges, but those challenges were not litigated to judgment in court.

Fourth, as is apparent throughout its opinion, the court gave great weight to evidence of the real-world conduct of the parties over the economic theories posited by the government, and to the lack of real-world evidence supporting the government's theories. For example, at one point the court observed that "the central problem with [one of the government's claims] is that it rests on speculation rather than real-world evidence that events are likely to unfold as the Government predicts" and that "antitrust theory and speculation cannot trump facts."

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