UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the matter of Evanston Northwestern Healthcare Corporation,	Docket No. 9315 **Public Record**

RESPONDENT'S PROPOSED POST-TRIAL CONCLUSIONS OF LAW

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Pursuant to the Court's Order on Post Trial Briefs on April 6, 2005, and Rule 3.46 of the Federal Trade Commission Rules of Practice ("Rules"), 16 C.F.R. § 3.46, Respondent Evanston Northwestern Healthcare Corporation ("ENH") hereby submits its Proposed Conclusions of Law.

I. COMPLAINT COUNSEL BEARS THE BURDEN OF PERSUASION AS TO EVERY ELEMENT OF ITS SECTION 7 CLAIM

1. In its Complaint, Complaint Counsel alleges that the merger between Highland Park Hospital ("HPH") and Evanston and Glenbrook Hospitals[1] (the "Merger") violated Section 7 of the Clayton Act. Compl. ¶¶ 28-32. Section 7 provides in pertinent part:

> No person . . . shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . of another person . . . where . . . the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

15 U.S.C. §18 (2005).

2. Complaint Counsel bears the burden of proving every element of its Section 7 claim. *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 116-17 (D.D.C. 2004).

3. The paradigm for merger litigation was set forth in *United States v. Baker Hughes, Inc.*, and followed by numerous courts as well as the Commission. First, the government must establish a presumption that the merger will substantially lessen competition by producing evidence of undue concentration in a relevant geographic and product market. *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982 (D.C. Cir. 1990). If the government establishes such a presumption, the burden of producing evidence to rebut this presumption then shifts to the defendant. *Id.* Following the defendant's production of evidence, the burden of producing additional evidence of anti-competitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times. *Id.* at 983. *See also FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2001); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1218 (11th Cir. 1991); *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1110 (N.D. Cal. 2004); *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 116 (D.D.C. 2004); *In re Chicago Bridge & Iron Co.*, Dkt. No. 9300, at 7-8 (2005) (Opinion of FTC Comm'n); *In re Textron, Inc.*, No. 9226, 1994 WL 16010997, at *3 (1994) (FTC Consent Order).

4. Analysis of whether a particular transaction violates Section 7 "requires determinations of (1) the 'line of commerce' or product market in which to assess the transaction, (2) the 'section of the country' or geographic market in which to assess the transaction, and (3) the transaction's probable effect on competition in the product and geographic markets." *FTC v. Staples*, 970 F. Supp. 1066, 1072-73 (D.D.C. 1997); *see United*

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[1] "HPH" refers to Highland Park Hospital; "Evanston Hospital" refers to pre-Merger Evanston and Glenbrook Hospitals when referred to in the past tense, and Evanston Hospital alone when referred to in the present tense; and "ENH" refers to all three hospitals collectively after the Merger.

States v. E.I. DuPont de Nemours, 353 U.S. 586, 593 (1957); U.S. Dept of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (1992, as amended 1997) (*hereinafter "Merger Guidelines*").

5. Additionally, to prevail on a Section 7 claim, Complaint Counsel must show more than some impact on competition – it has "the burden of showing that the acquisition is reasonably likely to have 'demonstrable and substantial anticompetitive effects.'" *New York v. Kraft Gen. Foods, Inc.*, 926 F. Supp. 321, 358 (S.D.N.Y. 1995) (*quoting United States v. Atl. Richfield Co.*, 297 F. Supp. 1061, 1066 (S.D.N.Y. 1969), *aff'd*, 401 U.S. 986 (1971)).

6. These elements are identical even when the claim relates to a merger or acquisition that has already been consummated. *See CB&I*, Dkt. No. 9300, at 7 ("We are guided in our assessment of this merger by the case law and the *Merger Guidelines*, both of which set out the general framework for our analysis and provide instruction for the issues raised on appeal.").

II. COMPLAINT COUNSEL DID NOT MEET ITS BURDEN OF PROVING THE REQUISITE RELEVANT MARKET

A. Complaint Counsel Failed To Meet Its Burden Of Proving A Relevant Market Within Which The Alleged Anti-Competitive Effects Will Occur

7. The Complaint contains two distinct counts that the Merger violated under Section 7. In Count I, Complaint Counsel alleged a relevant product and geographic market. Compl. ¶¶ 15-27. Count II contains no such allegation. Compl. ¶¶ 28-32.

8. Complaint Counsel only alleges harm with respect to one class of the hospitals' "customers," the managed care organization ("MCO").[2] Compl. ¶¶ 16, 29; Compl. Counsel's Revised Pretrial Brief at 30, 33. Courts have recognized, however, that hospitals have many other classes of customers as well, including Medicare/Medicaid, self-payors, employers and physicians. *United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121, 134 (E.D.N.Y. 1997).

1. Complaint Counsel Did Not Prove A Relevant Product Market

9. A relevant product market normally consists of "products that have reasonable interchangeability for the purposes for which they are produced — price, use and qualities considered." *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377, 404 (1956). In determining a relevant market, the actual market realities, such as customer preference or industry recognition of a product, are of key significance. *Eastman Kodak Co. v. Image Tech. Serv., Inc.*, 504 U.S. 451, 466-67 (1992); *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962); *Bon-Ton Stores, Inc. v. May Dept. Stores Co.*, 881 F. Supp. 860, 874 (W.D.N.Y. 1994); *see also Gen. Indus. Corp. v. Hartz Mountain Corp.*, 810 F.2d 795, 805 (8th Cir. 1987) (in defining the relevant product market, "the reality of the marketplace must serve as the lodestar.").

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[2] The terms "MCO" and payor are interchangeable.

10. The *Merger Guidelines* analyze the relevant product market by performing a demand-side analysis that begins with the product or service that the consumer actually purchases from the merging parties. *Merger Guidelines* § 1.1. Where the customer purchases several services together, it is those services taken as a whole that constitute the relevant product market, even when the services are not substitutable in and of themselves. *See e.g., Staples, Inc.* 970 F. Supp. 1066 1074, 1078 (market defined as consumable office supplies purchased from an office superstore because customer purchasing patterns confirmed a particular consumer demand for this set of goods as sold by office superstores); *JBL Enters., Inc. v. Jhirmack Enters., Inc.,* 698 F.2d 1011, 1016 (9th Cir. 1983) (product market consisted of lines of beauty supplies to beauty salons and professional outlets); *Bon-Ton Stores,* 881 F. Supp. 860 (department stores constitute their own product market because they offer a collection of products to a different group of customers).

11. In past hospital merger cases, where the product market has excluded outpatient services, the consumer upon whom the analysis focused was the individual patient, rather than the MCOs. *See United States v. Rockford Mem'l Corp.* 898 F.2d 1278 (7th Cir 1990); *FTC v. Butterworth Health Corp.* 946 F. Supp. 1285 (W.D. Mich. 1996); *Santa Cruz Med. Clinic v. Dominican Santa Cruz Hosp.*, 1995 WL 853037 (N.D.Cal. 1995). Complaint Counsel's identification of the MCOs as the primary customer, however, compels a new focus on the product market and compels inclusion of outpatient services in the relevant market.

12. Defining the relevant product market here as including both impatient and outpatient services comports with the *Merger Guidelines*, which begins the relevant product market by examining the services sold by each merging firm. *Merger Guidelines* § 1.1. As demonstrated in Respondent's Proposed Findings Of Fact, MCOs negotiate and purchase virtually all of a hospital's services (including inpatient and outpatient services) in the same transaction, which they package into a network or health plan that they market to employers and self-insured individuals. Respondent's Proposed Findings Of Fact ("FOF") ¶¶ 369-375. Moreover, MCOs are generally agnostic as to the actual prices negotiated for inpatient or outpatient services. (FOF ¶ 371). Instead, MCOs generally look at the total cost of *all* contracted services — inpatient and outpatient services combined. (FOF ¶¶ 370-71). Accordingly, all of the services these MCOs purchase should be included in the relevant product market.

2. Complaint Counsel Did Not Prove A Relevant Geographic Market

13. The relevant geographic market is "the 'area of effective competition . . . in which the seller operates, and to which the purchaser can practicably turn for supplies.'" *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 359 (1963) (*quoting Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961)).

14. While courts do not compel "scientific precision" in defining the geographic market, they do insist that any such market be "well-defined." *FTC v. Freeman Hosp.*, 69 F.3d 260, 268 (8th Cir. 1995); *See Id.*; *California* v. *Sutter Health Sys.*, 130 F. Supp. 2d 1109, 1120 (N.D. Cal. 2001). Consequently, "[t]he geographic market selected must both 'correspond to the commercial realities' of the industry and be economically significant." *Brown Shoe*, 370 U.S. at 336-37.

15. Under the *Merger Guidelines*, the process of defining the geographic market "begin[s] with the location of each merging firm (or each plant of a multiplant firm) ... [and] add[s] the location from which production is the next-best substitute for production at the merging firm's location." *Merger Guidelines* § 1.21. The geographic market is defined by continuing to add such firms until the collection of firms, if viewed as a single entity, would profitably raise prices above a competitive level. *Id.*

16. A geographic market is defined not just by distance, but also by travel times — which are affected by roads, traffic patterns and natural impediments such as rivers or mountains. *See e.g., Sutter Health Sys.*, 130 F. Supp. 2d at 1126 (travel time is relevant to a dynamic analysis of the geographic market); *J&S Oil, Inc. v. Irving Oil Corp.*, 63 F. Supp.2d 62, 68 (D. Me. 1999) ("Simply put, the geographic market for retail gasoline depends on how far individuals are willing and able to travel to purchase the product."). The geographic market in hospital merger cases has typically been entire counties, or even multiple counties, even in urban and suburban areas. *See e.g., Long Island Jewish Med. Ctr.*, 983 F. Supp. at 141-42; *Rockford Mem'l Corp.*, 898 F.2d at 1284-85; *Sutter Health Sys.*, 130 F. Supp. 2d at 1123; *Butterworth Health Corp.*, 946 F. Supp. at 1293.

17. Respondent's primary economic expert, Dr. Monica Noether, conducted a geographic market analysis that conforms to the economic principles underlying the *Merger Guidelines*.

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(FOF ¶¶ 392, 395, 406, 461, 474, 485). Dr. Noether considered these factors because they provide information about patients' hospital preferences which, as discussed in the findings of fact, influence managed care contracting choices. (FOF ¶¶ 156, 386, 391). An examination of all of these various factors revealed that HPH and Evanston were not close competitors of each other.

18. Complaint Counsel advocates a geographic market that encompasses only the three hospitals involved in the Merger. Compl. Counsel Interrog. Answers at 20 (FOF ¶ 498). No case involving a hospital merger has ever defined geographic market to include only the merging hospitals.

19. To the contrary, in a previous case involving the merger of two suburban metropolitan hospitals, with payors identified as one of the hospitals' consumers, the court rejected the government's proposed definition of the relevant product and geographic markets that included only the merging hospitals. *Long Island Jewish Med. Ctr.*, 983 F. Supp. at 140.

B. Section 7 Requires Complaint Counsel To Define And Prove The Relevant Market

20. Count II of the Complaint alleges neither a relevant product market nor a relevant geographic market. *See* Compl. ¶ 28. Section 7 explicitly requires proof that a merger will substantially lessen competition in a relevant market before liability is imposed, prohibiting only acquisitions that harm competition "in any line of commerce or in any activity affecting commerce in any section of the country." 15 U.S.C. § 18.

21. This portion of Section 7 has consistently been interpreted to require proof of a relevant product and geographic market. *See United States v. Gen. Dynamics Corp.* 415 U.S. 486, 510 (1974); *United States v. Marine Bancorporation*, 418 U.S. 602, 618 (1974); *Phila. Nat'l Bank*, 374 U.S. at 356; *Brown Shoe Co.*, 370 U.S. at 335; *E.I. duPont de Nemours & Co.*, 353 U.S. at 593; *Tenet Health Care Corp.*, 186 F.3d at 1051 (8th Cir. 1999); *FTC* v. *Cardinal Health* 12 F. Supp.2d 34, 45 (D.D.C. 1998). According to the legislative history, Congress intentionally viewed a properly defined relevant market as a necessary element of a Section 7 claim. *See, e.g.*, S. REP. 81-1775 at 6 (1950) ("In determining the area of effective competition for a given product, it will be *necessary* to decide what comprises an appreciable segment of the market.") (emphasis added).

22. Determination of a relevant market is necessary in order to provide a framework within which to analyze the alleged anti-competitive effects of the merger, even where the government brings a challenge years after the merger was consummated. *E.I. du Pont de Nemours & Co.*, 353 U.S. at 593 (substantial lessening of competition can be determined only in terms of the market affected); *Brown Shoe Co.*, 370 U.S. at 339 ("delineat[ing] the product and geographic markets within which the effects of th[e] merger are to be measured.") This is true even where there is alleged "direct" evidence that the merger caused anticompetitive harm in the past. In a recent decision in which the Commission analyzed the legality of a merger after it had been consummated, the Commission explicitly declined the opportunity to base Section 7 liability on "actual anti-competitive conduct" that took place after consummation of the merger. Rather, the Commission found liability under a traditional analysis based on market definition and concentration. *CB&I Dkt. No. 9300,* at 7 ("We are guided in our assessment of this merger by the case law and the *Merger Guidelines*, both of which set out the general framework for our analysis and provide instruction for the issues raised on appeal.").

23. Furthermore, the FTC's own *Merger Guidelines* require the delineation of the relevant product and geographic market before determining whether a particular merger raises competitive concerns. *Merger Guidelines* § 1.0 ("A merger is unlikely to create or enhance market power or to facilitate its exercise unless it significantly increases concentration and results *in a concentrated market, properly defined and measured* . . . ").

24. Even in cases where direct evidence of market power has been analyzed under the Sherman Act, a statute not relevant here, a relevant market must still be defined. *See Republic Tobacco Co. v. N. Atl. Trading Co., Inc.*, 381 F.3d 717, 737 (7th Cir. 2004). As the Seventh Circuit explained, the plaintiff must still define the parameters of the relevant market because proof of an anti-competitive effect "is virtually meaningless if it is entirely unmoored from at least a rough definition of a product and geographic market." *Id.*

III. COMPLAINT COUNSEL DID NOT MEET ITS BURDEN OF SHOWING THAT THE MERGER WILL CAUSE COMPETITIVE HARM

A. Mere Evidence Of Relative Price Increases Does Not Prove Competitive Harm

25. Under Section 7, Complaint Counsel is required to demonstrate that the purported anti-competitive effect was caused, and will likely continue to be caused, by the Merger. *See,*

e.g., Ricchetti v. Meister Brau, Inc., 431 F.2d 1211, 1215 (9th Cir. 1970) ("There must be a further showing that, as a result of the post merger acts, the merger has an effect on commerce which is proscribed within the meaning of all elements of Section 7"); *Smith-Victor Corp. v. Sylvania Elec. Prod., Inc.*, 242 F. Supp. 315, 320 (N.D. Ill. 1965) ("Section 7 requires more than allegations that there were mergers or acquisitions and a lessening of competition in a relevant line of commerce; it requires that the lessening of competition result from the mergers or acquisitions"). Moreover, the need to prove causation holds equally true for Section 7 claims against consummated mergers. *E.I. duPont de Nemours & Co.*, 353 U.S. at 607 (holding in a post-consummation challenge that "the test of a violation of § 7 is whether, at the time of suit, there is a reasonable probability that the acquisition is likely to result in the condemned restraints."); *Phila. Nat'l Bank*, 374 U.S. at 362.

26. In order to utilize evidence of price increases to prove that a firm possesses market power, that evidence must be accompanied by proof that the price increased above a competitive level and can be sustained at that level over a period of time, or is associated with a reduction of output. *See e.g., Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 790 n.19 (1984) ("Market power is the ability to raise prices above those that would be charged in a competitive market"); *Forsyth v. Humana, Inc.*, 114 F.3d 1467, 1476 (9th Cir. 1997) (proof of higher prices and profits, without a corresponding decrease in output, is not sufficient direct evidence to show market power); *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1411-12 (7th Cir. 1995) ("[W]hen dealing with a heterogeneous product or service, such as the full range of medical care, a reasonable finder of fact cannot infer monopoly power just from higher prices…"); *See also Geneva Pharm. Tech. Corp. v. Barr Lab., Inc.*, 386 F.3d 485, 500 (2d Cir. 2004) (noting that pricing evidence is ambiguous with respect to monopoly power in the absence of analysis of firm's costs or evidence of restricted output); *Levine v. Cent. Fla. Med. Affiliates*, 72 F.3d, 1538, 1552 (11th Cir. 1996) (evidence of rising fees is insufficient to show a detrimental effect on competition unless prices are above actual prices charged by competitors); *Rebel Oil Co. v. Atl. Richfield Co.*, 51 F.3d 1421, 1434 (9th Cir. 1995) (direct proof of market power consists of evidence showing restricted output and pricing above competitive levels); *Godix Equip. Exp. Corp. v. Caterpillar, Inc.*, 948 F. Supp. 1570, 1582 (S.D.Fla. 1996) (evidence of price increases, without showing that pricing exceeds competitive price levels within the market, is insufficient to show market power); *In re Schering-Plough Corp.*, Dkt. No. 9297, at 116 (2002) (Initial Decision) ("Pricing evidence alone is not sufficient to prove monopoly power."), *overturned on other grounds*, *In re Schering-Plough Corp.*, Dkt. No. 9297 (2003) (opinion of FTC Comm'n); *Merger Guidelines* § 0.1 ("Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.").

27. As the Commission recognized in *Chicago Bridge*, a theory of competitive harm must show an "exercise of market power [which] results in lower output and higher prices and a corresponding transfer of wealth from buyers to sellers or a misallocation of resources." *CB&I*, Dkt. No 9300, at 6-7. Indeed, Complaint Counsel's expert, Dr. Elzinga, explained that a merger is only anti-competitive if it causes prices to increase <u>and</u> output to fall. (FOF ¶ 320). Complaint Counsel's failure to prove that ENH's relative price increases were accompanied by a corresponding decrease in output of hospital services renders meaningless its evidence of relative price increases. Moreover, Respondent provided evidence that output increased. (FOF ¶ 1164).

ENH's relative price increases cannot, therefore, constitute proof of market power or competitive harm.

28. As a matter of economic theory, price increases cannot prove market power unless all competitively benign causes for those price increases have been ruled out. (FOF ¶¶ 315, 519-20). Complaint Counsel itself has acknowledged that its alleged proof of anti-competitive effects holds true only if "the direct evidence demonstrates that these undisputed relative price increases were not attributable to other factors" and "could only be attributable to market power." Compl. Counsel Pretrial Brief at 30. Complaint Counsel has ignored a variety of competitively neutral factors that could have affected prices around the time of the Merger and thus it failed to prove that the price increases were evidence of competitive harm. (FOF ¶¶ 523(d),(e),(l),(n),(p), 1023)

B. ENH's Relative Price Increases Resulted From ENH "Learning About Demand," Not Its Acquisition Of Market Power

29. The normal assumption in examining assertions of market power is that the price being charged by a firm is at least the competitive price. *CF Indus. Inc. v. Surface Transp. Bd.*, 255 F.3d 816, 824 (D.C. Cir. 2001) (*citing* IIA AREEDA & HOVENKAMP, ANTITRUST LAW ¶537b at 200). In a situation where that assumption does not apply, however, an increase in revenue by raising prices is not indicative of market power because "a firm in a fully competitive market that is pricing below market levels would expect to earn greater revenues by raising its prices to meet its competitors." *Id.* (citation omitted).

30. The evidence established that Evanston was pricing itself below competitive levels before the Merger. (FOF ¶¶ 684, 754, 796, 857, 864). The evidence further established that after the Merger, as a result of learning about the demand for its services, it raised its prices to competitive levels. (FOF ¶¶ 1110-14, 1155). Thus, Complaint Counsel has not proven that the Merger increased ENH's market power or caused competitive harm.

C. Complaint Counsel's Theory Of Competitive Harm Cannot Be Supported

31. Complaint Counsel has alleged a unilateral effects theory of competitive harm. Under such a theory, a merger may diminish competition in a "differentiated products" market where, as a result of the acquisition of market power, "merging firms may find it profitable to alter their behavior unilaterally following the acquisition by elevating price and suppressing output." *Merger Guidelines* at § 2.2.

32. A "differentiated product" market is one where the "products sold by different participants in the market are not perfect substitutes for one another." *Merger Guidelines* § 2.21. Both parties agree that the product produced by the merging parties in this case is appropriately classified as a "differentiated product." (FOF ¶ 368)

33.

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A theory of competitive harm almost identical to this was presented, and rejected by a federal court, in a case whose facts are extremely similar to this one. *Long Island Jewish Med. Ctr.*, 983 F. Supp. at 121.

34. In order to properly support a theory of unilateral effects, Complaint Counsel must show that (a) Evanston and HPH were close substitutes for each other, (b) they were sufficiently different from other hospitals in the area, such that the Merger enabled them to raise prices without losing sales to the other nearby hospitals and (c) repositioning by other firms is unlikely. *Oracle Corp.*, 331 F. Supp. 2d at 1117-18; *Merger Guidelines* at § 2.211-12. The *Merger Guidelines* generally define close substitutes as consumers' first and second choice and require that the merging parties have a combined 35% share of the relevant market. *Merger Guidelines* at § 2.211.

35. As in all determinations of market power, including those in merger cases, evidence of entry (including expansion/repositioning) is relevant. *Baker Hughes Inc.*, 908 F.2d at 987; see *Rebel Oil* 51 F.3d at 1441 ("The ability to control output and prices – the essence of market power – depends largely on the ability of existing firms to quickly increase their own output in response to a contraction by the defendant."); *United States v. Microsoft*, 253 F.3d 34, 82 (D.C. Cir. 2001); *Ball Mem'l Hospital, Inc. v. Mut. Hosp. Ins., Inc.*, 784 F.2d 1325, 1335-36 (7th Cir. 1986) (noting that a firm's market share does not imply market power where competitors may enter or expand production); *see also Oahu Gas Serv., Inc. v. Pac. Res., Inc.*, 838 F.2d 360 366-67 (9th Cir. 1988) (high market share does not imply monopoly power in a market with low entry barriers); AREEDA ¶ 501 (defining market power as the ability to raise price substantially above the competitive level *and* persist in doing so for a significant period without erosion by new entry or expansion).

36. Complaint Counsel has not proven the elements necessary to support a unilateral effects case. In setting out this theory, Complaint Counsel never identifies Evanston and HPH as close substitutes that are significantly different from other hospitals in the area. In fact, the evidence in this case shows the opposite – that ENH and HPH were not close substitutes to each other and each was more similar to other hospitals than they were to each other. (FOF ¶¶ 415, 418, 426, 538-539, 547, 557, 559, 974-83). Furthermore, Complaint Counsel never showed the existence of significant barriers to entry and expansion. Rather, the facts at trial showed recent evidence of growth and expansion among competitor hospitals and that regulatory barriers to entry will soon cease to exist. (FOF ¶¶ 390, 434, 2280-82, 2290-91, 2293-97).

D. HPH's Deteriorating Financial Condition And ENH's Community Mission Make It Unlikely That The Merger Would Cause Competitive Harm

1. Absent The Merger, HPH's Deteriorating Financial Condition Would Have Is This Our Convention Significantly Reduced Its Competitive Significance

37. The Supreme Court has held that an acquired firm with scarce future resources has far less competitive significance than its market share or present market status would otherwise indicate. *Gen. Dynamics Corp.*, 415 U.S. 486, 503-04 (1974). As a result, the acquisition of a company whose future resources were "severely limited" would not cause a reduction in competition. *Id. General Dynamics* and its progeny demonstrate that a firm need

not be destined for imminent failure in order for its weakened financial condition to be a relevant and significant factor in assessing the legality of a merger. *Id. See also Baker Hughes Inc.*, 908 F.2d at 984-86 (weakened market position used to rebut government's prima facie case); *Kaiser Aluminum & Chem. Corp. v. FTC,* 652 F.2d 1324, 1341 (7th Cir. 1981) (financial weakness of acquired firm is part of the relevant inquiry); *United States v. Int'l Harvester Co.*, 564 F.2d 769, 773-74 (7th Cir. 1977) (evidence of a weakened competitor is a "mandated" area of inquiry).

38. The weakened firm analysis was most recently invoked in *Arch Coal.* 329 F. Supp. 2d at 158. The Court in *Arch Coal* found no Section 7 violation in part because the acquired firm was a "relatively weak competitor" in the current market. *Id.* The acquired firm "face[d] high costs, ha[d] low reserves, ha[d] at best uncertain prospects for loans or new reserves, [was] in a weakened financial condition, and ha[d] no realistic prospects for other buyers." *Id.* The Court concluded that the acquired firm's "past and future competitive significance in the [] market ha[d] been far overstated" in light of the acquired firm's "weak competitive status." *Id.*

39. In the context of hospital mergers, the declining operating statistics of the acquired hospital have also been held to be one of the factors what weighed heavily against any violation of the Clayton Act. *See, e.g., FTC v. Freeman Hosp.*, 911 F. Supp. 1213, 1225, 1227 (W.D. Mo. 1995) (hospital's "continuing decline in patient volume, financial sustainability, and competitive significance" diminished the acquired firm's "significance as a competitive force").

40. HPH's weakened financial condition significantly undermined its competitive significance in the market on a going forward basis. (FOF ¶¶ 234, 2299, 2327, 2336, 2354, 2366, 2405, 2407, 2412) As a result, the Merger did not "substantially . . . lessen competition" in violation of Section 7. 15 U.S.C. § 18.

2. ENH's Not-for-Profit Mission Reduces The Potential For Competitive Harm

41. The not-for-profit status of hospitals is a relevant consideration in evaluating the alleged anticompetitive effect of the Merger. *Long Island Jewish Med. Ctr.*, 983 F. Supp. at 146; *Butterworth Health Corp.*, 946 F. Supp. at 1296-97.

42. Factors such as close ties to the community and dedication to its welfare distinguish a non-profit hospital from a for-profit corporation in evaluating whether there was harm to competition as a result of a merger. *See Long Island Jewish Med. Ctr.*, 983 F. Supp. at 146; *Butterworth Health Corp.*, 946 F. Supp at 1296-97; *United States v. Carilion Health Sys.*, 707 F. Supp. 840, 849 (W.D.Va. 1989), *aff'd without opinion*, 892 F.2d 1042 (4th Cir. 1989). In addition, a non-profit hospital whose board is made up of businessmen from the same community will have an incentive to keep hospital costs and rates low. *Id.*

43. ENH's non-profit status, its entire mission and community commitment, as well as its close ties to the community, all significantly reduce the potential for the Merger to produce competitive harm.

IV. COMPLAINT COUNSEL FAILED TO PROVE THAT THE QUALITY IMPROVEMENTS RESULTING FROM THE MERGER WERE OUTWEIGHED BY ANY PURPORTED ANTI-COMPETITIVE EFFECTS THE MERGER WILL PRODUCE

44. In order to prove that the Merger was ultimately anti-competitive, Complaint Counsel must demonstrate that the negotiated price increases at issue outweigh post-Merger quality of care improvements. *See* Compl. ¶¶ 24, 28 (alleging that the increase in rates ENH charged to private payors for general acute care inpatient hospital services "*without a corresponding improvement in quality of care*, further reflects the market power exercised by the hospitals after the merger") (emphasis added).

45. Enforcement officials at the FTC and DOJ consider quality, innovation and similar factors to be an important part of analyzing the competitive effects of a transaction. *See* USDOJ Asst. Atty. Gen. Anne Bingaman, "Competition And Innovation: Bedrock Of The American Economy" Prepared Remarks, (September 19, 1996) ("[i]nnovation, whether in the form of improved product quality and variety or production efficiency that allows lower prices, is a powerful engine for enhancing consumer welfare."); "Leap-Frog And Other Forms Of Innovation: Protecting The Future For High-Tech And Emerging Industries Through Merger Enforcement" Address of Constance Robinson, Director Of Operations And Merger Enforcement, Antitrust Division (DOJ) (June 10, 1999) ("In evaluating a merger, innovation questions arise in the definition of product market, the identification of firms participating in the relevant market, and the analysis of market concentration, entry, and competitive effects").

46. Quality of care is particularly important when analyzing mergers in the healthcare industry. As noted by then-Chairman Muris:

> Quality is obviously an important part of the competitive mix when purchasing health care, and competition law does not hinder the delivery of high quality care. The Commission is always willing to consider arguments about how a particular transaction or conduct will improve quality, and it will pay close attention to such arguments in weighing the competitive implications. Moreover, because quality is so important in health care, we should err on the side of conduct that promises to improve patient care.

"Everything Old is New Again: Health Care and Competition in the 21st Century," Prepared Remarks of Timothy J. Muris, then-Chairman, FTC at 18.

47. In bringing recent enforcement actions, the antitrust agencies have asserted that quality and innovation are linked to the competitive impact of a merger. Among the allegations of anti-competitive harm in cases filed by the agencies during the past decade were a reduction in quality or innovation. *See United States v. Alcan Aluminum Corp.*, 69 FR 33406, 33407 (2004) (Proposed Final Judgment and Competitive Impact Statement); *United States v. Manitowoc Co., Inc.*, 2002 WL 32060288 at *9 (D.D.C. 2002); *In re Wesley-Jessen*, 61 FR 52799 (1996), (Analysis to Aid Public Comment).

48. Courts and antitrust authorities have also long recognized that factors such as improved quality and innovation are relevant to a competitive effects analysis. As the D.C. Circuit has observed, "[t]he Supreme Court has adopted a totality-of-the-circumstances approach to [Section 7], weighing a variety of factors to determine the effects of particular transactions on competition." *Baker Hughes, Inc.*, 908 F.2d at 984; *see also CB&I,* Dkt No. 9300, at 7, n. 35.

49. In the context of a merger, quality improvements have been specifically acknowledged as pro-competitive justifications that may outweigh any anticompetitive effect. *United State v. Idaho First Nat'l Bank*, 1970 WL 511 at *11 (D.Idaho 1970) (improvements in banking services, such as improving the quality of present services and adding new services, may outweigh the potential anticompetitive effects of the merger) (rejection of Clayton Act and Bank Merger Act challenge).

50. Joint venture and non-merger cases similarly demonstrate that the Commission and courts have considered improvements in quality and innovation relevant to a competitive effects analysis. *See In re Gen. Motors Corp.*, 103 FTC 374, Dkt. C-3132 (1984) (Statement of Chairman James C. Miller III) (noting that the opportunity for GM to learn Japanese manufacturing and management techniques was a "major pro-competitive benefit[.]"), *United States v. Brown Univ.*, 5 F.3d 658, 674-75 (9th Cir. 1993) (the goals of enhancing the quality of the educational system and extending education to a more diverse range of students were pro-competitive effects that are properly considered in a rule of reason analysis); *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 101-02, 120 (1984) (considering the NCAA's purposes in the "maintenance of a revered tradition of amateurism" and "add[ing] richness and diversity to intercollegiate athletics" in analyzing output restraints under the rule of reason.); *Banks v. NCAA*, 746 F. Supp. 850, 861-62 (N.D.Ind. 1990) (promoting integrity and quality of college football acknowledged as a pro-competitive effect). *See also In re Polygram Holding, Inc.* Dkt. 9298 (July 24, 2003) (Commission Decision) ("Cognizable justifications ordinarily explain how the specific restrictions enable the defendants to increase output or improve product quality, service or innovation.")

51. The district court's decision in *United States* v. *Rockford Mem'l Corp.,* cited previously by Complaint Counsel, is inapplicable to the merger analysis in this case. *United States v. Rockford Mem'l Corp.*, 717 F. Supp 1251 (N.D. Ill. 1989). The findings in that case regarding quality were, by their own terms, limited to the "present § 7 inquiry." *Id.* at 1289. Moreover, that decision was specifically not affirmed on the basis of the Section 7 analysis – the Seventh Circuit instead found that the merger violated Section 1 of the Sherman Act. The Seventh Circuit did not rely on, or even mention, the district court's remarks on quality. *Rockford Mem'l Corp.* 898 F.2d 1278 (7th Cir. 1990).

52. Complaint Counsel has not met its burden of establishing a presumption of competitive harm. Even if it did, however, the overwhelming evidence of quality improvements has rebutted that presumption and shifted the burden back to Complaint Counsel to prove that the quality improvements were outweighed by the anti-competitive effects the Merger will allegedly cause.

V. COMPLAINT COUNSEL FAILED TO PROVE THAT THE MERGER WILL RESULT IN FUTURE COMPETITIVE HARM

53. In its Complaint, Complaint Counsel alleged only that the Merger reduced competition in the past and its proof of competitive harm at trial focused solely on past, one-time price increases that ENH obtained coincident with the Merger. Compl. ¶¶ 27, 32.

54. Section 7 only prohibits acquisitions that represent a future harm to competition. 15 U.S.C. § 18 (Prohibiting mergers, the effect of which "*may be* substantially to lessen competition, or to tend to create a monopoly.") (emphasis added).

55. The Legislative history of the statute explains that the purpose of the statute is "to arrest the creation of trusts, conspiracies, and monopolies *in their incipiency and before consummation….*" S. Rep. No. 698, 63d Cong., 2d Sess. 1 (emphasis added). During the Conference Consideration of the bill in 1914, Edwin Y. Webb (D., N.C.), who chaired the House Judiciary Committee and had served as floor manager for the bill in the House, explained the incipiency aspect of the law by likening it to arresting the building of a chain at the creation of the first link. 51 Cong. Rec. at 16275 (1914).

> A person who only builds one link in the chain is denounced here. … The Sherman law takes care of restraints of trade and monopoly. This bill is intended to prevent those individual acts which, if multiplied and persisted in, may lead to a violation of the Sherman law.

Id.

56. In 1980, the House Committee on the Judiciary reiterated Congress' intent that Section 7 be distinct from Section 2 of the Sherman act "by reaching restraints of trade before they become full fledged monopolies subject to the proscriptions of Section 2 of the Sherman Act." H. R. Rep. No. 96-871, at 4 (1980) (emphasis added).

57. The Supreme Court has explained that "incipiency," as used in the Senate Report of the bill, means that "an acquisition may be said with reasonable probability to contain a threat that it *may lead* to a restraint of commerce or *tend* to create a monopoly in a line of commerce." *E.I. duPont de Nemours & Co.*, 353 U.S. at 597 (emphasis added). *See also Ash Grove Cement Co. v. FTC*, 577 F.2d 1368, 1378 (9th Cir. 1978). Since then, the Supreme Court has repeatedly demanded evidence of probable anti-competitive effects *in the future* in order to find a violation of Section 7, even in challenges to consummated mergers. *See, e.g., United States v. General Dynamics* 415 U.S. 486 (1974) *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967) ("The core question is whether a merger may substantially lessen competition, and necessarily requires a prediction of the merger's impact on competition, present *and future*.") (emphasis added); *Brown Shoe Co.*, 370 U.S. at 333 ("It is the probable effect of the merger *upon the future* as well as the present which the Clayton Act commands the courts and the Commission to examine.") (emphasis added); *Univ. Health, Inc.*, 938 F.2d at 1218.

58. In *General Dynamics*, the Court found no Section 7 violation in part because the future competitive ability of the merged entity was significantly weaker than current market share statistics indicated. *Gen. Dynamics*, 415 U.S. at 503. Acknowledging the Government's data regarding market share at the time, the Supreme Court explained that "the essential question remains whether the probability of such *future* impact exists at the time of trial." *Id.* at 505; *see also Lektro-Vend Corp. v. The Vendo Co.*, 660 F.2d 255, 275 (7th Cir. 1981).

59. The Commission's most recent post-consummation case under Section 7 re-confirmed that a future competitive harm is required before imposition of Section 7 liability. In *CB&I*, despite alleged evidence of past anti-competitive harm, the Commission's analysis in finding a Section 7 violation was strictly forward looking, ultimately holding that entry was not sufficient to constrain the merged entity's pricing "in the foreseeable future." *CB&I*, Dkt. No. 9300, at 9.

VI. AS A MATTER OF LAW, THE MERGER OF EVANSTON AND HPH COULD NOT VIOLATE SECTION 7

60. Section 7 of the Clayton Act provides in pertinent part that "[n]o person . . . shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . [or] the whole or any part of the assets of another person" when "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18. Accordingly, an integral element of Section 7 is missing in this case - namely, the existence of two separate "persons" at the time of the Merger.

61. Neither ENH or HPH issues any "stock" or "shared capital," but instead has "membership" interests in accordance with Illinois General Not-For-Profit Corporation Act of 1986, as amended. 805 Ill. Comp. Stat. Ann. § 105/101.01; (FOF ¶ 207). Since 1989, and at the time of the Merger, the Northwestern Healthcare Network ("NHN") had been the *sole* corporate member of both ENH and HPH, pursuant to a Network Affiliation Agreement dated October 23, 1989. (FOF ¶¶ 198, 207). From 1993 forward, NHN had significant powers with respect to member hospitals, including the power to: review and approve member institutions' strategic plans; create a "macro" strategic plan for the entire network; review and approve member institutions' operating and capital budgets; appoint and remove member institutions' boards of directors and CEOs; to direct asset transfers by member institutions to accomplish network goals and objectives; and, to negotiate with managed care organizations on behalf of member institutions. (FOF ¶¶ 208-12)

62. Before consummating a merger that meets certain jurisdictional thresholds, the merging parties must file a Report and Notification Form ("HSR Form") pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended ("HSR Act"). 15 U.S.C. § 18a. The HSR Act provides that "no person shall acquire, directly or indirectly, any voting securities or assets of any other person, unless both persons (or in the case of a tender offer, the acquiring person) file notification. . . ." *Id.*, at § 18a(a).

63. The parties here did not file on HSR form, however, because they were advised by the staff of the FTC's Premerger Notification Office that "because the parent already holds all of the assets held by the entities it controls," they were not required to file an HSR Form,

pursuant to 16 C.F.R. § 801.1(c)(8). FTC Pre-Merger Notification Office Informal Staff Opinion No. 9908002, available at http://www.ftc.gov/bc/hsr/informal/opinions/9908002.htm. This exemption from filing under the HSR Act confirms that the parties were not distinct "persons" whose transaction could violate Section 7.

64. The above analysis is consistent with the Supreme Court's rationale in *Copperweld Corp.*, the Supreme Court recognized that a parent and its *wholly-owned* subsidiary are not distinct entities that are capable of conspiring as a matter of law. 467 U.S. at 777. The Court's rationale in *Copperweld* and subsequent case law confirms that a parent and its wholly-owned subsidiary are deemed to have a unity of interest as a matter of law. *See Am. Chiropractic Ass'n v. Trigon Healthcare*, 367 F.3d 212, 223 (4th Cir. 2004); *Siegel Transfer, Inc. v. Carrier Exp., Inc.*, 54 F.3d 1125, 1131-32 (3rd Cir. 1995).

65. Since *Copperweld*, courts have extended this logic to many other types of corporate affiliations, including two wholly owned subsidiaries of a common parent. *See, e.g., Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133, 1147 (9th Cir. 2003) (holding *Copperweld's* "single-entity rule . . . applies to . . . subsidiaries controlled by a common parent") (citations omitted); *Advanced Health-Care Servs., Inc. v. Radford Cmty. Hosp.*, 910 F.2d 139, 146 (4th Cir. 1990) ("Applying the Supreme Court's reasoning [in *Copperweld*], we conclude that two subsidiaries wholly owned by the same parent corporation are legally incapable of conspiring with one another for purposes of § 1 of the Sherman Act."); *Directory Sales Mgmt. Corp. v. Ohio Bell Tel. Co.*, 833 F.2d 606, 611 (6th Cir. 1987) ("*Copperweld* precludes a finding that two wholly-owned sibling corporations can combine for purposes of section 1"); *Greenwood Utils. Comm'n v. Miss. Power Co.*, 751 F.2d 1484, 1497 n.8 (5th Cir. 1985); *see also* VII AREEDA ¶ 1464f, p. 215 & n.31 ("post-*Copperweld* decisions are virtually unanimous" that "the *Copperweld* holding also denies conspiratorial capacity to sister corporations' dealings with one another"); ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 27 (5th ed. 2002) ("Most Courts have held that the *Copperweld* rule extends to conspiracies between sister corporations").

66. Courts have also extended the logic of *Copperweld* to claims involving the Robinson-Patman Act, Section 3 of the Clayton Act and issues of standing. *See, e.g., Caribe BMW, Inc. v. Bayerisch Motoren Werke Aktiengesellschaft*, 19 F.3d 745, 749-51 (1st Cir. 1994) (Robinson-Patman Act); *Advanced Health-Care*, 910 F.2d at 152 (Clayton Act § 3); *In re Vitamins Antitrust Litig.*, No. 99-197, 2001 U.S. DIST. LEXIS 8903, at *73, 325 (D.D.C. 2001).

67. Because the merging parties here were wholly-owned subsidiaries of NHN at the time of the Merger, the challenged transaction is legally incapable of violating Section 7.

VII. THE DIVESTITURE REMEDY SOUGHT BY COMPLAINT COUNSEL WOULD HARM CONSUMERS AND FAIL TO CURE THE ALLEGED ANTI-COMPETITIVE EFFECTS

A. The Law Does Not Require That HPH Be Divested From ENH Even Assuming, For the Sake Of Argument, That The Merger Violated Section 7

68. Any consideration of Complaint Counsel's request that ENH be forced to divest HPH must begin with the basic premise that "[d]ivestiture is itself an equitable remedy designed to protect the public interest." *United States v. E.I. duPont de Nemours & Co.*, 366 U.S. 316, 326 (1961). As an equitable remedy, "[c]ourts are *not* authorized in civil proceedings to punish antitrust violators, and relief must not be punitive." *Id.* (emphasis added). Consequently, "even in a case of a judicial determination that an acquisition was in violation of Section 7, a claim of hardship attendant upon complete divestiture can be considered in determining the appropriate remedy for the redress of antitrust violations where something short of divestiture will effectively redress the violation." *United States v. Int'l Tel. & Tel. Corp.*, 349 F. Supp. 22, 31 (D. Conn. 1972); *see also Hecht Co. v. Bowles*, 321 U.S. 321, 329-30 (1944) (holding that essence of equity jurisdiction is the tribunal's ability "to mould each decree to the necessities of the particular case").

B. Complaint Counsel Offered No Proof With Respect To Remedy

69. Divesture is a "drastic" remedy; it "cannot be had on assumptions." *United States v. Crowell, Collier & MacMillan, Inc.*, 361 F. Supp. 983, 991 (S.D.N.Y. 1973). Rather, there must be "factual bases and economic theory as applied to such facts" to support such a remedy. *Id.* To obtain the equitable remedy of divestiture, a plaintiff must prove, and not merely assume, that such a remedy would most effectively restore whatever competition purportedly was lost through the merger. *E.I. du Pont de Nemours & Co.*, 366 U.S. at 326 ("The key to the whole question of an antitrust remedy is of course the discovery of measures effective to restore competition."); *CB&I,* Dkt. No. 9300, at 94-95 ("[T]he relief must be directed to that which is 'necessary and appropriate in the public interest to eliminate the effects of the acquisition offensive to the statute.'").

C. Divestiture In This Case Would Not Protect the Public Interest

70. Unwinding the Merger at this late juncture would raise serious community and patient welfare concerns given the substantial quality benefits flowing from the Merger. (FOF ¶¶ 1232, 1384, 1429-34 2483-84, 2491-93). As Luke Froeb, Director of the Bureau of Economics for the FTC, stated, "Once consummated, mergers are very costly to undo[.]" Luke Froeb, Steven Tschantz, & Philip Crooke, *Mergers Among Asymmetric Bidders: A Logit Second-Price Auction Model*, at 10, Mimeo, Vanderbilt Univ. (1999).

71. The elimination of the substantial benefits accruing from the Merger would substantially outweigh any increase in competition that would be achieved by a divestiture. As a result, consumers would not benefit from such a divestiture, particularly if HPH's quality of care levels reverted to pre-Merger levels.

72. To the extent there was any anti-competitive effect immediately following the Merger, the quality improvements since the Merger have eviscerated any such effect. (FOF ¶ 1157-59). The divestiture, therefore, would be both unnecessary and harmful.

D. There is an Alternative Remedy To Divestiture That Is More Appropriate Even Assuming, For The Sake Of Argument, That The Merger Violated Section 7

73. This court has significant discretion in fashioning appropriate relief when other options are available. The Commission itself has acknowledged that:

> It is. . . well settled that the normal remedy in cases where Section 7 violation is found is the divestiture of what was unlawfully acquired. . . . *This is not to say that divestiture is an automatic sanction, mechanically invoked in merger cases. In cases where several equally effective remedies are available short of a complete divestiture, a due regard should be given to the preservation of substantial efficiencies or important benefits to the consumer in the choice of an appropriate remedy.*

In re Retail Credit Co., 92 FTC 1, 1978 FTC LEXIS 246, at *258-59 (1978) (emphasis added). The Commission has held that divestiture, at times can be a "cure ... worse than the disease," and that in such cases, it would not be an appropriate remedy. *See In re Ekco Prods. Co.*, 65 FTC 1163, 65 FTC LEXIS 115, at *127 (1964) (divestiture may be "impracticable or inadequate, or impose unjustifiable hardship - which underscores the importance of the Commission's having a range of alternatives in its arsenal of remedies.").

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CERTIFICATE OF SERVICE

I hereby certify that on May 27, 2005, copies of the foregoing **Respondent's Proposed Conclusions of Law (Public Version)** was served (unless otherwise indicated) by messenger on:

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