

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: William E. Kovacic, Chairman
Pamela Jones Harbour
Jon Leibowitz
J. Thomas Rosch

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In the Matter of)	
)	
Inova Health System Foundation,)	
a corporation, and)	Docket No. 9326
)	[Public Record Version]
Prince William Health System, Inc.)	
a corporation.)	
_____)	

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Respondents Inova Health System Foundation (“Inova”) and Prince William Health System, Inc. (“PWHS”), having entered into a merger agreement, which if consummated would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint pursuant to Section 11(b) of the Clayton Act, 15 U.S.C. § 21(b), stating its charges as follows:

NATURE OF THE CASE

1. The merger of Inova and PWHS (“the Merger”) will reduce vital competition and result in higher prices and reduced non-price competition for general, acute care inpatient hospital services in Northern Virginia. Although health plans are the direct customers of Respondents, higher prices for hospital services are passed on to employers, unions, and other group purchasers of health insurance plans and - ultimately - are borne by the individuals and families residing in Northern Virginia.

2. Both Inova and PWHS provide high quality general, acute care inpatient hospital services to health care consumers in Northern Virginia.¹ Inova already is the dominant hospital system in Northern Virginia. With the Merger, Inova would eliminate a critical head-to-head competitor, PWHS, and control over 73 percent of licensed hospital beds in Northern Virginia, dwarfing its only four remaining independent competitors.
3. Unless prevented, the combination of these two financially sound, high-quality hospitals will reduce competition and result in significantly higher prices and reduced non-price competition for hospital services and amenities provided to health care consumers. These consumers include health insurance plans, employers, unions, and ultimately the citizens of Northern Virginia, many of whom will not be able to afford these higher prices and will be forced to reduce or even drop their health insurance coverage. Indeed, the respondents do not dispute that health care prices will increase as a result of the merger. It is also indisputable that higher healthcare costs will result in fewer residents of Northern Virginia receiving medical care, including hospital services, and, thus, those not able to purchase medical care likely will suffer adverse health effects.

BACKGROUND ON INOVA AND PWHS

4. Respondent Inova, a corporation, is the largest hospital system in Northern Virginia with its office and principal place of business located at 8110 Gatehouse Road, Falls Church, Virginia 22042. Inova operates five inpatient general, acute care hospitals and provides other health services, including emergency and urgent care centers, home care, nursing homes, wellness classes, and mental health and blood donor services. Inova has grown primarily through acquiring its competitors, including Loudoun Hospital in 2005 and Alexandria Hospital in 1997. A little over ten years ago, Inova owned three hospitals and faced eight independent competitors. The Inova hospitals combined have approximately 1,892 licensed beds in Northern Virginia. For 2006, Inova had a total net operating revenue of \$1.8 billion and operating income of \$132 million.

¹ Northern Virginia encompasses the Commonwealth of Virginia's Health Planning Region II plus Fauquier County.

5. The five hospitals that Inova operates throughout Northern Virginia are listed below.

Inova Health System Hospitals

<u>Inova Hospital</u>	<u>Location</u>	<u>Licensed Beds²</u>
Inova Fairfax Hospital	Falls Church, VA	884
Inova Alexandria Hospital	Alexandria, VA	334
Inova Fair Oaks Hospital	Fairfax, VA	182
Inova Loudoun Hospital	Leesburg, VA	255
Inova Mt. Vernon Hospital	Alexandria, VA	237
	Total:	1892

6. Respondent PWHS is a corporation with its headquarters and principal place of business located at 8700 Sudley Road, Manassas, VA 20110. PWHS operates a single general, acute care inpatient hospital with 180 licensed beds located in Manassas, Virginia. In 2006, PWHS had a total net operating revenue of \$170.5 million and operating income of \$5.2 million. PWHS' primary service area includes western Prince William County and the cities of Manassas and Manassas Park.

JURISDICTION

7. Inova and PWHS are, and at all relevant times have been, engaged in commerce or in activities affecting commerce, within the meaning of Section 7 of the Clayton Act. Inova's merger with PWHS constitutes an acquisition under Section 7 of the Clayton Act.

THE MERGER

8. Pursuant to an agreement dated August 1, 2006, Inova intends to merge with PWHS and integrate PWHS into the Inova system.

COMPETITION BETWEEN INOVA AND PWHS BENEFITS CONSUMERS

9. Like many general acute care hospitals, the Inova hospitals and PWHS sell acute care inpatient hospital services to a variety of commercial health plans. These health insurance plans reduce health care costs by encouraging hospitals to compete vigorously on price and non-price terms. They do so by contracting with hospitals in an area and providing financial incentives to encourage its enrollees to use the hospitals with which it contracts.

² Estimates are approximate.

10. Hospitals compete for inclusion in health insurers' plan networks by offering preferential prices for the services that they provide to the plan's enrollees. Hospitals that do not offer competitive pricing risk exclusion from a health plan's network, especially if there are substitutes for the excluded hospital.
11. Competition among hospitals for inclusion in those networks has lowered, and will continue to lower or constrain, the cost of health care services, ultimately lowering the costs to consumers and taxpayers, while continuing to make high-quality health care available.
12. Hospitals also compete for patients on the basis of quality, customer service, location, price, and cost-effectiveness.
13. The primary health insurers in Northern Virginia are: Aetna, Inc.; Anthem Plans of Virginia; CIGNA; CareFirst, Inc.; Kaiser Foundation Health Plan; and United Healthcare.
14. These health insurers compete by developing and selling health plans on the basis of the breadth and quality of their networks, as well as on the premiums they offer and their benefits structure. Employers or group purchasers and their individual and family members purchase access to a health plan network that will provide them with a menu of physician and hospital options if diagnosis or treatment is required. Health insurers, therefore, generally try to offer a network health plan with a broad range of attractive and convenient physician and hospital services.
15. Competition between Inova and PWHS currently constrains the rates that the merging parties, particularly PWHS, are able to negotiate with health plans. When hospitals compete for patients, health plans can threaten explicitly or implicitly during negotiations to exclude a hospital and substitute a competing hospital in its place. This threat of substitutability increases health plans' bargaining leverage during negotiations with hospitals. Health plans in Northern Virginia currently have the option of contracting with Inova and not contracting with PWHS. This threat forces PWHS to offer competitive rates which helps keep health care costs affordable to employers in the area.
16. [

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17. Because of their quality, convenience, and location, Inova Fair Oaks and Fairfax are PWHS' closest competitors. In 2006, over 87 percent of all residents in PWHS' primary service area (the region comprising 75 percent of PWHS' discharges in the relevant product market) who were hospitalized were admitted to PWHS or an Inova hospital. Hospitals other than Inova Fair Oaks and Fairfax – specifically Fauquier and Potomac Hospitals – have only small shares in PWHS' primary service area. Health plans also view Inova as the next best substitute for PWHS in setting up their networks. As a result, PWHS views Inova Fair Oaks and Fairfax as its primary competitors.

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PRODUCT MARKET

19. The relevant product market in which to analyze the Merger is general, acute care inpatient hospital services sold to private payors, including commercial health plans. General acute care inpatient hospital services are a broad cluster of basic medical and surgical diagnostic and treatment services that include an overnight stay in the hospital by the patient. General acute care inpatient hospital services exclude: (a) services at hospitals that serve solely children, military personnel and veterans; (b) services at outpatient facilities that provide same-day service only; (c) sophisticated services known in the industry as “tertiary” services such as open heart surgery and transplants; and (d) psychiatric, substance abuse, and rehabilitation services.

20. Patients who require acute care inpatient hospital services must be admitted to a general acute care inpatient hospital by a physician with admitting privileges at that hospital.

GEOGRAPHIC MARKET

21. The relevant geographic market in which to analyze the Merger is an area no larger than Northern Virginia or the Commonwealth of Virginia's Health Planning Region II (“HPR II”) and Fauquier County. HPR II is a geographic region designated by the Commonwealth of Virginia as a healthcare planning region for Certificate of Public Need purposes and as such represents Virginia's view that the area is a distinct healthcare area for purposes of determining healthcare needs and licensing facilities. HPR II includes the counties of Arlington, Fairfax, Loudoun, and Prince William, as well as the independent cities of Alexandria, Fairfax, Falls Church, Manassas, and Manassas Park.

22. Hospitals and systems outside of the relevant geographic market do not compete with respondents for the provision of general, acute care inpatient services in the relevant geographic market. Few patients who live within the relevant geographic market travel

outside its borders to seek these general, acute care inpatient services in, for example, Maryland or Washington, D.C. hospitals. In 2006, for the hospitals located in Northern Virginia, approximately 90 percent of their patients came from Northern Virginia. Of the patients who reside in Northern Virginia, approximately 90 percent go to hospitals in Northern Virginia.

23. The explanation for these patterns is simple. Patients prefer to be admitted to a high quality general acute care hospital close to where they live. Therefore, patients perceive only conveniently-located hospitals that provide quality care to be acceptable for general acute care inpatient hospital services.

CONCENTRATION

24. There is a limited number of suppliers of general, acute care inpatient services in the relevant geographic market. In addition to the Inova Hospitals and PWHS, there are only four other suppliers of general, acute care inpatient services in the relevant geographic market: Fauquier Hospital (86 licensed beds) in Warrenton, Virginia; Reston Hospital Center (187 beds) in Reston, Virginia; Virginia Hospital Center (334 beds) in Arlington, Virginia; and Potomac Hospital (153 beds) in Woodbridge, Virginia. Although treated herein as if it were an independent competitor, Potomac Hospital claims it is an “Affiliate of Inova Health System” based on an affiliation and loan agreement between Inova and Potomac Hospital and a right of first refusal for Inova to purchase Potomac.
25. The Merger would leave only five firms in the relevant market. As shown below, Inova would control 73 percent of the licensed hospital beds in Northern Virginia.

Northern Virginia Hospital Shares by Beds

<u>Hospitals in Northern Virginia</u>	<u>Licensed Beds</u>	<u>Share</u>
Prince William Hospital (Manassas)	170	6.0
Inova Hospital System	1,892	67.0
Potomac Hospital (Woodbridge)	153	5.4
Fauquier Hospital (Warrenton)	86	3.0
Reston Hospital Center (HCA) (Reston)	187	6.6
Virginia Hospital Center (Arlington)	334	11.8

26. The U.S. Department of Justice and the Federal Trade Commission have issued *Horizontal Merger Guidelines* (“*Merger Guidelines*”) that provide the analytical framework used by the U.S. antitrust enforcement agencies in assessing the effects of proposed mergers. Under the *Merger Guidelines*, market concentration is measured with the Herfindahl-Hirschman Index (“HHI”). Markets in which the post-merger HHI is

above 1800 are highly-concentrated, and mergers that produce an increase in the HHI (the “delta”) of more than 100 are presumed likely to create or enhance market power or facilitate its exercise and are presumed to be unlawful.

27. A little more than ten years ago, Inova owned three hospitals and faced eight independent competitors. It then started acquiring its competitors including Alexandria Hospital in 1997 and Loudoun Hospital Center in 2005. With the Merger, Inova would acquire yet another competitor and control 73 percent of the general, acute care inpatient hospital services in Northern Virginia, leaving just four independent competitors. The Merger would increase the HHI (measured by beds) in the market for general, acute care inpatient hospital services in Northern Virginia from 4754 to 5562, an increase of 808. Measured by privately-insured discharges, the Merger would increase the HHI in the relevant product and geographic markets from 4810 to 5784, with an increase of 974. Measured by inpatient revenue from commercial payors, the Merger would increase the HHI in the relevant product and geographic markets from 5635 to 6174, with an increase of 539. Under all of these measures, as seen below, the HHI in the relevant product and geographic market and its delta are well above the level at which the Merger is presumptively unlawful under the *Merger Guidelines*.

**Shares of Estimated Inpatient Revenue
From Commercial Payors in Northern Virginia, 2006**

	Inpatient Revenue	Pre-Merger		Post-Merger	
		Share of Revenue	HHI	Share of Revenue	HHI
Inova Health System	\$601,455,520	74.0%	5,481	77.7%	6,033
Prince William Hospital	\$29,584,030	3.6%	13		
Fauquier Hospital	\$22,023,952	2.7%	7	2.7%	7
Northern Virginia Community Hospital	\$1,534,024	0.2%	0	0.2%	0
Potomac Hospital	\$34,225,648	4.2%	18	4.2%	18
Reston Hospital Center	\$61,105,764	7.5%	57	7.5%	57
Virginia Hospital Center	\$62,478,488	7.7%	59	7.7%	59
Total	\$812,407,426	100.0%	5,635	100.0%	6,174
Delta HHI					539

Source: VHI 2006 Hospital Detail Report

**THE MERGER WOULD ELIMINATE
BOTH PRICE AND NON-PRICE COMPETITION**

28. As described in Paragraphs 17 through 20, above, Inova and PWHS are currently close competitors for the provision of general, acute care inpatient services in the relevant geographic market of Northern Virginia. Because one of the key factors influencing bargaining leverage for a health plan is the availability of independent substitutes for the negotiating hospital, a merger of close substitutes eliminates this competitive discipline. After the Merger, health plans will no longer have the threat of excluding PWHS because it will be part of the Inova system, which is currently PWHS' closest substitute. Without this competitive discipline, Inova, negotiating the rates of PWHS, will force health plans to pay higher prices for services from PWHS.
29. Without PWHS as an independent alternative hospital for health insurers' plans, Inova also will gain additional bargaining leverage in its negotiations with health insurers. This increased leverage for both PWHS and Inova will lead to higher prices and higher health care costs for employers, health plan enrollees, and consumers in the relevant geographic market.
30. [
- Redacted**
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31. [
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32. Higher hospital prices to health insurers' plans lead directly to higher health care costs to the plans' members. While higher prices will harm all consumers, the increases will have the most significant impact on small employers and their employees. Several small employers in Northern Virginia have stated that providing health insurance is a significant financial burden and fear that a price increase postmerger may prevent them from offering health insurance to their employees in the future. Other small employers who aspire to offer their employees health insurance believe that if health care costs increase, they will be precluded from that alternative. As a result, the employees will suffer the consequences from less health care insurance and foregoing the care they can no longer afford.

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ENTRY IS DIFFICULT

34. It is unlikely that entry into the market would remedy, in a timely manner, the anticompetitive effects of the Merger. A new hospital, or expansion of an existing hospital, sufficient to defeat a price increase or other anticompetitive effect would likely take three years or longer. In addition to planning and construction lead times, such projects would require state regulatory approval which can take a significant amount of time. Competitors like Inova can and do oppose such approvals in administrative and judicial proceedings, substantially prolonging the approval process.

THE MERGER WILL NOT RESULT IN EFFICIENCIES

35. The Merger is not necessary to permit the parties to achieve substantial efficiencies. Currently, the quality of PWHS' services is comparable to, and at times superior to, the quality of Inova's services, as measured by numerous objective quality criteria. Accordingly, Inova is unlikely to improve PWHS' quality of service or to help generate other efficiencies sufficient to offset the Merger's anticompetitive effects.
36. PWHS is a financially sound institution with the capacity to fund capital investments and quality improvements on its own or with another merger partner. Indeed, PWHS is currently successfully engaged in capital investment and quality improvement projects.

VIOLATION

37. The allegations of Paragraphs 1 through 38 are incorporated by reference as though fully set forth herein.
38. The Merger of Inova and PWHS, if consummated, would substantially lessen competition in the provision of general, acute care inpatient hospital services in Northern Virginia in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18.

NOTICE

Notice is hereby given to the respondents that the eighth day of August, 2008, at 10:00 a.m., or such later date as determined by an Administrative Law Judge of the Federal Trade Commission, is hereby fixed as the time and Federal Trade Commission offices, 600 Pennsylvania Avenue, NW, Room 532, Washington, D.C. 20580, as the place when and where a hearing will be had before an Administrative Law Judge of the Federal Trade Commission, on the charges set forth in this complaint, at which time and place you will have the right under the Federal Trade Commission and Clayton Acts to appear and show cause why an order should not be entered requiring you to cease and desist from the violations of law charged in the complaint.

Pending further order of the Commission, the Commission will retain adjudicative responsibility for this matter. *See* § 3.42(a) of the Commission's Rules of Practice for Adjudicative Proceedings. The Commission hereby allows you 20 days from the date of service of this Complaint upon you to file either an answer or a dispositive motion. If you file a dispositive motion within that time, your time for filing an answer is extended until 10 days after service of the Commission's order on such motion. If you do not file a dispositive motion within that time, you must file an answer. An answer in which the allegations of the complaint are contested shall contain a concise statement of the facts constituting each ground of defense; and specific admission, denial, or explanation of each fact alleged in the complaint or, if you are without knowledge thereof, a statement to that effect. Allegations of the complaint not thus answered shall be deemed to have been admitted.

If you elect not to contest the allegations of fact set forth in the complaint, the answer shall consist of a statement that you admit all of the material facts to be true. Such an answer shall constitute a waiver of hearings as to the facts alleged in the complaint and, together with the complaint, will provide a record basis on which the Administrative Law Judge shall file an initial decision containing appropriate findings and conclusions and an appropriate order disposing of the proceeding. In such answer, you may, however, reserve the right to submit proposed findings and conclusions under § 3.46 of the Commission's Rules of Practice for Adjudicative Proceedings and the right to appeal the initial decision to the Commission under § 3.52 of said Rules.

Failure to answer within the time above provided shall be deemed to constitute a waiver of your right to appear and contest the allegations of the complaint and shall authorize the Administrative Law Judge, without further notice to you, to find the facts to be as alleged in the complaint and to enter an initial decision containing such findings, appropriate conclusions, and order.

The Administrative Law Judge will schedule an initial prehearing scheduling conference to be held not later than 14 days after the last answer is filed by any party named as a respondent in the complaint. Unless otherwise directed by the Administrative Law Judge, the scheduling

conference and further proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, NW, Room 532, Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the prehearing scheduling conference, and Rule 3.31(b) obligates counsel for each party, within 5 days of receiving a respondent's answer, to make certain initial disclosures without awaiting a formal discovery request.

NOTICE OF CONTEMPLATED RELIEF

Should the Commission conclude from the record developed in any adjudicative proceedings in this matter that the Merger of Inova and PWHS challenged in this proceeding violates Section 7 of the Clayton Act, as amended, the Commission may order such relief against respondents as is supported by the record and is necessary and appropriate, including, but not limited to:

1. If the merger is consummated, divestiture of PWHS, and associated assets, in a manner that restores the hospital as a viable, independent competitor in the relevant market, with the ability to offer such services as PWHS was offering and planning to offer prior to its acquisition by Inova.
2. A ban, for a period of time, on any transaction between Inova and PWHS that combines their hospitals or other health facilities in any section of the country, except as may be approved by the Commission.
3. A requirement that, for a period of time, Inova provide prior notice to the Commission of acquisitions, mergers, consolidations, or any other combinations of its hospital or other health facilities in the relevant markets with other hospitals or health facilities in the relevant market.
4. A requirement to file periodic compliance reports with the Commission.
5. Any other relief appropriate to correct or remedy the anti-competitive effects of the transaction or to restore PWHS as a viable, independent competitor in the relevant market.

IN WITNESS WHEREOF, the Federal Trade Commission has caused this complaint to be signed by its Secretary and its official seal to be hereto affixed, at Washington, D.C. this eighth day of May, 2008.

By the Commission, Commissioner Rosch not participating.

SEAL:

Donald S. Clark
Secretary