

FEDERAL TRADE COMMISSION DECISIONS

Findings, Opinions and Orders

IN THE MATTER OF

AMERICAN MEDICAL INTERNATIONAL, INC., ET AL.

FINAL ORDER, OPINION, ETC. IN REGARD TO ALLEGED VIOLATION OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE  
CLAYTON ACT

*Docket 9158. Complaint, July 30, 1981—Final Order, July 2, 1984*

This final order requires a Beverly Hills operator of the nation's third largest chain of proprietary hospitals, among other things, to divest French Hospital in San Luis Obispo, California, to a Commission-approved buyer within twelve months from the effective date of the order. The purpose of the divestiture is to reestablish the facility as a viable competitor in San Luis Obispo County, and respondent is required to take all measures necessary to prevent any deterioration of the hospital's present operating abilities or market value, pending divestiture. The order further requires the company to provide the Commission, for a period of ten years, with advance notification of its intention to acquire any hospital located in the states specified in the order.

*Appearances*

For the Commission: *L. Barry Costilo, Peter M. Kazon, Sharon Eubanks, Oscar M. Voss, and Judith A. Moreland.*

For the respondent: *William T. Coleman, Jr., Richard C. Warmer, Richard G. Parker, Christopher W. Savage, and Mark D. Plevin, O'Melveny & Myers, Washington, D.C.*

COMPLAINT

The Federal Trade Commission having reason to believe that American Medical International, Inc., and its wholly-owned subsidiary corporation hereinafter also named as respondent, corporations subject to the jurisdiction of the Commission, have acquired the stock or assets of the hospital hereinafter described, in violation of Section 7 of the Clayton Act, as amended (15 U.S.C. 18), and having further reason to believe that respondents have engaged in unfair methods of competition in violation of Section 5 of the Federal Trade Commission

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Act, as amended (15 U.S.C. 45), and that a proceeding in respect thereof is in the public interest, hereby issues its complaint pursuant to the provisions of Section 11 of the aforesaid Clayton Act as amended (15 U.S.C. 21), and Section 5(b) of the Federal Trade Commission Act, as amended (15 U.S.C. 45(b)), stating its charges as follows:

*Respondents*

1. Respondent American Medical International, Inc., hereinafter "AMI," is a corporation organized and existing under the laws of the State of Delaware, with its principal executive offices at 414 North Camden Drive, Beverly Hills, California.

2. AMI is primarily engaged in the operation and management of proprietary hospitals in the United States and in foreign countries. In AMI's fiscal year 1980, it had total revenues of approximately \$661 million. It owns approximately 64 hospitals in the United States and abroad. It is the third largest proprietary hospital chain in the United States. [2]

3. Respondent AMISUB (French Hospital), hereinafter "AMISUB French," is a wholly-owned subsidiary corporation of AMI, organized and doing business under the laws of the State of California, with its principal office at 414 North Camden Drive, Beverly Hills, California. AMISUB French was established by AMI for the purpose of acquiring and operating French Hospital located in San Luis Obispo, California.

*Trade and Commerce*

4. At all times relevant herein, the respondents have been and are now engaged in commerce within the meaning of the Clayton Act, as amended, and are corporations whose businesses are in or affecting commerce within the meaning of the Federal Trade Commission Act, as amended. AMI does business in a number of states. AMI and its hospitals in San Luis Obispo County, California, among other things:

- (a) purchase substantial amounts of supplies, equipment and medicines from sources outside of the State of California;
- (b) receive substantial revenues from private and governmental insurers located outside of the State of California; and
- (c) treat some patients who travel from or reside outside of the State of California.

5. AMI, through its wholly-owned subsidiaries, presently owns and operates three of the five general acute care hospitals in San Luis Obispo County, California. These hospitals are Sierra Vista Hospital, Arroyo Grande Community Hospital and French Hospital. AMI's ownership of each of these hospitals was obtained by means of separate acquisitions.

6. General acute care hospitals, hereinafter sometimes referred to as "hospital(s)," are health facilities, other than federally-owned facilities, with an organized medical staff which provide 24 hour inpatient care, including at least the following services: nursing, surgical, anesthesia, laboratory, radiology, pharmacy and dietary services. General acute care hospitals is the relevant product market.

7. San Luis Obispo County, California, and/or parts thereof, are the relevant geographic markets.

8. Barriers to entry into the hospital market in San Luis Obispo County are high. [3]

COUNT I

*The Acquisition*

9. On July 18, 1979, AMI, through AMISUB French, acquired sole ownership of the assets and related facilities of the proprietary French Hospital in the city of San Luis Obispo, California. It acquired the assets used by French Hospital from Central Coast Hospital Company, a limited partnership; French Hospital Corporation; Central Coast Clinic Company, a limited partnership; and French Medical Clinic, Inc.

10. At the time of this acquisition, French Hospital competed with AMI's Sierra Vista and Arroyo Grande Community hospitals. Sierra Vista was the largest hospital in the city of San Luis Obispo, California with approximately a 43% share of hospital beds in the city, and French Hospital was the second largest hospital in the city with approximately a 34% share of hospital beds in the city. The only other hospital in the city was the nonprofit San Luis Obispo General Hospital, which was operated by the county primarily for indigent patients.

11. At the time of its acquisition by AMI, French Hospital had approximately a 24% share of hospital beds in San Luis Obispo County and AMI's two other hospitals had a combined share of approximately 44% of the hospital beds in the county. AMI's combined share of filled hospital beds in San Luis Obispo County is higher than the figures set forth above.

*Effects*

12. The effects of the French Hospital acquisition by AMI, through its wholly-owned subsidiary, may be to lessen competition substantially or tend to create a monopoly in the relevant product and geographic markets enumerated in Paragraphs 6 and 7, above, in the following ways, among others:

(a) actual and potential competition has been eliminated among French, Arroyo Grande Community and Sierra Vista hospitals;

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- (b) concentration has been substantially increased;
- (c) already high barriers to entry have been increased and new entry into the market has been foreclosed;
- (d) respondents have obtained a dominant market position; [4]
- (e) patients, physicians, and large group purchasers of hospital services, such as health maintenance organizations, may be denied the benefits of free and open competition based on price, quality, and service in choosing among hospitals.

*Violation Charged*

13. The acquisition of French Hospital constitutes a violation of Section 7 of the Clayton Act, as amended, and Section 5 of the Federal Trade Commission Act, as amended.

COUNT II

14. The allegations of Paragraphs 1 through 11 of this complaint are incorporated by reference herein.

15. Beginning sometime in the past and continuing to the present AMI, through its wholly-owned subsidiaries, has, with specific intent to exclude competitors and maintain the power to control delivery of hospital services, attempted to monopolize and has otherwise engaged in unfair methods of competition in the market for general acute care hospital services in San Luis Obispo County or parts thereof.

16. In furtherance of the conduct alleged in Paragraph 15, AMI has engaged in the following acts and practices, among others:

- (a) acquired French Hospital;
- (b) prevented a competing national proprietary hospital chain from purchasing French Hospital and offering competition to AMI's two hospitals located in San Luis Obispo County, California; and
- (c) directed or authorized its three hospitals in San Luis Obispo County to take a united position in refusing to compete with each other by offering price and other concessions to Los Padres Group Health, an individual practice association health maintenance organization.

17. The acts and practices referred to in Paragraph 16 are in or affect commerce.

18. The effects, tendency and capacity of the conduct set forth in Paragraphs 15 and 16 are to restrain trade and eliminate [5] competition in the relevant product and geographic markets enumerated in Paragraphs 6 and 7, above, in the following ways, among others:

- (a) create a dangerous probability of monopoly, which would (i) provide respondents with the power to raise prices and exclude com-

petitors, and (ii) reduce respondents' incentives to provide high quality services;

(b) increase already high barriers to entry and foreclose new entry into the market;

(c) provide respondents with a dominant market position;

(d) deny patients, physicians, and large group purchasers of hospital services, such as health maintenance organizations, the benefits of free and open competition among hospitals based on price, quality, and service.

19. The course of conduct and effects alleged in Paragraphs 14 through 18 are continuing and will continue in the absence of the relief herein requested.

*Violation Charged*

20. The course of conduct and effects alleged in Paragraphs 14 through 18 violates Section 5 of the Federal Trade Commission Act, as amended.

INITIAL DECISION BY

ERNEST G. BARNES, ADMINISTRATIVE LAW JUDGE

JULY 27, 1983

PRELIMINARY STATEMENT

The complaint in this matter issued on July 30, 1981, charging American Medical International, Inc. ("AMI"), a corporation, and AMISUB (French Hospital), a corporation, with violations of Section 7 of the Clayton Act, as amended (15 U.S.C. 18 [1976]), and Section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. 45 [1976]).

Count I of the complaint alleges that AMI, through a wholly-owned subsidiary AMISUB (French Hospital), acquired all the assets and related facilities of the proprietary French Hospital in the city of San Luis Obispo, California. The effects of the acquisition, it is alleged, may be to lessen competition substantially or tend to create a monopoly in the general acute care hospital market in San Luis Obispo County, California, and/or parts thereof, in the following ways, among others:

(a) actual and potential competition has been eliminated among French, Arroyo Grande Community and Sierra Vista hospitals; [2]

(b) concentration has been substantially increased;

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(c) already high barriers to entry have been increased and new entry into the market has been foreclosed;

(d) respondents have obtained a dominant market position;

(e) patients, physicians, and large group purchasers of hospital services, such as health maintenance organizations, may be denied the benefits of free and open competition based on price, quality, and service in choosing among hospitals.

(Complaint, ¶ 13) The acquisition is alleged to violate Section 7 of the Clayton Act, and Section 5 of the Federal Trade Commission Act.

Count II of the complaint alleges that AMI, through its wholly-owned subsidiaries, has, with specific intent to exclude competitors and maintain the power to control delivery of hospital services, attempted to monopolize and has otherwise engaged in unfair methods of competition in the market for general acute care hospital services in San Luis Obispo County, or parts thereof. In furtherance of the aforesaid conduct, it is alleged that AMI has engaged in the following acts and practices, among others:

(a) acquired French Hospital;

(b) prevented a competing national proprietary hospital chain from purchasing French Hospital and offering competition to AMI's two hospitals located in San Luis Obispo County, California; and

(c) directed or authorized its three hospitals in San Luis Obispo County to take a united position in refusing to compete with each other by offering price and other concessions to Los Padres Group Health, an individual practice association health maintenance organization.

(Complaint, ¶ 16) It is alleged that the effects, tendency and capacity of this conduct are to restrain trade and eliminate competition in the general acute care hospital market in San [3] Luis Obispo County, California, and/or parts thereof, in the following ways, among others:

(a) create a dangerous probability of monopoly, which would (i) provide respondents with the power to raise prices and exclude competitors, and (ii) reduce respondents' incentives to provide high quality services;

(b) increase already high barriers to entry and foreclose new entry into the market;

(c) provide respondents with a dominant market position;

(d) deny patients, physicians, and large group purchasers of hospital services, such as health maintenance organizations, the benefits of free and open competition among hospitals based on price, quality, and service.

(Complaint, ¶ 18) This course of conduct and effects thereof are alleged to violate Section 5 of the Federal Trade Commission Act, as amended.

The Notice of Contemplated Relief included with the complaint stated that divestiture of the acquired assets, including subsequent improvements, may be required and that respondents may be prohibited, without prior Commission approval, from making future acquisi-

tions of general acute care hospitals in areas where respondents already own or operate such a hospital.

On October 8, 1981, respondents filed an answer to the complaint admitting some of the complaint allegations, but denying those paragraphs of the complaint that allege violations of law. Respondents affirmatively stated that the complaint failed to state a claim upon which relief can be granted, and that the Commission is without jurisdiction to entertain the complaint allegations in that none of the alleged acts had a substantial effect on interstate commerce.

The first prehearing conference was held on November 13, 1981, and trial commenced on September 20, 1982. Complaint counsel, during the opening statement at the commencement of trial on September 20, 1982, abandoned all claims regarding Los Padres Group Health. (Tr. 74; see Complaint, ¶ 16(c)) Complaint counsel offered a rebuttal case which consisted entirely of documents. Respondents' surrebuttal case was comprised of documents and the testimony of one [4] witness. The last date of trial was March 2, 1983, and the record for the reception of evidence was closed on March 28, 1983. The record consists of 2531 pages of transcript and in excess of 450 exhibits. Complaint counsel called ten witnesses during the case-in-chief and respondents called a total of thirteen witnesses.<sup>1</sup>

This proceeding is now before the Administrative Law Judge for decision based upon the complaint, the answer, pleadings, testimony and documentary evidence of record, proposed findings of fact and conclusions of law, and legal memoranda submitted by the parties. These submissions have been given careful consideration and, to the extent not adopted herein in the form proposed or in substance, are rejected as not supported by the record or as immaterial. All motions not heretofore or herein specifically ruled upon, either directly or by the necessary effect of the conclusions in this Initial Decision, are hereby denied.

Having heard and observed the witnesses and after having carefully reviewed the entire record in this proceeding, together with the proposed findings of fact and conclusions of law submitted by the parties, the Administrative Law Judge makes the following findings of fact and conclusions, and issues the Order set out at the end hereof.<sup>2</sup>  
[5]

<sup>1</sup> Respondents' Proposed Findings of Fact and Conclusions of Law ("RPF") identify each witness who appeared during the trial. (RPF 0.16) Complaint counsel prepared a similar listing. (CPF, p. viii-ix) Mr. Charles Reilly, Senior Vice President, AMI, was called as a witness by both complaint counsel and respondents. (RPF 0.16, pp. 6-8) Norman Loftin, Senior Vice President, AMI, who testified in defense, was recalled by respondents as a surrebuttal witness.

<sup>2</sup> The findings of fact include references to supporting evidentiary items in the record. The supporting evidence cited in each instance is not necessarily all-inclusive of the record evidence. The following abbreviations have been used:

F. - Findings of this Initial Decision followed by the number of the finding(s) being referenced. Refer-

(footnote cont'd)

## I. FINDINGS OF FACT

A. *Identity of the Parties*

1. Respondent American Medical International, Inc. ("AMI") is a corporation organized and existing under the laws of the State of Delaware, with its principal executive offices located at 414 North Camden Drive, Beverly Hills, California. (Complaint ¶ 1; Answer ¶ 2) AMI is primarily engaged in the owning, operation and management of general acute care hospitals in the United States and in foreign countries. (Reilly, 737) More than 85 percent of AMI's revenues are derived from its operation of such institutions. (Weisman, 1712-13) AMI also provides health care services through subsidiaries to hospitals and physicians which include medical-technical support services, financial and management services, and health care development services. (CX 10N; Weisman, 1712-13) In AMI's fiscal year 1982, it had total operating revenues of approximately \$1.4 billion and net income of \$78.8 million. (RX 5823 at 32) It owns, operates, or has under construction 72 hospitals in the United States and 24 hospitals abroad. (RX 5823 at 50-51; Reilly, 755; Weisman, 1747-48) AMI is the nation's third largest proprietary hospital chain in terms of domestic hospitals owned. (Reilly, 1797) AMI currently owns and operates three hospitals in San Luis Obispo County, California. They are Sierra Vista Hospital ("Sierra Vista") and French [6] Hospital ("French") located in the city of San Luis Obispo, California, and Arroyo Grande Community Hospital ("Arroyo Grande") located in Arroyo Grande, California. (RX 5823 at 50)

2. Respondent AMISUB (French Hospital) is a wholly-owned subsidiary corporation of AMI, organized and existing under the laws of the State of California, with its principal offices at 414 North Camden Drive, Beverly Hills, California. (Complaint ¶ 3; Answer ¶ 4) AMISUB (French Hospital) was established by AMI for the purpose of acquiring and operating French Hospital. (Complaint ¶ 3; Answer ¶ 4) For purposes of this action, AMI and AMISUB (French Hospital) can be treated as a single entity.<sup>3</sup> (Prehearing Conference [Nov. 13, 1981], 3, 36)

ences to the transcript are designated by the name of the witness followed by the transcript page number(s).

- CX - Complaint counsel's exhibits followed by the exhibit number and the referenced page(s).
- RX - Respondents' exhibits followed by the exhibit number and the referenced page(s).
- CPF - Complaint counsel's Proposed Findings of Fact and Conclusions of Law.
- CB - Complaint Counsel's Post-Trial Brief In Support of Its Proposed Findings of Fact and Conclusions of Law.
- RPF - Respondents' Proposed Findings of Fact and Conclusions of Law.
- RB - Brief in Support of Respondents Proposed Findings of Fact and Conclusions of Law.

<sup>3</sup> Hereafter "AMI" is used to refer to both AMI and AMISUB (French Hospital).

*B. Identity of Other Firms Involved in the Challenged Acquisition*

3. Central Coast Hospital Company at the time of the acquisition was a limited partnership organized and existing under the laws of the State of California. (CX 68L) The partnership consisted of both general and limited partners, all but two of whom were physicians. (Friedmann, 1602-03) This partnership owned the land, buildings, and other improvements relating to French Hospital. (Answer ¶ 9(a)) Central Coast Hospital Company had one wholly-owned subsidiary, French Hospital Corporation. The Company and its subsidiary filed separate federal and California state income tax returns. (CX 35S) In the year ending June 30, 1978, Central Coast Hospital Company and its subsidiary, French Hospital Corporation, had total revenues of \$8,171,482 and a combined net income of \$745,160. (CX 35-0)

4. French Hospital Corporation is a corporation organized and existing under the laws of the State of California. (CX 20) French Hospital Corporation operated French Hospital, owned or leased the hospital's equipment, and held the license for the hospital prior to the acquisition. (Answer ¶ 9(c); CX 41B; F. 8) French Hospital Corporation was a wholly-owned subsidiary of Central Coast Hospital Company. (CX 35A) Central Coast Hospital Company leased to French Hospital Corporation the property on which French Hospital is located and the improvements on that property, including the buildings housing the hospital's facilities. (CX 534; CX 730-O-P) [7]

5. Central Coast Clinic Company was a limited partnership organized and existing under the laws of the State of California. (CX 73G) Many of its partners were also partners in Central Coast Hospital Company which owned French Hospital. (Boyd, 363-64) Central Coast Clinic Company owned the land and building adjacent to French Hospital which comprised the French Medical Clinic prior to the acquisition. (CX 41B) Central Coast Clinic Company had one wholly-owned subsidiary, French Medical Clinic, Inc. (CX 41B; F. 6) In the year ending June 30, 1978, Central Coast Clinic Company and its subsidiary had assets valued at \$3,216,603. (CX 35Z5)

6. French Medical Clinic, Inc. was a professional corporation organized and existing under the laws of the State of California. (CX 73B) French Medical Clinic, Inc. owned or leased the equipment used at French Medical Clinic. (CX 41, I) On February 22, 1974, French Medical Clinic, Inc. entered into a Master Lease Agreement with United Medical Leasing Company, Inc., Chicago, Illinois (RPF 14.9), covering a variety of medical equipment. (CX 70Z1-Z2) During 1974, the lessor assigned a part of this lease to a California limited partnership, Fraser Medilease, Pasadena, California. (CX 74A) United Medical Leasing Company, Inc. was the sole general partner in Fraser Medilease.

Lease payments to Fraser Medilease amounted to \$673.27 per month. (CX 74B) French Medical Clinic, Inc. also had a lease with Xerox Corporation. (CX 70Z2) In 1979, French Medical Clinic, Inc. represented to AMI that its total rental costs with United Medical Leasing Company, Inc. would not exceed \$202,587.50 per year. (CX 76) Other documents indicate that French Medical Clinic, Inc. had rental obligations amounting to \$168,108 per year. (CX 49B, I) As of February 1979, French Medical Clinic, Inc. owned equipment valued at \$700,000. (CX 41F, K; CX 35Z5)

7. AMISUB (French Clinic) is a wholly-owned subsidiary corporation of AMI, organized and existing under the laws of the State of California, with its principal offices at 414 North Camden Drive, Beverly Hills, California. (CX 70D-E; CX 70Z37) AMISUB (French Clinic) owns the computerized axial tomographic scanner ("CAT scanner") and x-ray and laboratory equipment AMI purchased from French Medical Clinic, Inc. (CX 70D-F, CX 71A, F)

### C. The Acquisition

8. On July 19, 1979, AMI acquired from Central Coast Hospital Company all of the common stock of French Hospital Corporation. (CX 63; CX 68E-G, Z25) That corporation operated French Hospital (Answer ¶ 9(c)); held the license necessary to operate it (CX 85; Friedmann, 1601-02); owned or leased the [8] hospital's equipment (CX 41B);<sup>4</sup> and held a long-term lease which covered both the property on which French Hospital is located and the improvements on that property, including the French Hospital building itself. (CX 534; CX 730-O-P) In the same transaction AMI also acquired from Central Coast Hospital Company its other assets, excluding cash, cash equivalents, and certain notes receivable. (CX 63; CX 68E, G) Those assets were: (a) the Company's ownership interest in the French Hospital premises leased to French Hospital Corporation, and (b) a vacant lot. (CX 41B; CX 58L; CX 68E, G; CX 534)

9. At the same time AMI purchased from French Medical Clinic, Inc. a CAT scanner and other x-ray and laboratory equipment. (CX 70D-F, W, X-Z-2; CX 78) While the purchase contract designated AMISUB (French Clinic) as the purchaser, AMI paid the entire consideration for the purchase from its own funds. (CX 60; CX 70D-F; CX 73D-F) AMISUB (French Clinic) also that day subleased from French Medical Clinic, Inc. space for use as a CAT scanning and x-ray facility

<sup>4</sup> French Hospital Corporation held substantial amounts of leased, as well as owned, equipment. French Hospital Corporation held leases of hospital equipment with total original purchase price of approximately \$1.5 million. (See CX 535, [lease agreement with American Financial Leasing & Services Company, Cincinnati, Ohio]; RX 5597L-V)

and a clinical laboratory.<sup>5</sup> (CX 71A, F) After the acquisition, the CAT scanner, at least, was used in connection with the operation of the hospital. (F. 167, n. 18; see CX 274H; CX 91)

10. The total cost to AMI of the transactions described above was \$10,970,000. AMI issued to Central Coast Hospital Company 220,225 shares of stock, with a fair market value of approximately \$6.5 million. (RX 5851B-D, H-Y; Loftin, 1508; Friedmann, 1594-95) In addition, AMI assumed approximately \$3.9 million in long-term debt of Central Coast Hospital Company. (*Id.*) Finally, AMI paid \$570,000 in cash for the CAT scanner, x-ray, and laboratory equipment. (CX 70E, G; CX 73D-F) By letter dated December 19, 1980, AMI was advised that the Commission was investigating the acquisitions. (CX 1010) [9]

*D. Description of the San Luis Obispo County Area  
and Location of Area Hospitals*

11. San Luis Obispo County, California is located midway between Los Angeles and San Francisco. In 1980, it had a population of 155,345. (CX 1064 at II-1) The main center of population in the county is the city of San Luis Obispo, which is also the county seat. (CX 217D) The population of the city in 1980 was 33,684. (CX 1064 at II-1, Data Supp.) The county is 3,184 square miles in size. It is bounded by Monterey County to the north; Santa Barbara County to the south; Kern County and the Temblor Range to the east; and the Pacific Ocean to the west. (CX 217D; RX 5826) The southern boundary between San Luis Obispo and Santa Barbara Counties follows the Cuyama and Santa Maria Rivers. (CX 217D; RX 5826) The topography varies from the relatively flat land in the southern-most section of the Arroyo Grande Valley to the peaks of five mountain ranges. (CX 217D)

12. Both industry observers and health planners have considered the existence of three separate subareas within the county: the North County, the South County, and the Central/Coast Area. (CX 188; CX 192J; CX 255C; CX 217Z10-11) Local health planners have recognized that each subarea should be considered a separate service area for health planning purposes. (CX 217Z10-11; CX 197N; RX 5467Z10; RX 5437Z47)

13. The South County is an area which stretches from Shell Beach in the north, to the Santa Maria River in the south (CX 188; 192J), and encompasses the so-called "5 Cities" of Pismo Beach, Arroyo Grande, Grover City, Oceano, and Nipomo. (CX 192J; CX 197D) Although parts of the South County are connected with the cities of

<sup>5</sup> AMISUB (French Clinic) leased the CAT scanner and x-ray equipment back to French Medical Clinic, Inc. for several months (CX 79), apparently because French Hospital, unlike the Clinic, had to obtain government approval to operate the CAT scanner. (Boyd, 376; Friedmann, 1601)

Santa Maria and San Luis Obispo by Highway 101, public transportation consists of infrequent Greyhound bus service. (CX 217Z10; *see* RX 5468Z62)

14. The North County area consists of the area from the Cuesta Grade north to the county line. (Boyd, 344; CX 192J; CX 198B; CX 217Z12) Some towns in the north are as much as 45 minutes away from the South County area (CX 736C), and although "[t]he Santa Lucia Mountain Range which lies between the City of San Luis Obispo and the North County offers steep and hazardous grades" (CX 217Z10), automobile travel over a four-lane highway can be accomplished routinely. (Anderson, 255) Public transportation consists of infrequent Greyhound bus service. (CX 217Z10; *see* RX 5468Z62)

15. The Central/Coastal area includes the city of San Luis Obispo, Los Osos, Avila Beach, and Morro Bay. (CX 255C) The city of San Luis Obispo is the center of health services in the county. (CX 255H; RX 5435C) [10]

16. San Luis Obispo County is part of California Health Systems Area 8, over which the Mid-Coast Health Systems Agency has jurisdiction. (CX 1064 at I-1) There are five general acute care hospitals in San Luis Obispo County. (*See* CX 1064 at V-8; Anderson 235) French, Sierra Vista Hospital ("Sierra Vista") and San Luis Obispo General Hospital ("SLO General") are located in the city of San Luis Obispo. (CX 736B) Twin Cities Community Hospital ("Twin Cities") is located in the north area of the county in Templeton, California. (CX 736B; RX 5592) Arroyo Grande Community Hospital is located in the south area of the county in Arroyo Grande, California. (*Id.*)

17. Appendix A, a reproduction of RX 5592, illustrates the locations of the hospitals described in Findings 18-26 *infra*.

18. French Hospital is a 138-bed, general acute care hospital located in the city of San Luis Obispo, California. (CX 736B; Steacy, 144-45) It "has a pleasant and attractive physical plant, a respected and well qualified medical staff, a good employee staff, and is well respected in the community." (CX 306A) French, the second largest hospital in the county, was acquired by AMI on July 18, 1979, and is the focus of this proceeding. (CX 736B; Complaint ¶ 9) The hospital provides most acute care services with the exception of obstetrics. (CX 91; CX 274B)

19. The original French Hospital was a 35-bed facility located on Marsh Street in the city of San Luis Obispo that was owned by Dr. Edison French. (Friedmann, 1565) In 1972, Dr. French opened the new facility at the existing site on Johnson Avenue. The new hospital had 138 beds. (Friedmann, 1565) Dr. French also owned the French Clinic which consisted of a group of doctors who were paid a salary by Dr. French. (Harvey, 1640-41) These physicians had their offices in the French Clinic building adjacent to French Hospital. (Boyd, 363) In late

1975, Dr. French decided to sell the hospital and clinic. (Harvey, 1642) In July, 1976, the hospital was purchased by the Central Coast Hospital Company, a partnership consisting of 17 partners, sixteen doctors from the French Clinic plus Mr. Kenneth Friedmann. (Friedmann, 1569; CX 41B) These doctors also purchased the French Clinic. (Boyd, 364) In 1978, the partnership began negotiations for the sale of the hospital. (Friedmann, 1592) AMI purchased French on July 18, 1979. (F. 8-10)

20. Sierra Vista Hospital is a general acute care hospital located in the city of San Luis Obispo, California. (CX 736B; Steacy, 144-45) Sierra Vista is located approximately two miles from French. (CX 736C) Sierra Vista, the largest hospital in the county, has 172 licensed beds and is owned by [11] AMI. (CX 736B) AMI purchased Sierra Vista in July 1968. (Carlson, 1317-18) At that time, the hospital had 93 licensed beds. (Carlson, 1317) In December 1972, Sierra Vista occupied a patient tower that had been added to the original building, and the number of hospital beds was eventually increased to 172. (Carlson, 1318-20)

21. San Luis Obispo General Hospital is a general acute care hospital located in the city of San Luis Obispo, California. (CX 736B; Steacy, 144-45) SLO General and French are approximately one block apart. (CX 736C) SLO General has 78 licensed acute care beds and is a nonprofit facility owned by San Luis Obispo County. (CX 736B) It also has 14 licensed psychiatric beds. (CX 736B) SLO General has the fewest acute care beds of any hospital in the county. (*Id.*)

22. The occupancy rate at SLO General in 1979 was 37 percent. (RX 5436W) SLO General is viewed in the community as the primary obstetrics facility in the county, with contemporary modalities of practice and lower costs than other area facilities. (RX 5436Z28) SLO General also has a dialysis program that is not duplicated anywhere in the area. (Anderson, 267) Other than for obstetrics, however, few physicians use SLO General on a regular basis because it does not have the modern facilities they need. (Anderson, 305) SLO General, which is run by the county, has the legal obligation of caring for the medically indigent. (Bernhardt, 1298)

23. Arroyo Grande Community Hospital is a general acute care hospital located in San Luis Obispo County in the city of Arroyo Grande, California, about 15 miles south of the city of San Luis Obispo. (CX 736B; Steacy, 144-45) It is the only hospital in the South County area. (*See* RX 5592) Arroyo Grande has 79 acute care beds, one more than SLO General, and is owned by AMI. (CX 736B) It is smaller than AMI's hospitals in the city of San Luis Obispo and not as modern or as well-equipped as AMI's facilities there. (Schwam, 585-86) AMI

acquired Arroyo Grande as part of its 1972 merger with Chanco Medical Industries. (CX 9Z12)

24. Twin Cities Community Hospital is located in San Luis Obispo County in the city of Templeton, California, about 22 miles north of the city of San Luis Obispo. (CX 736B) Twin Cities has 84 licensed beds. (*Id.*) It is a for-profit hospital owned by National Medical Enterprises. (CX 736B) Twin Cities is a general acute care hospital. (Steacy, 144-45) It is the only hospital in the North County area. (*See* RX 5592)

25. Santa Maria, California is in Santa Barbara County, south of San Luis Obispo County. (RX 5826) Marian Medical Center and Valley Community Hospital are both located in Santa [12] Maria, 30 miles from the city of San Luis Obispo. (CX 736B) Marian Medical Center is a general acute care hospital with 125 licensed beds. It is a nonprofit facility owned by the Sisters of St. Francis of Penance and Christian Charity. (CX 736B; Steacy, 143-46) Valley Community Hospital is a general acute care hospital with 48 licensed beds. (CX 736B; Steacy, 148-49) It is a for-profit facility, owned by Summit Health. (CX 736B) Valley and Marian are approximately two miles apart. (CX 736C) These two hospitals serve the same community of patients and have, for the most part, the same medical staff. (Steacy, 149)

26. George L. Mee Memorial Hospital is located in Monterey County in King City, California. This is about 81 miles north of the city of San Luis Obispo. (CX 736B) Mee Memorial has 42 licensed beds and is owned by Southern Monterey County Memorial Hospital, Inc., a nonprofit organization. (CX 736B)

#### E. *Interstate Commerce*

27. AMI admits that it operates and manages hospitals in the United States and in foreign countries, and that it does business in a number of states. (Answer ¶ 3a, ¶ 5b) At the time AMI acquired French Hospital, AMI owned or leased 44 general acute care hospitals in the United States, located in nine states. (CX 729Z3) AMI also managed three hospitals in Arkansas and Texas. (CX 729Z3-Z4) Between June 1978 and July 1979, when it acquired French Hospital, AMI acquired four domestic hospitals, a computer-aided design and architectural firm, and a prepaid health care program, all of which were located in States other than California. (CX 729Z5-Z7; CX 731B) As of August 31, 1979, AMI provided cardio-pulmonary, diagnostic, and therapeutic services under contracts with hospitals in 40 states. (CX 729Z4) These operations are directed from AMI's headquarters in California. (*See* RX 5823)

28. At the time French Hospital Corporation was acquired by AMI, it had been making payments of \$16,986.75 per month for several years under equipment lease agreements with Provident Bank; those

payments were sent to locations outside California (CX 535; CX 730N; CX 731B) prior to its acquisition by AMI. French Hospital received millions of dollars per year in interstate payments for hospital services rendered. (See F. 30) Those payments were received by French Hospital Corporation. (CX 735A) French Hospital, which was operated by French Hospital Corporation before the acquisition (Answer ¶ 9(c)), occasionally treated patients who did not reside in the state of California. (Answer ¶ 5(d))

29. AMI issued to Central Coast Hospital Company shares of AMI common stock worth approximately \$6.5 million as part of [13] the purchase price for French Hospital. (RX 5851B-C; CX 65; F. 10) AMI obtained approval from the New York Stock Exchange for the listing on that exchange of the stock issued to Central Coast Hospital Company, as required by the contract for the acquisition of French Hospital. (CX 68Z14; CX 69A)

30. French, Sierra Vista, and Arroyo Grande make interstate purchases of substantial amounts of drugs, devices, equipment and supplies, and make interstate payment therefor; and receive substantial interstate payments for hospital services, as set forth in Appendix B. The funds used to cover the hospitals' Medicare reimbursement checks were Treasury funds drawn from the San Francisco Federal Reserve Bank, pursuant to letters of credit issued by the Baltimore, Maryland headquarters of the Health Care Financing Administration. (CX 735B) Some of those Treasury funds originated outside California. (CX 735B) Payments of the hospitals' Medicare reimbursement checks reduce, by the amount of the checks, the amount of Treasury funds transferred at the end of each business day from the San Francisco Federal Reserve Bank to the New York Federal Reserve Bank. (CX 735B) The hospitals' Medicare reimbursements are charged against two trust funds maintained on the books of the United States Treasury, headquartered in Washington, D.C. (CX 735A) A substantial part of the funding for those trust funds comes from payroll taxes and Medicare Part B premiums collected nationwide. (CX 735A-B) A major part of the interstate payments received by French Hospital and the interstate purchases and payments received by the other hospitals that are noted on Appendix B were received prior to AMI's acquisition of French Hospital.

31. The Vidar Division of TRW, Inc., which employs approximately 600 persons at its plant in San Luis Obispo, and is the second largest non-governmental employer in the San Luis Obispo area (RX 5435Q), had a health benefits plan for its employees and their dependents, effective April, 1981, which paid 100% of certain hospital charges, and 80% of certain other hospital charges (subject to a deductible and a \$1,000,000 maximum lifetime benefit for major medical expenses)

incurred by an employee or dependent. (CX 561A, G-H, K-L, W-Z3) Benefits under the plan are paid on behalf of the employer by the Travelers Insurance Company. (CX 561B) All Travelers' payments for hospital services to AMI's hospitals in San Luis Obispo County are interstate payments. (CX 734B)

32. Payors that reimburse for hospital services on the basis of the reasonable costs of providing those services—such as Medicare and, until recently, Medi-Cal (*see* F. 33, 158)—will be affected to the extent that this acquisition affects those costs. (*See* F. 33) Third-party payors that [14] reimburse on the basis of hospital charges—*i.e.*, private insurance companies (*see* Guy, 661)—and self-pay patients, will be affected to the extent that this acquisition affects charges. (*See* F. 174-187)

33. The acquisition of French increased the "cost basis" of the hospital for Medicare purposes and therefore the amount of interstate Medicare payments French was entitled to receive. Under Medicare regulations, depreciation of hospital facilities and (for proprietary hospitals only) return on equity capital are "allowable costs" for Medicare reimbursement. (42 C.F.R. 405.415, 405.429 (1982)) The "cost basis" of a particular French asset, for purposes of calculating depreciation and return on equity, is governed by those Medicare regulations. To the extent that AMI claims a higher cost basis for French than that claimed by the previous owners, Medicare reimbursement will be increased. This possibility was recognized by Mr. Steven Takahashi in a May 21, 1979 memorandum (CX 52), written when he was Treasurer and Vice President of AMI. (CX 12Z21) His memorandum estimated that if AMI calculated the cost basis of the assets based on their appraised value at the time of the acquisition, rather than the book value used by the previous owners, there would be an increase in Medicare reimbursement to French of over \$8 million over the 30-year life of the assets. (CX 52A) AMI followed Mr. Takahashi's advice and by fiscal year 1981, the first full fiscal year after AMI's acquisition of French, was claiming a "cost basis" for French's assets (CX 712Z262) which corresponded to the value of those assets as appraised in 1979 (with adjustments for intervening purchase, construction, and disposal of assets). (CX 31Z5; CX 712Z83, Z202) This new "cost basis" was considerably greater than the book value of the assets in the hands of the previous owners. (CX 52A) While hospitals participating in the Medicare program are subject to limitations on reimbursable cost (42 C.F.R. 405.460 [1982]; RX 5828; Schramm, 2278-79; Derzon, 1997-2005, 2054-55; Lave, 947-48, 950), a fairly liberal standard is utilized which can be met by the average hospital. (*See* RX 5828)

34. Until recently, California's Medi-Cal program generally fol-

lowed Medicare reimbursement principles. (Derzon, 2005) Thus, the increase in Medicare reimbursement from the increased "cost basis" of French would be accompanied by a similar increase in Medi-Cal reimbursement. The Federal Government pays a certain percentage of the Medi-Cal reimbursement for those services eligible for Federal subsidy. (42 U.S.C.A. 1396b(a)(1), 1396d(b) (West Supp. 1982)) Those Federal payments are interstate payments. (CX 734A-B) [15]

#### F. *The Relevant Product Market*

35. General acute care hospitals offer a variety of health services in a single location. In California, to be a general acute care hospital, a facility must offer the following services on a 24-hour basis: medical, nursing, surgical, anesthesia, laboratory, radiology, pharmacy and dietary services. (*Cal. Health & Safety Code* Section 1250(a) [Deering 1982]; see also RX 5469Q) While some facilities may offer one or two services which hospitals offer, no other facility offers them all. (Steady, 145-47; Lave, 882) The cluster of services offered by general acute care hospitals provides for the complete treatment of patients with a broad range of conditions. (Steady, 146) Thus, the hospital offers a variety of facilities to help diagnose disease (Boyd, 330); it offers facilities for surgery (Boyd, 329-30); it provides nurses who work round-the-clock to carry out the orders left by the doctor and keep the doctor informed of any change in a patient's condition (Boyd, 330); it provides the nurses necessary to administer certain medications to a patient. (Bernhardt, 1281-82; see also Schwam, 565) Most importantly, hospitals provide the equipment and personnel to deal with unexpected, but potentially life-threatening, situations. (Boyd, 335; Schwam, 567-68) While a particular service may be available at some other institution, general acute care hospitals are unique in that they alone offer this whole cluster of services in a single setting. (Lave, 881-82)

36. There is a well-accepted definition of "acute care hospitals" used by health planning organizations, the American Hospital Association, and the State of California, including the California Health Facilities Commission. (Lave, 880-81) This definition draws a distinction between acute care and long-term hospitals and between hospitals and other providers of health care, such as doctors, clinics, and hospices. (Lave, 881) California statutes distinguish general acute care hospitals from other "health facilities" offering inpatient care, such as psychiatric and specialty hospitals, and skilled nursing and intermediate care facilities. "Health facilities" are further distinguished from "clinics" offering only outpatient services. (*Cal. Health & Safety Code* Sections 1200, 1250 [Deering 1982 & Supp. 1983]) Administrators of hospitals also use the term "general acute care hospi-

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tals"; it is a term generally recognized in the industry. (Steady, 143-44; Anderson, 235-36)

37. AMI's primary business is the owning and operating of general acute care hospitals; over 85 percent of AMI's revenues are derived from its operations of such institutions. (Reilly, 737; Weisman, 1712-13) Most important, AMI itself has recognized that its hospitals compete only with other general acute care hospitals. Included in one memorandum analyzing the French acquisition is a chart entitled "Competition—French [16] Hospital." It lists only the other four general acute care hospitals in the county. (CX 38M) In its study of AMI's competition in San Luis Obispo, Friesen International, Inc., an AMI subsidiary, analyzed only other general acute care hospitals. (RX 5435T-Z4) The administrator of Sierra Vista, in referring to his competition, mentioned only other general acute care hospitals. (Carlson, 1327-28)

38. It is "critically important" for doctors to have access to general acute care hospitals. (Schwam, 563; *see also* Boyd, 329; Bernhardt, 1284; Harvey, 1681) Surgeons, for example, require hospitals not only for the surgery itself, but also for the other support staff and services necessary to care for the patient before and after the surgery. (Anderson, 236; Boyd, 330) Only hospitals have the necessary equipment to perform major surgery. (Anderson, 236) Likewise, hospitals are often the only facilities able to perform certain sophisticated tests which doctors require. (Bernhardt, 1231; Schwam, 565)

39. A number of physical ailments can be treated safely only by admitting a patient to the hospital. (Anderson, 236; Boyd, 334; Schwam, 567-69; Bernhardt, 1231; Harvey, 1681) These situations include, among others, patients in need of certain kinds of surgery (Boyd, 334-35; Anderson, 236; Bernhardt, 1231), patients requiring certain diagnostic procedures (Bernhardt, 1231; Harvey, 1679-80), and patients in need of observation or around-the-clock monitoring. (Boyd, 333; Harvey, 1678-79) Almost any patient with acute cardiovascular disease must be admitted to the hospital for treatment. (Harvey, 1681) Patients in need of intravenous medication (Schwam, 568; Bernhardt, 1281-82); and those in need of intensive care services must be admitted to the hospital. (Schwam, 568-69) Also, patients having procedures which require general anesthesia usually will be admitted to the hospital. (Boyd, 332-33; *see* RX 5469Z172)

40. In a number of other situations it is possible to treat a patient without admission to a hospital, but several factors make this option unattractive. In those instances where nursing care is required, a patient could be treated at home only if private duty nurses were employed at great expense. (Boyd, 334, 336; Schwam, 567-68) Even if nurses were hired, it still might be necessary to admit a patient if

complications arose. (Boyd, 335) The risk of unexpected complications makes treating certain conditions on a nonhospital basis extremely risky. (Boyd, 334; Harvey, 1680) Treating other conditions outside the hospital would require a doctor to spend excessive amounts of time with a single patient, thus forcing the doctor to neglect others. (Schwam, 567-68) Finally, even when a patient could be treated at home, it would often be impossible [17] for the doctor to render the same standard of care to the patient as would be possible in the hospital. (Schwam, 567-68)

41. Certain categories of illness can be treated in either the hospital or in a nonhospital setting, such as the doctor's office or the patient's home. (Boyd, 332) However, whether a doctor treats a particular patient with such a condition in the hospital or outside of it will depend on the severity of the illness and whether some "predisposing condition" creating the risk of complications is present. (Harvey, 1677-78; Collins, 1449, 1463-64; Schwam, 564-66) In most instances, patients are admitted to the hospital only when they cannot be treated outside of it. (Boyd, 332; Bernhardt, 1281; Harvey, 1677) A number of factors prevent a patient who could be treated in a nonhospital setting from being admitted to the hospital. First, hospital utilization review and federal reimbursement regulations prevent doctors from admitting patients to the hospital unless it is medically necessary. (Derzon, 1970-71; see Stahl, 1381, 1392-93) Second, doctors prefer to have as few patients as possible in the hospital, since they do not wish to spend time unnecessarily making hospital rounds. (Harvey, 1678; see also Boyd, 340; Bernhardt, 1285) Third, patients prefer to be at home if possible, and often it is less expensive for a patient to be treated outside the hospital setting. (Bernhardt, 1240-41)

42. Respondents submitted a chart, RX 5794, which purports to show the number of inpatient surgeries performed at French and Sierra Vista which also could have been performed on an outpatient basis. This chart has some basic flaws. First, it does not show whether the patients had "predisposing conditions" which necessitated the procedure being done on an inpatient basis. (Collins, 1449, 1463-64, 1466-69) Second, the chart included as inpatients, patients admitted under Sierra Vista's "one-day stay" program, where patients do not stay in the hospital overnight. (Collins, 1460-61) Finally, there is disagreement concerning which procedures can safely be performed on an outpatient basis. For example, one of the lists upon which respondents' chart is based included heart catheterizations among procedures which could be done on an outpatient basis. (RX 5641Z37) However, a cardiologist testified in this proceeding that heart catheterizations can be done safely only on inpatients. (Harvey, 1679-80)

43. Some ancillary services, such as x-rays and lab tests, which are

rendered to inpatients also are available in a nonhospital setting. Some doctors' offices and clinics offer x-ray procedures and laboratory tests (Schwam, 599-600; Bernhard, 1232), and private labs also are capable of performing many tests. (Stahl, 1403; CX 452B) However, these nonhospital facilities are not used to treat individuals in need of inpatient care. When people needing inpatient care require such [18] services, they use the facilities present in the hospital. (Schwam, 566-67) Doctors never send inpatients out of the hospital for ancillary services when those services are available in the hospital. (Bernhardt, 1283; Schwam, 567)

44. General acute care hospitals also offer certain services which do not require a patient to be admitted to the hospital. Such services include tests, ambulatory surgery procedures, and some emergency room services. However, outpatient procedures account for only a small part of the activity of general acute care hospitals. In San Luis Obispo County, most hospitals derived no more than 13 percent of their adjusted gross revenues from such outpatient services, although SLO General received about 32 percent from such services. Only 7.5 percent of French's adjusted gross revenues were from outpatient services between 1977 and 1980. (CX 1062)

45. In only a few instances are the outpatient services provided by hospitals a substitute for those offered in a nonhospital setting. The most important outpatient service provided by a hospital is the hospital's emergency room. All hospitals in San Luis Obispo County offered full-time emergency room services. (See RX 5469Z88) In some cases, emergency rooms may treat relatively minor problems that probably could be treated in a doctor's office or a clinic. But patients often come to emergency rooms unaware of what is wrong with them, but aware that the full gamut of care is available to them at an emergency room. (See RX 5469Z70) Doctors' offices, which are not open 24 hours a day and cannot provide as broad a range of services as emergency rooms, are therefore not a substitute for a patient who believes he needs emergency care. A patient needing emergency care may use the emergency room because he does not have a regular doctor or is not readily knowledgeable about an available doctor.

46. Hospitals also offer facilities for outpatient surgery, which is surgery which does not require the patient to remain overnight. (Boyd, 333; Collins, 1446-47; RX 5469Z172) Outpatient surgery at hospitals is usually performed on patients who do not require a long period of observation. (Stahl, 1380; RX 5469Z177) Some minor surgery is performed in doctors' offices. (Boyd, 331-32) However, the surgeries done on an outpatient basis in hospitals are usually those procedures which cannot be done in a doctor's office. (See Collins, 1462-63) Also, some patients have tests or x-rays performed on an outpatient basis

at a hospital even though such procedures can also be done outside the hospital. (Bernhardt, 1235) When doctors have their own equipment outside the hospital, they do not use the hospital's equipment. (See Schwam, 566) For those doctors who do not have access to such facilities, [19] however, there is no substitute for the equipment available at the hospital. (Bernhardt, 1235)

47. In San Luis Obispo County the five hospitals are all general acute care hospitals. (Anderson, 235; Steacy, 144-45) While some other institutions offer some of the same type of services, none can offer the essential cluster of services offered by acute care hospitals. Certain diagnostic procedures and simple surgery can be done in physician's offices and clinics; however, no clinic or doctor can offer the full range of tests, especially the more sophisticated tests provided by a general acute care hospital (Schwam, 565), and a number of such procedures cannot be done in doctors' offices. (Boyd 333-34) In addition, no clinic can treat those conditions which require that patients be admitted to the hospital. (See F. 39)

48. Some procedures which are performed in hospitals can be done in "freestanding surgicenters." (RX 5812A-B) No such facility exists in San Luis Obispo County (Anderson, 238; Bernhardt, 1282), and it is unlikely that such a facility will be built. The Mid-Coast Health Systems Agency has noted that existing ambulatory surgical capability in the county's hospitals is currently underutilized, and would recommend that the necessary regulatory approval for such a facility be denied. (CX 1064 at VI-45 to VI-46; see also RX 5469Z174; RX 5821Z61-Z62) In addition, similar facilities such as birthing centers or freestanding renal dialysis centers, do not exist in San Luis Obispo County. (See Lave, 883)

49. The only inpatient psychiatric service offered in San Luis Obispo County is at SLO General, which has 14 beds set aside for psychiatric patients. (CX 1064 at V-64) These beds are licensed separately from the hospital's general acute care beds, and government approval would have to be obtained to shift those beds into service as general acute care beds. (Johns, 1877; *Cal. Health and Safety Code* Sections 437.10(a), 1250.1 [Deering 1982 & Supp. 1983]) Further, these psychiatric services are not considered to be general acute care services (Anderson, 303); the nature of the illness is fundamentally different from the physical illnesses treated in general acute care facilities, and the form of treatment prescribed is different. (Steacy, 147-48)

50. There are home health care services in San Luis Obispo County. These services send nurses periodically to the homes of patients who require continuing care. (Schwam, 600-01) Home health care services provide care only to patients near recovery from their illnesses. (Schwam, 604) They do not offer the round-the-clock care offered by

general acute care hospitals, nor can they perform surgical procedures or other tests. (See generally RX 5469Z318-Z327; Schwam, 600-01)

51. There is one hospice operating in San Luis Obispo County. (RX 5469Z332) This service "provides palliative and [20] supportive care to the terminally ill patients and their families." (RX 5469Z328) In San Luis Obispo County this service is provided to patients in their homes, not in a private facility. (RX 5469Z331-Z333) Furthermore, unlike general acute care hospital services, hospices are long-term as opposed to short-term services (RX 5469Z333-Z335), and the average census of the hospice in San Luis Obispo was only eight patients. (RX 5469Z335) Most importantly, hospices deal only with terminally ill people to give them comfort and rest as long as they survive. (RX 5469Z328) Thus, this service represents a substitute for only a minute portion of the services offered by a general acute care hospital.

52. For the bulk of services offered by general acute care hospitals, demand is relatively inelastic. A person who believes himself seriously ill will go to a hospital, rather than a nonhospital setting, regardless of the cost. Even in less extreme cases, there is little price or quality cross-elasticity of demand between hospital and nonhospital services. (Lave, 882-83)

53. As noted above, some tests and x-rays are available on an outpatient basis both in the hospital and in doctors' offices. (F. 43) In addition, to a limited extent, some surgical procedures could be performed in either a doctor's office or on an outpatient basis at a hospital. (F. 40-42) However, there is virtually no competition for the cluster of services or breadth of care offered by hospitals on an inpatient basis. "[T]here is a core of services which are not offered elsewhere. . . ." (Lave, 882) In other instances, treating the patient outside the hospital is especially dangerous since it raises the risk of complications. (F. 39-40) While there might be adequate sources for some outpatient services to substitute for those offered by the hospital should an increase in price or a reduction in quality occur, no similar substitutes for inpatient care exist. Even if the number of procedures done on an outpatient basis would increase, this would not change the unique nature of the essential core of services offered on an inpatient basis. As one doctor testified, "[C]learly there are some things that will always need to be done in hospitals and certain conditions that need to be treated in hospitals." (Bernhardt, 1283)

#### G. *The Relevant Geographic Markets*

54. The relevant geographic market defines the area within which market power could be successfully exercised. Determination of the market requires an inquiry into where people go when they need

hospitalization; and what alternatives are available in the event market power is exercised. It also [21] is relevant to look at the perceptions of people in the marketplace to determine the economic realities of the situation. (Lave, 888-89)

55. The origin of patients at hospitals is relevant in determining the relevant geographic market. (Lave, 886; Schramm, 2338) Ronald Rowe, an FTC staff accountant, at complaint counsel's request reviewed patient origin information by ZIP Code submitted by all the hospitals in San Luis Obispo County, plus those in King City (Monterey County) and Santa Maria (Santa Barbara County), and summarized this patient origin data in a series of charts, CX 614 through CX 621. (Rowe, 121-22) These charts showing the residence of patients admitted to hospitals in San Luis Obispo County are summarized in Appendix C. Each hospital in the county drew over 90 percent of its patients from within the county. Only a small percentage of patients came from areas outside the county. French had the highest number of patients from Santa Maria, but they amounted to only 4 percent of all of its admissions. Twin Cities, the only hospital in the North County area, drew only 1.6 percent of its patients from the neighboring county to the north, Monterey County.

56. AMI had concluded that the service areas of French and Sierra Vista were defined by the boundaries of San Luis Obispo County since 90 percent of their patients came from within the county. (CX 255C, F; CX 38Z7-Z8) AMI's wholly-owned subsidiary, Friesen, prepared three studies of AMI hospitals in San Luis Obispo County in 1980-81 and found that most of the patients at AMI's three hospitals were residents of the county. (RX 5435Z29-Z30; RX 5436Z30-Z31; RX 5437Z28-Z29) In addition, according to AMI's and Friesen's studies, few patients come to San Luis Obispo County hospitals from outside the county. (CX 255C; RX 5435Z30; RX 5436Z31; RX 5437Z29) Friesen also concluded that the market of each hospital was limited to patients residing in the county or some portion thereof. For example, with regard to Sierra Vista, Friesen reported:

*Current market definition:*

Patients of the full range of medical specialties with primary and secondary illnesses and patients with trauma, rehabilitative needs and some tertiary illnesses who live in all parts of San Luis Obispo County.

(RX 5436Z51; *see also* RX 5435Z51; RX 5437Z47)

57. The extent to which residents of San Luis Obispo County leave the county for their hospital care, referred to as outmigration, is a relevant factor in determining whether the [22] county is the proper geographic market. (Lave, 886-88; *see* Schramm, 2340-45; Mittelstaedt, 1084) Outmigration may be due in large part to residents who

