ANALYSIS OF AGREEMENT CONTAINING CONSENT ORDERS
TO AID PUBLIC COMMENT
In the Matter of DaVita, Inc., File No. 111-0103

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 CDSI I Holding Company, Inc. ("DSI"). Under the terms of the Consent Agreement, DaVita is required to divest 28 dialysis clinics and terminate one management contract in 22 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 February 4, 2011, DaVita proposes to acquire DSI for approximately $689 million. 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 for the provision of outpatient dialysis services in 22 markets.

The Parties

Headquartered in Denver, Colorado, DaVita is the second largest provider of outpatient dialysis services in the United States. DaVita operates 1,612 outpatient dialysis clinics in 42 states and the District of Columbia at which approximately 125,000 end stage renal disease ("ESRD") patients receive treatment. In 2010 DaVita's revenues were approximately $7.63 billion.

DSI, headquartered in Nashville, Tennessee, is a privately held company and the fifth largest provider of outpatient dialysis services in the United States. DSI operates 106 dialysis centers, providing dialysis services to approximately 8,000 patients in 23 states.

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 one market and would cause the number of providers to drop from three to two in fifteen other markets. Additionally, concentration increases significantly in the remaining six markets addressed by the Consent Agreement. In each of these markets, the post-acquisition HHI level exceeds 3,500, and the change in HHI is more than 170. The high post-acquisition concentration levels, along with the elimination of DaVita and DSI'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 DSI when negotiating rates charged by dialysis providers. 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.

The Consent Agreement

The Consent Agreement effectively remedies the proposed acquisition's anticompetitive effects in 22 markets where both DaVita and DSI operate dialysis clinics by requiring DaVita to divest -- prior to acquiring DSI -- 29 outpatient dialysis clinics to Dialysis Newco, Inc., a corporation formed by Frazier Healthcare and New Enterprise Associates ("Frazier/NEA").

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 Frazier/NEA. 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 Frazier/NEA. These provisions ensure that Frazier/NEA 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 Frazier/NEA with the opportunity to interview and hire employees affiliated with the divested clinics and prevents DaVita from offering these employees incentives to decline Frazier/NEA's offer of employment. This will ensure that Frazier/NEA 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 Frazier/NEA 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 Frazier/NEA 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 Frazier/NEA with a license to use DSI's policies, procedures, and medical protocols, as well as the option to obtain DaVita's medical protocols, which will further enhance Frazier/NEA'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 22 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 Frazier/NEA is a qualified acquirer of the divested assets. Dialysis Newco, Inc. is a newly-formed company whose management has experience operating, acquiring, integrating, and developing outpatient dialysis clinics. The company has received a substantial equity investment from Frazier, a firm with a dedicated focus on healthcare, and NEA, the world's largest venture capital firm with over $10.5 billion under management.

The Commission has appointed Richard Shermer of R. Shermer & Co. as an Interim Monitor to oversee the transition service agreements, and the implementation of, and compliance with, the Consent Agreement. Mr. Shermer assists client companies undergoing regulator-mandated ownership transitions, including experience with transitions of outpatient dialysis clinics.

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.