

and control over 73 percent of licensed hospital beds in Northern Virginia, dwarfing its only four remaining independent competitors.

ANSWER: Respondent admits that it provides high quality general, acute care inpatient hospital services to health care consumers in Northern Virginia. Respondent denies the remaining allegations in paragraph 2.

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.

ANSWER: Respondent denies the allegations in paragraph 3.

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.

ANSWER: Respondent admits that it is a not-for-profit corporation and hospital system based in Northern Virginia with offices located at 8110 Gatehouse Road, Falls

Church, Virginia 22042. Respondent admits that it 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. Respondent admits that it acquired Alexandria Hospital in 1997 and Loudoun Hospital in 2005, and that it operated three hospitals prior to these acquisitions.

Respondent admits that in 2006 Inova had about \$1.8 billion in total net operating revenues and about \$132 million in operating income. Respondent denies the remaining allegations in paragraph 4.

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

ANSWER: Respondent admits that it operates the five hospitals at the locations set forth in paragraph 5. Respondent admits that Inova Fair Oaks Hospital has 182

² Estimates are approximate.

licensed beds and Inova Mt. Vernon Hospital has 237 licensed beds. Respondent denies the remaining allegations in paragraph 5.

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.

ANSWER: Respondent admits on information and belief that PWHS operates a single general acute care inpatient hospital located in Manassas, Virginia. Respondent is without information or knowledge sufficient to form a belief as to the truth of the remaining allegations in paragraph 6 and, on that basis, denies these allegations.

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.

ANSWER: The allegations in paragraph 7 are legal conclusions that require no answer.

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

ANSWER: Respondent admits that it entered into an agreement with PWHS dated August 1, 2006 and that agreement speaks for itself. Respondent denies the remaining allegations in paragraph 8 on the ground that the term "integrate" is vague and ambiguous.

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.

ANSWER: Respondent admits that insurance company health plans pay for some health care services provided by Respondent, including some inpatient hospital services. Respondent is without information or knowledge sufficient to form a belief as to the truth of the remaining allegations in paragraph 9 and, on that basis, denies these allegations.

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.

ANSWER: Respondent is without information or knowledge sufficient to form a belief as to the truth of the allegations in paragraph 10 and, on that basis, denies these allegations.

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.

ANSWER: Respondent is without information or knowledge sufficient to form a belief as to the truth of the allegations in paragraph 11 and, on that basis, denies these allegations.

12. Hospitals also compete for patients on the basis of quality, customer service, location, price, and cost-effectiveness.

ANSWER: Respondent is without information or knowledge sufficient to form a belief as to the truth of the allegations in paragraph 12 and, on that basis, denies these allegations.

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.

ANSWER: Respondent admits that Aetna, Inc.; Anthem Plans of Virginia; CIGNA; CareFirst, Inc.; Kaiser Foundation Health Plan; and United Healthcare are health insurers in Northern Virginia.

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.

ANSWER: Respondent is without information or knowledge sufficient to form a belief as to the truth of the allegations in paragraph 14 and, on that basis, denies these allegations.

15. Competition between Inova and PWHHS currently constrains the rates that the merging parties, particularly PWHHS, 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.

ANSWER: Respondent denies the allegations in the first sentence of paragraph

15. Respondent is without information or knowledge sufficient to form a belief as to the truth of the remaining allegations in paragraph 15 and, on that basis, denies these allegations.

16. [

Redacted

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ANSWER: Because the Commission has filed the complaint under seal and redacted paragraph 16 from the public record complaint, Respondent has not been permitted to review the allegations contained therein and on that basis denies them.

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.

ANSWER: Respondent is without information or knowledge sufficient to form a belief as to the truth of the allegations in paragraph 17 and, on that basis, denies these allegations.

18. [

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ANSWER: Because the Commission has filed the complaint under seal and redacted paragraph 18 from the public record complaint, Respondent has not been permitted to review the allegations contained therein and on that basis denies them.

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.

ANSWER: Respondent states that the allegations in paragraph 19 are legal conclusions that require no answer. To the extent an answer is required, Respondent denies the allegations in paragraph 19.

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.

ANSWER: Respondent admits that physicians generally must have admitting privileges in order to admit a patient to a hospital for inpatient services.

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.

ANSWER: Respondent states that the allegations in the first sentence of paragraph 21 are legal conclusions that require no answer. To the extent an answer is required, Respondent denies the allegations in the first sentence of paragraph 21. Respondent admits that Health Planning Region II is a geographic region designated by the Commonwealth of Virginia for Certificate of Public Need purposes and includes the counties and cities listed in paragraph 21. Respondent is without information or knowledge sufficient to form a belief as to the truth of the remaining allegations in paragraph 21 and, on that basis, denies these allegations.

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.

ANSWER: Respondent states that the allegations in paragraph 22 are based upon legal conclusions as to the relevant geographic market and relevant product market and therefore require no answer. To the extent an answer is required, Respondent denies the allegations in paragraph 22.

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.

ANSWER: Respondent is without information or knowledge sufficient to form a belief as to the truth of the allegations in paragraph 23 and, on that basis, denies these allegations.

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.

ANSWER: Respondent admits that it entered into an affiliation agreement and loan agreement with Potomac Hospital, which includes a right of first refusal to purchase Potomac. Respondent admits that Fauquier Hospital, Reston Hospital Center, Virginia Hospital Center and Potomac Hospital all provide acute care inpatient services in

Northern Virginia. Respondent states that the allegations in the first and second sentences of paragraph 24 are based upon legal conclusions as to the relevant geographic market and relevant product market and therefore require no answer. To the extent an answer is required, Respondent denies the allegations in the first and second sentences of paragraph 24.

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

ANSWER: Respondent states that the allegations in paragraph 25 are based upon a legal conclusion as to the relevant market and therefore require no answer. To the extent an answer is required, Respondent denies the allegations in paragraph 25.

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.

ANSWER: Respondent states that the allegations in paragraph 26 are legal conclusions and require no answer. To the extent an answer is required, Respondent states that the Merger Guidelines speak for themselves and denies the allegations in paragraph 26.

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

Inpatient Revenue	Pre-Merger		Post-Merger	
	Share of Revenue	HHI	Share of Revenue	HHI
			Delta HHI	539

Source: VHI 2006 Hospital Detail Report

ANSWER: Respondent admits that it acquired Alexandria Hospital in 1997 and Loudoun Hospital in 2005, and that it operated three hospitals prior to these acquisitions. Respondent states that the remaining allegations in paragraph 27 are based upon legal conclusions as to the relevant geographic market and relevant product market and therefore require no answer. To the extent an answer is required, Respondent denies the allegations in paragraph 27.

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.

ANSWER: Respondent states that the allegations in the first sentence of paragraph 28 are based upon legal conclusions as to the relevant product market and relevant geographic market and therefore require no answer. To the extent an answer is required, Respondent denies the allegations in the first sentence of paragraph 28. Respondent is without information or knowledge sufficient to form a belief as to the truth of the allegations in the second sentence in paragraph 28 and, on that basis, denies these allegations. Respondent denies the remaining allegations in paragraph 28.

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.

ANSWER: Respondent denies the allegations in paragraph 29.

30. [

Redacted

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ANSWER: Because the Commission has filed the complaint under seal and redacted paragraph 30 from the public record complaint, Respondent has not been permitted to review the allegations contained therein and on that basis denies them.

31. [

Redacted

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ANSWER: Because the Commission has filed the complaint under seal and redacted paragraph 31 from the public record complaint, Respondent has not been permitted to review the allegations contained therein and on that basis denies them.

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.

ANSWER: Respondent is without information or knowledge sufficient to form a belief as to the truth of the allegations in paragraph 32 and, on that basis, denies these allegations.

33. [

Redacted

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ANSWER: Because the Commission has filed the complaint under seal and redacted paragraph 33 from the public record complaint, Respondent has not been permitted to review the allegations contained therein and on that basis denies them.

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.

ANSWER: Respondent admits that projects involving opening a new hospital or expanding an existing hospital require planning and construction lead time as well as state regulatory approval. Respondent also admit that it participates in such regulatory and judicial proceedings in order to protect its rights and interests under state and federal law. Respondent states that the allegations in the first sentence of paragraph 34 are legal conclusions and therefore require no answer. Respondent denies that the Merger will result in a price increase or other anticompetitive effect. Respondent denies the remaining allegations in paragraph 34 on the ground that they contain terms that are vague and ambiguous, such as “significant amount of time” and “substantially prolonging.”

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.

ANSWER: Respondent denies the allegations in paragraph 35.

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.

ANSWER: Respondent denies the allegations in paragraph 36.

37. The allegations of Paragraphs 1 through 38 are incorporated by reference as though fully set forth herein.

ANSWER: Respondent incorporates its answers to the allegations of paragraphs 1 through 38 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.

ANSWER: Respondent denies the allegations in paragraph 38.

AFFIRMATIVE DEFENSES

First Affirmative Defense

The Merger will not substantially lessen competition or tend to create a monopoly.

Second Affirmative Defense

Prince William Health System lacks the market strength to substantially affect competition.

Third Affirmative Defense

The Merger will create substantial efficiencies and improve quality of care, thereby benefiting consumers.

Fourth Affirmative Defense

Respondent reserves the right to assert other defenses as discovery proceeds.

Dated: June 2, 2008

Respectfully submitted,

A handwritten signature in black ink, appearing to read "David P. Gersch", written over a horizontal line.

David P. Gersch
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CERTIFICATE OF SERVICE

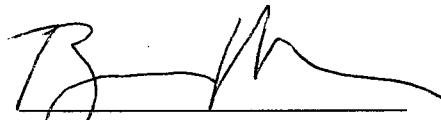
I HEREBY CERTIFY that on June 2, 2008, I filed the foregoing via hand delivery and electronic mail upon:

Donald S. Clark
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