

# ANALYSIS OF AGREEMENT CONTAINING CONSENT ORDERS TO AID PUBLIC COMMENT

*In the Matter of DaVita, Inc., File No. 051 0051*

## I. Introduction

The Federal Trade Commission (“Commission”) has accepted, subject to final approval, an Agreement Containing Consent Orders (“Consent Agreement”) from DaVita Inc. (“DaVita”). The purpose of the Consent Agreement is to remedy the anticompetitive effects resulting from DaVita’s purchase of Gambro Healthcare Inc. (“Gambro”) from Gambro AB. Under the terms of the Consent Agreement, DaVita is required to divest 69 dialysis clinics and terminate 2 management services contracts in 35 markets across the United States.

The Consent Agreement has been placed on the public record for 30 days to solicit comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission will again review the Consent Agreement and the comments received, and will decide whether it should withdraw from the Consent Agreement or make it final.

Pursuant to an Agreement dated December 6, 2004, DaVita proposes to acquire Gambro from Gambro AB for approximately \$3.1 billion. The Commission’s complaint alleges that the proposed acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, by lessening competition in the market for the provision of outpatient dialysis services in 35 markets.

## II. The Parties

Headquartered in El Segundo, California, DaVita is the second largest provider of outpatient dialysis services in the United States. DaVita operates 665 outpatient dialysis clinics in 37 states and the District of Columbia at which approximately 55,000 end stage renal disease (“ESRD”) patients receive treatment. In 2003, DaVita’s revenues were approximately \$2.1 billion.

Gambro AB is a publicly-traded Swedish corporation with worldwide operations focused in three business fields: operating dialysis centers, manufacturing dialysis equipment, and providing technology and products to blood centers and hospital blood banks. Gambro is Gambro AB’s entire U.S. dialysis services business. Gambro, headquartered in Denver, Colorado, is the third largest provider of outpatient dialysis services in the United States, with 565 outpatient dialysis clinics serving approximately 43,200 ESRD patients in 33 states and the District of Columbia. In 2003, Gambro’s revenues were approximately \$1.8 billion.

### **III. Outpatient Dialysis Services**

Outpatient dialysis services is the appropriate relevant product market in which to assess the effects of the proposed transaction. For patients suffering from ESRD, dialysis treatments are a life-sustaining therapy that replaces the function of the kidneys by removing toxins and excess fluid from the blood. Most ESRD patients receive dialysis treatments three times per week in sessions lasting between three and five hours. Kidney transplantation is the only alternative to dialysis for ESRD patients. However, the wait-time for donor kidneys -- during which ESRD patients must receive dialysis treatments -- can exceed five years. Additionally, many ESRD patients are not viable transplant candidates. As a result, many ESRD patients have no alternative to ongoing dialysis treatments.

The relevant geographic markets for the provision of dialysis services are local in nature. They are limited by the distance ESRD patients are willing and/or able to travel to receive dialysis treatments. Most ESRD patients are quite ill and suffer from multiple health problems. As such, it is difficult for ESRD patients to travel long distances for dialysis treatment. Generally, ESRD patients are unwilling and/or unable to travel further than 30 miles or 30 minutes to receive dialysis treatments, depending on traffic patterns, local geography, and the patient's proximity to the nearest center. As a result, competition among dialysis clinics occurs at a local level, corresponding to metropolitan areas or subsets thereof.

Entry into the outpatient dialysis services markets addressed by the Consent Agreement on a level sufficient to deter or counteract the likely anticompetitive effects of the proposed transaction is not likely to occur in a timely manner. The primary barrier to entry is the difficulty associated with locating nephrologists with established patient pools to serve as medical directors. By law, each dialysis clinic must have a nephrologist medical director. As a practical matter, medical directors are essential to the success of a clinic because they are the primary source of referrals. The lack of available nephrologists with an established referral stream is a significant barrier to entry into each of the relevant markets. Beyond that, entry is also inhibited where certain attributes (such as a rapidly growing ESRD population, a favorable regulatory environment, average or below nursing and labor costs, and a low penetration of managed care) are not present, as is the case in many of the geographic markets identified in the Commission's complaint.

Each of the geographic markets addressed by the Consent Agreement is highly concentrated. The proposed acquisition represents a merger to monopoly in 11 markets and would cause the number of providers to drop from 3 to 2 in 13 other markets. Additionally, concentration increases significantly in the remaining 11 markets addressed by the Consent Agreement. In each of these markets, the post-acquisition HHI exceeds 4,000, and the change in HHI is at least 800. The high post-acquisition concentration levels, along with evidence of DaVita and Gambro's head-to-head competition in these markets, indicates that the combined firm would be able to exercise unilateral market power. The evidence shows that health insurance companies and other private payors who pay for dialysis services used by their

members benefit from direct competition between DaVita and Gambro when negotiating the rates to be charged by the dialysis provider. As a result, the proposed combination likely would result in higher prices and diminished service and quality for outpatient dialysis services in many geographic markets.

#### **IV. The Consent Agreement**

The Consent Agreement effectively remedies the proposed acquisition's anticompetitive effects in 35 markets where both DaVita and Gambro operate dialysis clinics by requiring DaVita to divest -- prior to acquiring Gambro -- 68 outpatient dialysis clinics to Renal Advantage and one outpatient dialysis clinic to its medical directors and their partners. The Consent Agreement also requires DaVita to terminate two management services agreements pursuant to which it manages outpatient dialysis clinics on behalf of third-party owners. As with the divestitures, termination of these management services agreements will ensure that these clinics remain viable independent competitors.

As part of these divestitures, DaVita is required to obtain the agreement of the medical directors affiliated with the divested clinics to continue providing physician services after the transfer of ownership to Renal Advantage. Similarly, the Consent Agreement requires DaVita to obtain the consent of all lessors necessary to assign the leases for the real property associated with the divested clinics to Renal Advantage. These provisions ensure that Renal Advantage will have the assets necessary to operate the divested clinics in a competitive manner.

The Consent Agreement contains several additional provisions designed to ensure that the divestitures are successful. First, the Consent Agreement provides Renal Advantage with the opportunity to interview and hire employees affiliated with the divested clinics and prevents DaVita from offering these employees incentives to decline Renal Advantage's offer of employment. This will ensure that Renal Advantage has access to patient care and supervisory staff who are familiar with the clinics' patients and the local physicians. Second, the Consent Agreement prevents DaVita from contracting with the medical directors (or their practice groups) affiliated with the divested clinics for three years. This provides Renal Advantage with sufficient time to build goodwill and a working relationship with its medical directors before DaVita can attempt to capitalize on its prior relationships in soliciting their services. Third, to ensure continuity of patient care and records as Renal Advantage implements its quality care, billing, and supply systems, the Consent Agreement allows DaVita to provide transition services for a period of 12 months. Firewalls and confidentiality agreements have been established to ensure that competitively sensitive information is not exchanged. Fourth, the Consent Agreement requires DaVita to provide Renal Advantage with a license to use DaVita's policies and procedures, as well as the option to obtain DaVita's medical protocols, which will further enhance Renal Advantage's ability to provide continuity of care to patients. Finally, the Consent Agreement requires DaVita to provide prior notice to the Commission of its planned acquisitions of dialysis clinics located in the 35 markets addressed by the Consent Agreement. This provision

ensures that subsequent acquisitions do not adversely impact competition in the markets at issue and undermine the remedial goals of the proposed order.

The Commission is satisfied that Renal Advantage is a qualified acquirer of the divested assets. Renal Advantage is a newly-formed company whose management has extensive experience operating, acquiring, and developing outpatient dialysis clinics. The company has received a substantial equity investment from Welsh, Carson, Anderson, and Stowe, which is the largest healthcare-focused private equity firm in the United States.

The Commission has appointed Mitch Nielson and John Strack of FocalPoint Medical Consulting Group (“FocalPoint”) as Monitors to oversee the transition service agreements, and the implementation of, and compliance with, the Consent Agreement. Messrs. Nielson and Strack are the principles of FocalPoint, which provides consulting services to the healthcare industry.

The purpose of this analysis is to facilitate public comment on the Consent Agreement, and it is not intended to constitute an official interpretation of the proposed Decision and Order or the Order to Maintain Assets, or to modify their terms in any way.