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What the last nail in the Anthem-Cigna coffin means for the healthcare industry

The end of the Anthem-Cigna merger gives other large payers "a chance to see how the Trump administration redefines the rules of the game," Numerof & Associates' Michael Abrams said.

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One attorney summed up the turn that the failed $54 billion merger between two health insurance giants had taken when he said Anthem "had Cigna tied up in the back seat." Cigna attorney William Savitt of Wachtell, Lipton, Rosen & Katz was illustrating in court how dysfunctional the communication between the two payers and relationship had gotten.

After many months of legal wrangling and finger-pointing, the plan that would have created the largest insurer in the country is officially not going to happen. The merger was originally challenged by the U.S. Department of Justice (DOJ) in July 2016.

But as the companies fought the federal government's antitrust concerns, they began to turn on each other. After dueling lawsuits, Anthem found itself on the losing end of several decisions and terminated the merger last week.

The saga isn't over yet.

But now that Anthem-Cigna is dead, some clarification on what the commotion was all about is needed to understand what both the health insurance and hospital industries could expect to see in future M&A activity.

What now?

Anthem and Cigna both reported healthy financials earlier this year while the deal was still on. However, the Q1 2017 earnings reports that Aetna and Humana posted after their failed merger suggest that Anthem is likely to suffer substantial financial losses and Cigna will likely receive a significant boost in its financials. That is if Cigna gets its way and makes Anthem pay up. Humana pointed to the failed merger for the massive increase in its net income – from $254 million in Q1 2016 to $1.1 billion – during the first quarter, while Aetna largely attributed its $381 million loss to it.

If Anthem and Cigna want to continue to pursue M&A deals, they will have to make sure that the next deal looks substantially different. "They would have to convince the Department of Justice or perhaps a court that the next deal is not like this deal, that the judge's opinion about this deal doesn't apply to the next deal," Mitchell Raup, an antitrust attorney of Polsinelli, told Healthcare Dive.

And it's not likely to be with a close competitor. Mergers with close competitors are the kinds of deals that catch the attention of federal antitrust enforcement, Martin Gaynor, professor of economics and health policy at Carnegie Mellon University, recently told Healthcare Dive.

Michael Abrams, managing partner at Numerof & Associates, believes that any future merger proposed by either Anthem or Cigna is going to look different in scale as they will want to avoid getting back on the DOJ's radar. An M&A deal that either of these companies would want to pursue in the future will likely involve much smaller, regional organizations and it will depend on where they want to grow their business.

"Payers are going to continue to look for ways to reduce the direct and indirect cost through local market partnerships and vertical integration," Abrams told Healthcare Dive. "They'll probably also give more attention to non-regulated diversified businesses and they'll continue to invest in creating populations with specific expertise to manage the health and risk of particular populations like Medicare or Medicaid populations and so on."

Who are the winners and losers?

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Despite the government's successful blocking of M&A deals both in the health insurance and in the hospital industries, this activity has not slowed down this year, according to recent reports from PwC and Kaufman Levin Associates. "As long as providers believe that they can find safety in size, they will continue to consolidate and as long as that continues, then payer consolidation will continue as well," Abrams said. "It's kind of a war of who can get bigger faster and build more influence."

However, Abrams argued that the industries should expected to see more vertical consolidation rather than horizontal. "In the same way that it looks attractive for a delivery organization to start its own insurance subsidiary, it looks attractive for a payer to start to buy a healthcare delivery organization," Abrams said.

It's pretty clear who the losers are from the failed merger. There are more winners that will benefit from the transaction not being completed than just the obvious ones like the DOJ, including other large payers and the Centers for Medicare and Medicaid Services (CMS). But the winners must learn from where Anthem-Cigna went wrong to avoid making the same mistakes that ended up costing both companies billions of dollars.

The end of the Anthem-Cigna merger "isn't altogether negative for the remaining large payers," Abrams said.

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“It gives them a chance to see how the Trump administration redefines the rules of the game,” Abrams said. “In the meantime, the cash that they had saved up for acquisition can be used for share buybacks and smaller mergers that won’t get on the radar at the DOJ.”

With regards to insurance coverage on the Affordable Care Act’s exchanges, Abrams argued that “if you took those two payers [Anthem and Cigna] and made them into one, the scope of their offerings across the country on the exchanges is such that they might have had significant clout with CMS in terms of the premiums that they would be allowed to charge,” he said.

> **“The failure of this merger and some of the other large payer mergers actually makes CMS a bit of a winner.”**
>
> Michael Abrams
> *Managing partner, Numerof & Associates*

Abrams also thinks that hospitals and health systems that create their own health insurance enterprises are also winners in the failure of the Anthem-Cigna merger. “By preventing this consolidation at the payer level, it makes the future competitive position for a provider-owned plan a bit less risky than it would otherwise have been,” Abrams said. “In that sense, it does encourage the continued growth of provider-owned plans and I think that it encourages providers broadly speaking to look seriously at the idea of starting their own insurance subsidiary because they may feel that they can exert better control over their business.”

What was all the hoopla about?

If the merger had been allowed to go through, Anthem-Cigna would have become the largest health insurance company in the U.S. Anthem is currently the second largest payer and Cigna the fourth.

The merger was coincidentally proposed around the same time that Aetna – the third largest payer – proposed to purchase Humana – the fifth largest payer – for $37 billion. Both of the deals were challenged by the DOJ in July 2016, citing increased prices to consumers, hindered innovation efforts and dampened competition. The courts blocked both transactions earlier this year, but while Aetna and Humana mutually agreed to end their merger plan, Anthem forged ahead with its pending Cigna purchase.

After the Court of Appeals upheld the court blocking, Anthem confirmed that it would be taking the case to the Supreme Court, arguing that the “1960s-era merger precedents relied upon by the courts below must be updated to reflect the modern understanding of economics and consumer benefit.” But the Delaware ruling that kept Anthem from continue to prevent Cigna from leaving was the final nail in the deal’s coffin.

What made it more difficult for Anthem and Cigna to prove to the judges that the combined company would be able to effectively implement the efficiencies they would seek to create was the constant infighting between the two, which would have presented a lot of challenges with integration.

If it had been completed, there would have likely been some Cigna executives that would have left as there were numerous disagreements with executives at Anthem. “Anthem would’ve directed how to do business and Cigna management that didn’t like it would’ve had to leave,” Raup said.

Anthem is arguing that Cigna isn’t entitled to the $1.85 billion contractual breakup fee because it “has failed to perform and comply in all material respects with its contractual obligations.” But this won’t fly with Cigna. It will “vigorously defend” and pursue its “claims for additional damages of over $13 billion against Anthem for the harm that it caused Cigna and its shareholders,” according to company filings.

M&A activity is always risky, regardless of the industry or sector. After months of fighting to have a merger go through, issues aren’t always going to end up as expected — as just proven by Anthem and Cigna. Their debate over what the breakup costs are going to be may go on for some time.

Before committing to an M&A plan, it is important to keep in mind that every merger, whether it’s between health insurance companies or between hospitals, comes with risks. On the face of it, this kind of activity makes sense but "in practice, it's not always that easy to pull off," Abrams said.