UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

BUREAU OF COMPETITION

JUL 23 1990

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Dear Ms. Fenton and Mr. Sims:

I am writing in response to your letters of September 25, 1989 and March 23, 1990, inquiring whether, in the opinion of the Bureau of Competition, the Commission would deem HCA Management Company, Inc. ("HMC") to be a "successor" to Hospital Corporation of America ("HCA") under the final Commission orders issued in Docket No. 9161 and Docket No. C-3167 ("the HCA Orders"). These orders are applicable to HCA "and to its . . . affiliates, successors and assigns." The Commission's decision in Docket No. 9161, reported at 106 F.T.C. 361, was affirmed on appeal, Hospital Corporation of America v. F.T.C., 807 F.2d 1381 (7th Cir. 1986), cert. denied, 481 U.S. 1038 (1987).

According to your letter of September 25, 1989, HMC came into existence on July 31, 1989, when a group of HCA managers and an investment firm acquired, for approximately $45 million, "assets used in the hospital consulting and management business from HCA." As a result of that acquisition, "HMC will provide management and consulting services to some 229 hospitals and health care systems with approximately 38,000 beds in the United States and Canada."

In that letter, you also state that "HMC does not believe it has any compliance obligations under the HCA Orders" on the grounds that the "issues presented here are very similar to those previously addressed by the Bureau of Competition in a request for an opinion by Healthtrust, Inc. -- The Healthcare Company ("HTI")." The "HTI Letter" concluded that "HTI is not a successor to HCA within the meaning of the final orders." See Letter to Joe Sims, Esquire (March 9, 1988). HTI, like HMC, was organized for the purpose of purchasing assets of HCA.

The Bureau of Competition is of the opinion that HMC is a successor to HCA under the orders. As the HTI Letter made clear, the obligations imposed by Commission orders may apply to purchasers, like HTI and HMC, that acquire less than substantially all of the assets of the person under order. That Letter suggested, however, an exception to successorship liability in some circumstances where the respondent remained in the line of business that led to the entry of the order. It is now clear that the HCA Orders are directed at preserving competition in local hospital markets, rather than solely competition in a national hospital line of business. Therefore, the advice given in the HTI Letter has been rescinded and this letter applies the general standard enunciated by the Commission on several earlier occasions that a person is a successor if it buys a business or a product line that is the subject of an order.

The HCA Divestitures

At the time the HCA Orders were entered, HCA was the largest operator of proprietary hospitals in the United States. It owned or managed about 400 hospitals in the United States. HCA's growth through acquisitions led to both of the orders being considered here. Since that time, it has divested to HTI 104 of its 186 acute care hospitals and to HMC 182 of the 200 or so management contracts under which HCA operated hospitals. HCA has also sold most of its foreign hospital operations.

The divestitures to HTI and HMC are strikingly similar in one respect: they reflect more a change in ownership than of management or operation of the businesses. In both instances, senior managers of HCA joined together to acquire, in highly leveraged buyouts, operations for which they had had management responsibilities. In general, those managers have continued in much the same capacities in the new corporations.

As HCA did prior to the divestitures, HMC intends to prosper by growth. According to its statement filed with the Securities and Exchange Commission on October 20, 1989, "The Company's business strategy will focus on growth through expansion of HMC and selective acquisitions" including the "acquisition of acute care hospitals, lease arrangements, joint ventures and profitsharing."

In addition, both HTI and HMC maintained some ongoing relationships with HCA. As your September 25, 1989, letter notes:

> HMC has agreed to purchase at market rates certain services (such as data processing services) from HCA . . . . HMC will also have the opportunity to participate in HCA's bulk purchase supply agreements, including one for the purchase of hospital supplies from Baxter Travenol.

Pursuant to their agreements HCA also has the right to appoint a director of HMC, was given warrants to acquire 1,500,000 shares of HMC, and has agreed not to compete with HMC for a period of five years.

Both HTI and HMC made their acquisitions knowing of the HCA Orders and as part of the purchase arrangements agreed "to be bound by, and comply with [the HCA Orders] if and only to the extent such terms and conditions are applicable to the [buying] Company . . . ."

Finally, as your September 25, 1989, letter states, "HCA remains in the business that led to the imposition of the HCA Orders. Along with its subsidiaries, it continues to own and operate more than 140 hospitals with 25,000 beds in the United States and abroad." These divestitures have significantly transformed HCA. It no longer is the largest operator of hospitals in the United States. HMC operates more hospitals than HCA; HCA now owns roughly the same number of hospitals as HTI.

The Effect on the HCA Orders

The order in Docket No. 9161 requires that HCA give notice to the Commission prior to making any acquisition in any area "in which HCA already operates a hospital" and as a result of the acquisition would "operate hospitals that combined have a twenty (20) per cent or more share of the licensed acute care hospital beds within that" area. "Acquire" is defined to include also any arrangement to manage or lease a hospital. In addition, HCA is required to obtain approval from the Commission prior to purchasing any hospital in the Chattanooga, Tennessee area for more than $1,000,000. Under the consent order, Docket No. C-3167, HCA has separate notification responsibilities prior to any acquisition of an acute care hospital in the Midland/Odessa, Texas area and prior to any acquisition of a psychiatric hospital or a hospital with a psychiatric unit in the Norfolk, Virginia area.

Under the HCA Orders, the Commission augmented the prior notice it receives about hospital acquisitions in many localities. This augmentation is significant because many hospital transactions are not reportable under the existing premerger reporting program established by § 7A of the Clayton Act. In each of these many localities a twenty percent or greater share of the hospital market is likely to be of competitive significance.

The effect of the HTI Letter was to deprive the Commission of the prior notice it had obtained under the HCA Orders. Were the conclusion of that letter applied to the divestitures to HMC, one third or fewer of the hospitals that were covered by the Orders would remain subject to the prior notice provisions. Indeed, one might argue that the logic of that conclusion would not find a successor as long as HCA owned hospitals in Chattanooga, Norfolk and Midland/Odessa even if HCA had divested all of its other facilities. There is no reason to believe that the Commission intended such a result.

The Standard for Successorship

The Commission has adopted the successorship standard enunciated by the United States Supreme Court in Golden State Bottling Co., Inc. v. NLRB, 414 U.S. 168, 184 (1973) (employer was successor where it "acquired substantial assets of its predecessor and continued, without interruption or substantial change, the predecessor's business operations"). In doing so, the Commission has joined those courts that have applied Golden State to patent law[1] and equal employment law[2] as well as labor law[3] and did not follow the opinion of the United States District Court in United States v. CPC International, Inc., 1981-1982 Trade Cas. (CCH) ¶64,428 (N.D. Cal. 1982). The HTI Letter described the successorship standard and the Commission's use of that standard:

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[1] See e.g., Vulcan, Inc. v. Fordees Corp., 658 F.2d 1106, 1111 (6th Cir. 1981) (person held bound as successor who acquired infringer's plans, notwithstanding that person did not buy all of the infringer's assets and infringer continued to exist after purchase); and Eli Lilly & Co. v. Premo Pharmaceutical Lab., Inc., 843 F.2d 1378, 1381 (Fed. Cir. 1988) (stating that a person is a successor where it "has succeeded in interest to the subject matter of the prior decree," that is, where it operates the business that was subject of the court's order).

[2] See e.g., EEOC v. MacMillan Bloedel Containers, Inc., 503 F.2d 1086, 1089 (6th Cir. 1974) ("the key factor" in determining successor status is whether there is "substantial continuity of identity in the business enterprise after the change" and not a continuity of ownership or an acquisition of all assets of the selling entity); and EEOC v. Local 638, 700 F.Supp. 739, 743-6 (S.D.N.Y. 1988) (holding union local the successor to order binding defunct local on various grounds including, "substantial continuity" of responsibilities, "notice of liabilities and obligations" of defunct local under the order, and need to "preserve the judgment and order of the federal district court" that implemented "national policies protecting employees").

[3] See e.g., Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27, 44 (1987) (holding "petitioner [was a successor where it] acquired most of Sterlingwale's real property, its machinery and equipment, and much of its inventory and materials" and "introduced no new product line"). See also, Restatement (Second) of Judgments § 43 comment a.

> The courts have held that, for public policy reasons, a successor company may be liable under a federal order despite the general rule that liabilities do not attach to purchasers of assets. In Golden State Bottling Co., Inc. v. NLRB, 414 U.S. 168 (1973), the Court concluded that the NLRB could validly bind successors when necessary to vindicate the policies of the National Labor Relations Act. The Court held that the bona fide purchaser of a business, who acquires and continues the business knowing that his predecessor had unlawfully discharged an employee, may be ordered by the NLRB to reinstate the employee with back pay. In this and in other cases, the Court balanced the private interests of business acquirers against the objectives of national labor law policy, including the goal of avoiding industrial strife. John Wiley & Sons v. Livingston, 376 U.S. 543, 549 (1964) (objectives of national labor policy require that the rightful prerogatives of owners to rearrange their businesses or cease operations must be balanced by the need to protect employees from a sudden change in the employment relationship).
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> Based upon this line of cases, I believe that there may be circumstances in which it would be appropriate to hold a company as a successor even if it acquires only some of a respondent's assets. Such a circumstance could arise, for example, when the order provides a specific remedy that the respondent, because of a transfer of assets, is no longer able to carry out. See Letter from the Secretary of the Commission to James T. Halverson, Esquire (August 20, 1986), at 10, in response to petitions filed by Beecham, Inc. on behalf of J.B. Williams Company, Inc., et al., Dockets Nos. 8547, C-2037 and C-2226, and Merk & Co., Inc., trading as Quinton Company, et al., Docket No. 8635.

In the matter of Allied Corporation, Docket No. C-3109, the Commission also found "reason to believe" that a divestiture of some assets created a successor for purposes of the order on the grounds that, under the new owner, the "business appears to be continuing in an essentially identical form." See Order Reopening the Proceeding and Modifying Cease and Desist Order, March 18, 1987, 109 F.T.C. at 84.

The Commission commonly applies order obligations to the business rather than solely to the entity that owned it at the time the order was entered. This preserves, but does not extend, the scope of a remedy that the Commission has achieved through litigated or consent orders. So, for example, the Compliance

Division advised in the matter of Godfrey Company, Docket No. C-3066, that Fleming Companies, Inc. did not become the successor to Godfrey as a result of acquiring it; rather Fleming became responsible as the parent corporation of Godfrey for Godfrey's continued compliance with the order. As a result, Fleming was required in the special circumstances described (concerning the separate operation of the Godfrey stores) to assure that Godfrey seek prior approval, but only for acquisitions of grocery stores by Godfrey and not for unrelated acquisitions by other Fleming entities. See Letter to John M. Mee, Esquire (September 28, 1987).

A similar result was reached in the matter of Germaine Monteil Cosmetiques Corporation Docket No. C-3098. Revlon, Inc. was advised by the Compliance Division that: "Revlon would be bound by the order against Germaine Monteil after merging Germaine Monteil into Revlon only with respect to the products, as defined in the order, of Germaine Monteil." See Letter to Owen M. Johnson, Jr., Esquire (June 5, 1989).

Application of the Successorship Standard

The individual hospitals owned and operated by HCA are the businesses that are the subject of the HCA Orders. Those orders are designed to preserve competition in local geographic markets. Thus, the Commission's successorship standard was not correctly applied in the HTI Letter. It should have been made clear that the sale of HCA's hospitals and management contracts in a local market is comparable, for antitrust purposes, to the sale of all Allied's high purity acid business or Merk's sale of Sucrets. As a result, none of the factors identified in my earlier letter as distinguishing the HTI acquisition exist for localities in which HCA has sold its hospital business: 1) HCA transferred all or substantially all of its assets in the relevant business; 2) HCA is no longer in business in a geographic market covered by the order; and 3) HCA is no longer capable of complying with the order provision in question, which require advance notice to the Commission of certain types of acquisitions.

In accordance with the Commission's application of Golden State, when HCA's hospitals are transferred to new owners or managers, the business remains subject to the Commission's orders. Thus, because HMC has acquired from HCA the right to manage a hospital in a locality, HMC has, in principle, the obligation to provide the Commission advance notice of any hospital acquisition, management contract, etc. it makes in that area, if as a result of that acquisition it would own and operate more than 20 percent of the hospital beds in that locality.

Your letter of March 23, 1990, suggests that this result could create some anomalies. You state that HMC, as a successor, would be obliged to obtain Commission approval prior to any acquisition in Chattanooga. You also state that the Bureau's view might result in two entities having separate notification obligations for the same locality. For reasons described below, the former is not true, and the latter, while possible, is not an anomaly. Separate notification would arise only to protect the effectiveness of the Commission's orders. It would be truly anomalous if the scope of the Commission's order diminished as a result of dividing HCA's business operations.

Ownership or management of an HCA hospital triggers a successorship obligation. Thus, HMC does not have notification obligations for hospital acquisitions in or contracts made for localities in which it does not operate, own, etc. hospitals that it acquired from HCA. See Letters, supra, to John M. Mee (re: Godfrey Co.) and Owen M. Johnson, Jr. (re: Germaine Monteil) indicating that responsibility under those orders extends only to the business acquired by the successor. Because HMC did not acquire hospitals in, or management contracts for, Chattanooga, Norfolk, or Midland/Odessa, HMC has neither prior approval nor prior notice obligations under the orders for these areas. Absent a closer or more complete relationship between HMC and HCA, such obligations would attach only if HMC had obtained hospitals in those areas from HCA.

The Commission's decision in the Allied Corporation reopening, supra, illustrates how separate obligations could arise under an order addressed to one person. In that decision, the Commission considered Allied's request to be relieved of prior approval obligations that applied to acquisitions of high purity acid manufacturing facilities. Allied had spun off all of its facilities to Henley. The Commission rejected Allied's request to terminate the prior approval provisions on the grounds that the business that gave rise to the order was continuing. The Commission went on to say that it believed Henley may be the successor to the obligations under the order, citing Golden State and noting that Henley was running the business and its liability was necessary to preserve the purpose of the order.

The Commission then considered whether Allied should still be bound by the order and identified two facts that led it to grant Allied's request: Allied had sold its business and it stated "that it does not intend now to reenter the market." Had Allied not made the quoted representation about its intention, it appears the Commission would not have released Allied from those provisions. In that event, two entities would have had separate obligations under the order.

Similarly, in this case, if HCA were to exit a local geographic hospital market by a sale of management contracts to HMC, the order obligations would follow the business in order to preserve the effectiveness of the order. But, if HCA reentered the geographic market it too would be subject to the order for subsequent acquisitions in that market.

Like the successor in Golden State, HMC had knowledge of the agency's orders before its acquisition and HMC knew those orders applied to the HCA management contracts that it was acquiring. As noted earlier, HMC and HCA entered into a "Compliance Agreement" whereby HMC "agreed to be bound by the requirements of the Chattanooga Order, the Forum Consent Order and the New Orleans Judgment, to the extent such requirements are applicable to [it]. . . ."

As in Golden State, the Commission's successorship standard exists to implement the objectives of federal law, here the effective enforcement of the objectives of § 7 of the Clayton Act. In this case, Hospital Corporation of America, the Commission rejected the claim that the prior notification remedy was unwarranted or should be imposed only upon proof of bad faith:

> Whether such relief is appropriate depends not on whether the respondent has a history of law violations or otherwise deserves to be punished, but on whether, in view of the violation proven in this case, the relief is necessary to detect and investigate future acquisitions that may significantly endanger competition.

106 F.T.C. at 516. The Commission's view was upheld on appeal. Hospital Corporation of America v. F.T.C., 807 F.2d 1381, 1393 (7th Cir. 1986). It is reasonable to require prior notice, in any area "in which HCA already operates a hospital," for any acquisition resulting in a market share of twenty percent or more. The litigation established the appropriateness of this prior notice provision to the enforcement of § 7 of the Clayton Act. Requiring a successor to abide by it merely preserves the remedy the Commission has already obtained.

Other Considerations

Although I believe that HMC is a successor under the HCA Orders, we have indicated in discussions with you that the circumstances of HMC may warrant some differences in treatment. As an initial matter, HMC may be able, until it receives this letter, to assert good faith reliance on the HTI Letter as an adequate reason for not having provided any required notices prior to its acquisitions. Also, it may be relevant if it can be established that the prior notice requirement burdens HMC's operations or if HMC has taken actions to its detriment in reliance on the HTI Letter. If HMC can make the showings required by section 5(b) of the Federal Trade Commission Act and § 2.51 of the Commission's Rules of Practice, it may urge these as grounds for modification of the orders as they apply to HMC.

Furthermore, as we stated in discussions with you, we think HMC's liability as a successor under HCA contracts may terminate with the expiration of those contracts if that occurs before the expiration of the order. Of course, such termination would not occur as a result of a mere novation; consequently we invited you to submit additional information concerning such contracts. In the final footnote of your March 23, 1990, letter you request the Bureau to address the effect of contract expiration. However, I cannot go beyond the statements we have made previously in the absence of more information about HMC's contracts and the hospital contracting process.[4]

Finally, your March 23, 1990, letter suggests the final paragraph of the HTI Letter may not be clear enough about the binding effect of the Bureau's advice when it expresses an opinion on a Commission order. You suggest that the Bureau committed itself not to change its views unless it discovered dispositive facts it had not previously considered. Any such interpretation is unwarranted.

The HTI Letter stated that the views it expressed were not binding on the Commission; neither are those views "binding" on the Bureau. They are an opinion on what the Commission would do if it was faced with the question posed to the Bureau. The views are a prediction, not a judgment subject to rules of finality. No reliance on statements in a letter is warranted after those views have been revised. The language quoted in footnote 6 of your March 23, 1990, letter refers to circumstances in which no reliance is ever justified, for example, to circumstances in which relevant facts were not disclosed to the Bureau. To avoid the possibility of any future misunderstanding, the final paragraph of this letter has been reworded.

The views expressed in this letter are restricted to the facts as you have represented them in your request. Moreover,

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[4] I have not discussed your argument concerning Ch. 5.3.4.1 of the Commission's Operating Manual, because, as the Manual states, the language you cite is intended for instances in which the person making an acquisition "might not otherwise be a successor under the law."

staff advice is not binding upon the Commission, and the Bureau may in appropriate circumstances reconsider, revoke, or rescind that advice. Further, this advice does not preclude the Commission from taking any action it deems appropriate, including an action for civil penalties, for any violation of the order.

Sincerely,

Daniel P. Ducore

Daniel P. Ducore
Assistant Director