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Anthem/Cigna; Aetna/Humana: As DOJ Staff Reviews Near Finish Line, a Closer Look at Ongoing State Approval Process, Timing Issues, Missouri Disapproval Setback for Aetna/Humana

Timing Update

As DOJ staff reviews of the proposed Anthem/Cigna and Aetna/Humana transactions near the finish line, DOJ has retained outside economic experts in both investigations, according to a source familiar with the matter. Although hiring potential testifying economists is fairly typical in competitively complex reviews, and does not guarantee that staff will ultimately recommend litigation, the move does speak to the Division's readiness to pursue a full-stop challenge to one or both transactions.

Likely near-term DOJ staff recommendations come against a backdrop of increasing timing uncertainty around the Anthem/Cigna transaction. In a May 6 securities filing, Cigna disclosed that the Anthem acquisition may not obtain requisite governmental approvals until 2017. And on May 22, the Wall Street Journal reported that Anthem and Cigna are at odds over any number of matters related to the merger review process—a situation that both sides fear could substantially delay the regulatory process.

Cigna's disclosure speaks to the unique timing issues at play in both transactions. Given concurrent state insurance department reviews, and close state/DOJ coordination, the parties lack timing leverage, therefore increasing the risk of a protracted, and potentially deal-killing, review timeline.

Of the two deals, Anthem/Cigna, which has obtained just 11 of 26 required state approvals, clearly faces the more onerous state approval pathway. As a result, the transaction faces significant risk of delay, or an outcome where a wave of state insurance department disapprovals follow a DOJ motion for full-stop injunction. Aetna/Humana, by contrast, appears relatively better positioned, having already obtained 15 of 20 required state approvals, and, by virtue of a favorable set of states outstanding, more likely to realize a favorable timing and outcome result.

That said, Aetna/Humana suffered a setback late yesterday, May 24, when the Missouri Department of Insurance, in an extensive written decision, issued a preliminary order concluding that the merger would violate competitive standards in the state's individual commercial and small group markets, as well as individual and group MA markets. In the event that Aetna consummates its Humana acquisition as initially proposed, the order states, the combined firm must "cease and desist from doing business in the State of Missouri" in the relevant product lines. Approval from Missouri, a Form E state, is not actually a condition to the Aetna/Humana merger's close. That said, Missouri is the first state to conclude that the deal would violate competitive standards, and the decision will provide deal opponents some momentum going forward.

The Missouri order is preliminary, and before it becomes final, which will not occur for at least 30 days, the order notes that the parties "may submit a plan to remedy the anticompetitive effect of the acquisition." Aetna will almost certainly work with the department in order to fix the issues—which may be addressable through the same remedies necessary to satisfy DOJ—namely, divestiture of overlapping MA plans. That said, Missouri's conclusion that the deal would violate competitive standards not just in the MA market, but also individual and small group commercial, may present additional barriers in devising an acceptable remedy.

A Closer Look at Timing

Given ongoing state reviews, HSR timeline inapplicable. Under the Hart-Scott-Rodino Act (HSR), parties enjoy significant control over the DOJ merger review timeline. Specifically, after the parties certify substantial compliance with the second request, the agency is bound to a 30-day time clock—the expiration of which removes the HSR bar to close. In practice, parties to large, competitively complex deals typically agree to extend the statutory waiting period, in order to, for example, secure meetings with the front office, or negotiate remedies. That said, the HSR timeline does provide parties substantial leverage through which to force the agency's hand on timing.

The fact that the Aetna/Humana and Anthem/Cigna deals require multiple state insurance department approvals, however, complicates this timing calculus. Like the HSR Act, state statute typically prescribes a timing process for state insurance department review. In Connecticut, for example, a public hearing is to be held no later than 30 days after the applicants' Form A is deemed complete, and a decision issued not later than 30 days after the public hearing's conclusion.

For applicants, however, the hang-up lies primarily in having the Form A declared complete. "The insurance commissioner has tremendous, and almost unfettered authority on the timing side of evaluating the Form A," explains a former state insurance department official. As a result, state insurance commissioners maintain very substantial control over timing. "There's absolutely nothing an applicant can do to accelerate the Form A process or force things along—these things go at about whatever pace the insurance department wants it to go," the former official continues.

The process in Connecticut, Cigna's domiciliary state, illustrates the issue. Anthem filed its Connecticut Form A on September 22, 2015, and, in response to the Department's December 30, 2015 request for additional information, an amended and restated Form A on February 17, 2016. Although over 8 months have elapsed since the initial filing, the Department has not yet deemed Anthem's submission complete. "Once the application is considered complete then by law we'll have a public hearing 30 days after that, but we're still quite a ways away," explains CDI spokesperson, Donna Tommelleo, who notes that the CDI is nonetheless "actively reviewing the application."

A second state timing issue is that, unlike the HSR waiting period's expiration, which requires no DOJ action, insurance transactions require state insurance departments' affirmative approval. Even once the Form A is accepted, and a public hearing held, then, commissioners may choose to simply ignore the statutory timeline, and therefore prevent a deal's close. And, in situations in which state insurance departments extend the waiting period for good cause, or are not bound to a statutory timeline in the first place (as is the case with California's Department of Managed Health Care), applicants, again, lack any real mechanism through which to accelerate timing.

Chicken or the egg issue may drive delay; state/DOJ coordination increases threat. Unlike DOJ merger review, then, parties to state insurance department reviews have effectively no way to accelerate the timing process. And this interplay creates something of a problem for the parties in controlling timing at the federal level.

Especially in deals with no ex-US component, the HSR waiting period's expiration is typically the last outstanding condition to close. In the pending managed care transactions, however, until the parties have obtained all, or at least a critical mass of, state insurance department approvals, the HSR waiting period's expiration has limited practical effect. The parties, then, face something of a chicken or the egg timing problem—there is no real plausible mechanism through which to accelerate state reviews, and, as a result, no real way to apply timing pressure to DOJ through the HSR mechanism.

Exacerbating the issue is the fact that, according to sources familiar with ongoing state reviews, at least some departments are closely coordinating with, and plan to wait on action by, the Justice Department prior to making their own decisions. This coordination is especially close among Democratic state insurance commissioners, who historically have worked collaboratively with Democratic Justice Departments, and oftentimes have issued decisions contemporaneously.

Timing—potential deal-killer. The interplay between DOJ and regulators not bound by HSR timing requirements has the potential to drive substantial delay and, ultimately, broken deals. In DOJ's recent Halliburton/Baker Hughes review, for example, the HSR waiting period expired on or around December 15, 2015. Given ongoing European Commission review (and concomitant bar on close), however, DOJ simply took no action. Roughly four months later, on April 6, 2016, DOJ filed a lawsuit seeking to enjoin the transaction, and the parties, already more than 17 months into the review process, abandoned their merger plans shortly thereafter.

Halliburton/Baker Hughes is just one of a number of deals DOJ has scuttled in recent months through extending timing in conjunction with non-HSR bound regulators. In Comcast/Time Warner Cable (14+ months from announcement to collapse), for example, DOJ worked closely with the FCC (which investigates mergers according to a non-binding "shot clock"), to drive a deal break without litigation. And in Applied Materials/Tokyo Electron (19+ months), DOJ collaborated with global regulators including MOFCOM and the KFTC to achieve the same result.

In short, protracted merger review timelines are the enemy of any deal. And if DOJ (or the Administration) harbors concerns about permitting one or both transactions to proceed, the concurrent state reviews give DOJ significant leverage to draw out timing, and therefore increase the likelihood that the parties will opt to abandon their transactions. Put differently, as has proven to be the case repeatedly in recent months, regulatory timing leverage is, to a large extent, outcome leverage as well.

That said, the deal at greater risk of protracted regulatory delay, Anthem/Cigna, has substantial protection—the merger agreement provides that, in the event the only outstanding to condition to close is HSR or state approval, either party may unilaterally extend the end date to April 30, 2017. The Aetna/Humana merger agreement is less generous, providing that either party, if the only outstanding closing condition involves HSR or state approval, may extend the end date to December 31, 2016.

Aetna/Humana—structural advantages drive early success. Although both deals, in theory, face similar timing issues, in practice, Aetna/Humana clearly occupies the stronger position. According to an Aetna spokesman, the Humana transaction has already secured 15 of the 20 necessary state approvals (including five in the past two months). And competitive merits of the respective deals aside, Aetna/Humana has benefitted from a number of structural advantages in the state review process.

First, Wisconsin is Humana's domiciliary state, and therefore the company's domestic regulator. Wisconsin's Insurance Commissioner Ted Nickel, a Gov. Scott Walker appointee, came to the Wisconsin OCI after 18 years as an insurance lobbyist, and is reportedly "crystal clear" about his desire to return to the private sector. Unsurprisingly, Nickel proved uninterested in deal opponents' arguments, and approved Aetna/Humana unconditionally, on April 15. Although empowered to act separately, state insurance departments typically look to the domiciliary state in multi-state reviews—and Wisconsin's approval, although expected, was an important win for Aetna.

Perhaps more importantly, on February 15, Aetna won approval in Florida—Humana's largest state by membership, and a state in which the parties have substantial overlap. In approving the deal subject to minor conduct remedies, Florida Insurance Commissioner Kevin McCarty handed the parties a substantial victory, concluding that traditional Medicare and Medicare Advantage effectively occupy the same relevant product market. Florida's decision, which appears to be the only substantive written decision issued by any state insurance department (prior to Missouri's May 24 decision), has proven hugely important for Aetna. "That decision in Florida has been marched out to a dozen insurance commissioners now in a very strong fashion in individual states," notes a source opposed to the deal.

A final structural advantage from which Aetna/Humana benefits is the fact that may of the deal's most competitively problematic states do not actually harbor Humana subsidiaries, and therefore do not require insurance department approval for changes in control. Specifically, Aetna is not required to file any notification in Iowa (combined 64% of statewide MA lives) or Kansas (90%), while in Missouri (52%) and West Virginia (85%), Aetna must submit a Form E filing only.

Structural advantages aside, the source opposed to the deal notes that Aetna's approach to state reviews, from timing and process standpoints, has proven extremely effective. "Just generally speaking, you can't compare the way the two do the state processes—Aetna knows how to do this stuff, "says a source. "You see it in the California hearing, just the way they had the efficiencies story in a much stronger fashion than Anthem did—Aetna's just doing this process a lot stronger," the source continues.

The favorable state path forward for Aetna/Humana. Adding to reasons for optimism around the Aetna/Humana state process is the fact that the transaction's outstanding required approvals present largely favorable terrain. At the outset, three of the five remaining states, Texas (7.4% of Humana's policyholders) Georgia (4.7%), and Illinois (3.2%), are Republican-led, and are therefore, as a general matter, less likely to credit deal opponents' arguments or pursue disapproval.

Of the Republican-led states, Georgia, where Commissioner Ralph Hudgens is the state's elected Insurance Commissioner, appears to be the only jurisdiction with any likelihood of driving a tough line. The GID has been slow to move on Aetna's Form A (filed July 23, 2015), and, according to a source, has retained an outside economist to conduct a thorough competitive review of the transaction "The commissioner is a pro-business, conservative, Republican kind of guy. However, he's an elected official, he cares about his constituents," says the source. "I definitely do know he is taking it very seriously, he is really seriously looking at it."

In California, where 3.5% of Humana's policyholders reside, the deal is subject to approval from a Democratic-appointed regulator—the DMHC's Shelley Rouillard. Humana's primary business in California, however, is Medicare PDP, and the Aetna/Humana medical membership overlap in the state is extremely limited. As such, although Rouillard is likely to seek at least some conditions on the merger, outright DMHC disapproval, or extended timing delay, appears unlikely. The same is likely to be true of the final outstanding approval, New York, where Humana's presence is likewise extremely limited.

Given favorable outstanding terrain, coupled with existing approval from Florida and Wisconsin, Aetna may be well-positioned to accelerate timing at the state level and, consequently, the federal level. Wisconsin's approval is especially important in this context, given that states typically defer to the target's domestic regulator in multi-state reviews. "That's really what we're looking for, if the domestic regulator is comfortable with it—and indeed once that occurs, most of the time, we're done," explains the former state insurance department official.

In short, none of Aetna/Humana's outstanding Form A states appear likely candidates for extended timing delay or full-stop disapproval. And this circumstance may impact not only DOJ timing, but also, to some extent, outcome. As a general matter, in the event that DOJ were to pursue a full-stop challenge to a multi-state managed care deal, outstanding state insurance departments, and Democratic-led insurance departments in particular, would be viewed as likely to join with follow-on disapprovals. Such an outcome would substantially complicate the litigation path to close, given that the parties would not only need to defeat DOJ in court, but then convince disapproving insurance commissioners, who apply different, and much broader, substantive law, to walk back disapproval. With the majority of state approvals already obtained, and important outstanding approvals required primarily from Republican-led states hesitant to align themselves with the current Administration, however, the risk of this outcome in Aetna/Humana is significantly diminished.

Anthem/Cigna—a tougher road ahead. Anthem/Cigna, by contrast, faces a number of structural disadvantages at the state level. At the outset, the transaction simply requires approval from a greater number of state regulators—26, rather than Aetna/Humana's 20.

From a domiciliary perspective, Anthem/Cigna likewise faces a tougher road, given Cigna's domicile in Connecticut. Connecticut Insurance Commissioner Katharine Wade, at first glance, appears a highly favorable draw—Wade worked as a lobbyist for Cigna for over 20 years, and her husband is currently employed as an attorney for the company. Despite these apparent conflicts of interest, deal opponents remain optimistic that Wade, in order to avoid any appearance of impropriety, will adopt a tough line on the deal. And, at the very least, from a timing perspective, Wade has clearly done the parties no favors—especially compared to Humana's domestic regulator, Wisconsin.

Aside from the domiciliary state issue, Anthem/Cigna, relative to Aetna/Humana, simply faces a tougher lineup of required state approvals. The deal has obtained just 11 state approvals, of a required 26. However, these approvals have come almost exclusively from Anthem non-Blue states, where the firms' overlap is generally minimal.

In Anthem's 14 Blue states (12 of which require Form A filings), however, the company typically already controls very high shares on both the buy-side and sell-side—an issue the Cigna deal will exacerbate substantially. "I think one of the issues with Anthem is in those states where they have the Blue plans, that is generally huge market share. And that's the major issue, where in most states, I would say Aetna's the third largest carrier," notes a former state insurance commissioner, in describing Anthem's state approval challenges. And of the 12 Anthem Blue states in which the Cigna transaction requires approval, only Kentucky, the least substantial overlap state (Cigna's statewide ASO share is just 2.7%), appears to have approved the deal thus far.

Of the remaining 11 Anthem Blue states, seven are led by Democratic insurance commissioners, who, as a general matter, are both more receptive to merger opponents' arguments, and more likely to coordinate with the Justice Department. Given that a substantial majority of state insurance commissioners are either Republican-appointed or

Republican elected officials, the fact that most Anthem Blue states are Democratic-led is an unhelpful circumstance—and will prove especially so in the event that DOJ pursues a full-stop injunction to the merger.

Given the composition of outstanding Anthem/Cigna state approvals, DOJ will have substantial confidence that, in the event of a full-stop challenge, a number of state insurance departments will follow on with disapprovals in relatively short order. Such a scenario, of course, would substantially complicate the parties' litigation path to close, and consequently, render front office concerns about litigation risk, oftentimes the primary barrier to a full-stop challenge, substantially less pressing.