

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION
600 Pennsylvania Avenue, N.W.
Washington, DC 20580

Plaintiff,

v.

LABORATORY CORPORATION OF
AMERICA

and

LABORATORY CORPORATION OF
AMERICA HOLDINGS
358 South Main Street
Burlington, NC 27215

Defendant.

No. ____-CV- ____

FILED UNDER SEAL

**COMPLAINT FOR TEMPORARY RESTRAINING ORDER
AND PRELIMINARY INJUNCTION PURSUANT TO
SECTION 13(b) OF THE FEDERAL TRADE COMMISSION ACT**

Plaintiff, the Federal Trade Commission ("FTC" or "Commission"), by its designated attorneys, petitions the Court, pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), and Section 16 of the Clayton Act, 15 U.S.C. § 26, for a temporary restraining order and preliminary injunction barring defendant Laboratory Corporation of America and Laboratory Corporation of America Holdings (collectively "LabCorp") from taking any further direct or indirect steps toward integrating any of the assets and other interests acquired from Westcliff Medical Laboratories, Inc. (the "Westcliff assets"), and requiring it to preserve the independent competitiveness and identity of the Westcliff assets

thereby maintaining the *status quo* during the pendency of an administrative proceeding that has been initiated by the Commission pursuant to Section 5 of the FTC Act, 15 U.S.C. § 45, and Sections 7 and 11 of the Clayton Act, 15 U.S.C. § 18 and § 21.

NATURE OF THE CASE

1. The Commission brings this action pursuant to its statutory authority to ask this court to preserve the Westcliff assets that LabCorp acquired through an anticompetitive merger on June 16, 2010 (the "Acquisition") until the completion of a plenary administrative trial. The Commission has issued an administrative complaint challenging the legality of the Acquisition and directed that the administrative trial relating to the Acquisition shall begin on May 2, 2011. (Exhibit A). Absent injunctive relief granted by this Court, however, LabCorp may integrate the former Westcliff assets after 11:59 p.m. on December 3, 2010.

2. Obtaining the requested injunctive relief is imperative to maintaining the Commission's ability to fulfill its mission of protecting consumers. Allowing the Defendant to integrate the Westcliff assets prior to a determination of the legality of the Acquisition would undermine, if not vitiate entirely, the Commission's ability to remedy the Acquisition's anticompetitive effects. Integration will commingle the Westcliff assets with those of LabCorp, making an independent Westcliff difficult, if not impossible, to reconstitute.

3. LabCorp's \$57.5 million acquisition of Westcliff (the "Acquisition") will have the effect of substantially lessening competition for the sale of clinical laboratory testing services to physician groups in Southern California. LabCorp and Westcliff are two of only three vendors of clinical laboratory testing services for the vast majority of physician groups in Southern California, with the other being Quest Diagnostics Incorporated ("Quest"). By eliminating one of only three significant alternatives for most physician groups, the Acquisition

will result in higher prices and inferior service for physician groups who contract with health plans to provide healthcare services to their members.

4. Clinical laboratory testing services are critical to the diagnosis and treatment of patients. These services are performed for patients pursuant to requisitions by their physicians, but the ultimate payer for clinical laboratory testing services varies depending on the type of health plan in which patients are enrolled. For tests performed on patients who belong to health maintenance organizations (“HMOs”) in California, the payer is routinely a physician group due to the structure of the California healthcare market. Physician groups are not synonymous with individual physicians, but rather are entities such as independent practice associations that exist to contract with health plans and vendors of ancillary services. Specifically, health plans in California usually contract with physician groups to provide healthcare services for the health plans’ HMO enrollees, including laboratory testing services, on a per-member per-month (or “capitated”) basis, regardless of actual utilization. This arrangement is called the “delegated managed care model” because health plans delegate to physician groups the financial risk and responsibility of providing healthcare and ancillary services for their HMO enrollees. Physician groups, in turn, routinely contract with clinical laboratory vendors, and pay them to provide those services on similar capitated terms, thereby shifting that portion of the risk to the clinical laboratory vendor.

5. Physician groups contract on a capitated basis for clinical laboratory testing services because it defrays the financial risk for services that they do not perform themselves, minimizes administrative costs and is significantly less expensive than purchasing clinical laboratory services on a fee-for-service basis. All physician groups prefer purchasing laboratory services on a capitated basis, and the overwhelming majority do so. A very small number,

however, have to purchase laboratory services on a fee-for-service basis, as the laboratory vendors deem them too small or unattractive to extend capitated terms. In addition, some are affiliated with hospitals that require, or strongly encourage, them to purchase services from the hospitals' laboratories at significantly higher fee-for-service prices. Thus, even if the market is expanded to include the sale of all laboratory services to physician groups, both on a fee-for-service and capitated basis, the competitive analysis does not change. In order to compete effectively for physician group business, a laboratory must be able to offer competitive capitated rates. Competition for the limited physician group business that is contracted on a fee-for-service basis does not affect capitated rates or the attractiveness of capitated contracting.

6. The Acquisition, if completed, will significantly reduce competition by eliminating Westcliff as an important independent competitor. Westcliff has been one of only three viable alternatives for most physician groups in Southern California, and has been particularly beneficial to consumers as a low-priced competitor that competed head-to-head with LabCorp. In fact, Westcliff has been willing to extend low-priced capitated contracts to customers that LabCorp and Quest have been unwilling to service in that manner. An immediate impact of the integration of the Westcliff assets is that LabCorp intends to increase prices to Westcliff customers. Further, the elimination of a price-cutting maverick competitor means that the Acquisition, if completed, will allow LabCorp to exercise market power both in coordination with its only remaining significant competitor, Quest, and by increasing prices on its own. The Acquisition therefore increases the likelihood that customers will pay higher prices and receive inferior service.

7. Substantial and effective expansion by smaller clinical laboratory vendors or the entry of new firms into the market sufficient to deter or counteract the substantial

anticompetitive effects of the Acquisition is unlikely to occur. Any efficiencies resulting from the Acquisition will not offset the Acquisition's anticompetitive effects.

8. Temporary and preliminary injunctive relief is imperative to preserve the *status quo* and allow the Commission to examine the Acquisition on the merits in its administrative trial. This relief can readily be obtained by extending the terms of the hold separate agreement to which LabCorp agreed on June 25, 2010. For the past five months, this agreement has preserved the Commission's ability to obtain effective and prompt structural relief should it prevail in a plenary administrative proceeding. That agreement is set to expire after December 3, 2010, and "LabCorp intends to integrate the Westcliff assets . . . into the LabCorp network immediately thereafter." By closing down and consolidating Westcliff's operation into its own, LabCorp will destroy, perhaps forever, Westcliff's independent competitive presence in this market, unless it is enjoined from doing so by this Court.

JURISDICTION AND VENUE

9. This Court's jurisdiction arises under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and Section 16 of the Clayton Act, 15 U.S.C. § 26, and upon 28 U.S.C. §§ 1331, 1337, and 1345. This is a civil action arising under Acts of Congress protecting trade and commerce against restraints and monopolies, and is brought by an agency of the United States authorized by an Act of Congress to bring this action. LabCorp and its relevant operating subsidiaries are, and at all relevant times have been, engaged in activities in or affecting "commerce" as defined in Section 4 of the FTC Act, 15 U.S.C. § 44, and Section 1 of the Clayton Act, 15 U.S.C. § 12.

10. LabCorp transacts business in the District of Columbia and is subject to personal jurisdiction of this court. Venue therefore is proper in this district under 28 U.S.C. § 1391 (b)

and (c). Venue is also proper under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and under Section 12 of the Clayton Act, 15 U.S.C. § 22.

11. Section 13(b) of the FTC Act, 15 U.S.C. 53(b), provides in pertinent part:

(b) Whenever the Commission has reason to believe –

(1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and

(2) that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond. . . .

PARTIES

12. Plaintiff, the Commission, is an administrative agency of the United States Government established, organized, and existing pursuant to the FTC Act, 15 U.S.C. § 41 *et seq.*, with its principal offices at 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. The Commission is vested with authority and responsibility for enforcing, *inter alia*, Section 7 of the Clayton Act and Section 5 of the FTC Act.

13. Defendant, LabCorp, is a corporation existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 358 South Main Street, Burlington, North Carolina 27215.

14. LabCorp and its relevant operating subsidiaries are engaged in “commerce” as defined in Section 4 of the FTC Act, 15 U.S.C. § 44, and Section 1 of the Clayton Act, 15 U.S.C. § 12.

THE ACQUISITION AND THE COMMISSION’S RESPONSE

15. Pursuant to an Asset Purchase Agreement (the “Agreement”) dated May 17, 2010, Westcliff agreed to sell substantially all of its business assets to LabCorp for \$57.5 million. To facilitate the sale, the Agreement required Westcliff to file a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. § 101 *et seq.* in the United States Bankruptcy Court for the Central District of California, Santa Ana Division (the “Bankruptcy Court”).

16. On June 2, 2010, FTC staff became aware of LabCorp’s potential acquisition of the Westcliff assets and advised LabCorp that such an acquisition may raise competitive concerns. On June 3, at the request of LabCorp, FTC staff sent a letter to LabCorp’s counsel stating that the FTC was investigating the legality of the then-proposed acquisition of Westcliff. Thereafter, LabCorp’s counsel informed FTC staff that LabCorp would not consummate its acquisition of Westcliff before June 18, 2010. On June 9, 2010, the Bankruptcy Court formally awarded the Westcliff assets to LabCorp. On June 16, 2010, LabCorp consummated its acquisition of the Westcliff assets, fully aware that the transaction was being investigated by the FTC, and in direct contravention of its commitment to FTC staff.

17. By June 22, 2010, LabCorp understood that the Commission was planning to conduct a full investigation and was likely to petition this Court to prevent the integration of the Westcliff assets in order to preserve a remedy should the Commission’s investigation reveal that the transaction violated the antitrust laws. Accordingly, LabCorp agreed to hold the Westcliff

business separate for a time sufficient to allow a thorough investigation by FTC staff and to give LabCorp time to attempt to persuade FTC staff that the Acquisition did not raise competitive concerns. On June 25, 2010, LabCorp entered into a hold separate agreement that required, among other things, that LabCorp hold the Westcliff assets “separate and apart from and independent of LabCorp” and to “maintain the viability, marketability, and competitiveness of the Westcliff Assets and Business.” The hold separate agreement also required that the Commission issue a contemplated Subpoena *Duces Tecum* and Civil Investigative Demand within 10 days of the date of the hold separate agreement’s execution. This provision promoted the interests of both LabCorp and the Commission in facilitating an efficient review of the transaction. Courtesy copies of the subpoena and CID were provided to LabCorp’s counsel on June 30, 2010, and they were formally served on July 2, 2010. LabCorp certified substantial compliance with the subpoena and CID on November 4, 2010, and thus, the hold separate agreement terminates, by its own terms, at 11:59 p.m. eastern time on December 3, 2010.

18. On November 30, 2010, the Commission issued its administrative complaint concerning LabCorp’s acquisition of the Westcliff assets, and authorized the commencement of this ancillary action under Section 13(b) of the FTC Act to seek a temporary restraining order and preliminary injunction prohibiting LabCorp from integrating the Westcliff assets and seeking other preliminary relief to preserve the independent identity and competitiveness of the Westcliff assets until the resolution of the administrative proceeding. The Commission has directed that the plenary trial on the merits of the Acquisition shall begin on April 29, 2011. Following issuance of an initial decision by an FTC Administrative Law Judge, the Commission will determine the legality of the Acquisition under Section 7 of the Clayton Act and Section 5 of the FTC Act, along with an appropriate remedy, in the event liability is found. Pursuant to

Section 5(c) of the FTC Act, 15 U.S.C. § 45(c) LabCorp may appeal an adverse Commission decision directly to any U.S. Court of Appeals within whose jurisdiction LabCorp resides or carries on business.

19. In authorizing the commencement of this action, the Commission determined that (1) it has reason to believe that the Acquisition violates Section 7 of the Clayton Act and Section 5 of the FTC Act by substantially reducing competition in one or more lines of commerce; and (2) it will promote the public interest for this Court to enjoin integration of the Westcliff assets and order other preliminary relief preserving the Westcliff assets pending resolution of the Commission's administrative trial, and any appeals, so as to minimize the potential harm to competition and preserve the Commission's ability to effectuate an adequate remedy if it concludes, after the plenary administrative trial, that the Acquisition is unlawful.

THE RELEVANT PRODUCT MARKET

20. The sale of capitated clinical laboratory testing services to physician groups operating under the delegated managed care model is a relevant product market for the purpose of analyzing the competitive effects of the Acquisition. The sale of clinical laboratory testing services to physician groups operating under the delegated managed care model is another relevant product market for the purpose of analyzing the competitive effects of the Acquisition. "Clinical laboratory testing services" encompass the full range of products and services provided by a clinical laboratory, including, but not limited to, the drawing and collection of specimens at patient service centers, as well as the transportation of specimens over a coordinated courier route system; a comprehensive menu of routine and esoteric clinical diagnostic tests; STAT testing capability; computerized tracking of specimens, record-keeping, and billing functions; and the electronic communication of test results, patient encounter data, and other data required

by customers, including the ability to interface with physicians' electronic medical records.

"Physician group" refers to any group medical practice, individual practice association (sometimes referred to as independent physician association), physician service organization, management service organization, medical foundation, or physician/hospital organization, that provides, or through which physicians contract to provide, healthcare services to enrollees of HMO health plans.

21. Clinical laboratory testing involves the analysis of body fluids, tissue, and other specimens to detect and evaluate the presence, concentrations, or composition of chemical, biological, or cellular components. Clinical laboratory tests are ordered by physicians to help manage a wide variety of patient medical conditions, and are essential to delivering quality healthcare. Physicians rely on clinical laboratories to provide accurate and timely testing information used to diagnose, monitor, and treat their patients' health conditions. No other products or services are viable substitutes for clinical laboratory testing services. Physician groups, which routinely operate under the delegated managed care model in Southern California, contract with clinical laboratories to purchase these services.

22. Physician groups do not regard the internal performance of clinical laboratory testing services as a competitively viable or cost-effective substitute for having those services provided by an independent clinical laboratory. Although physicians can perform a limited number of simple diagnostic tests in their own offices, this is not a substitute for the broad range of testing services provided by independent clinical laboratories, and would not be a viable substitute even in the event of a significant increase in the price of clinical laboratory testing services.

23. Physician groups are separate, distinct and readily identifiable purchasers of clinical laboratory testing services. Clinical laboratories always know when they are contracting with physician groups and provide services to them on markedly different terms than they do to other customer groups. Physician groups routinely require a clinical laboratory that offers, among other things, competitive capitation rates; an extensive specimen collection and distribution system that includes conveniently located patient service centers and courier networks across the groups' entire geographic coverage area; a comprehensive menu of clinical diagnostic tests; STAT testing capabilities; and advanced electronic data reporting and electronic medical record interfacing capabilities. Because physician groups are easily identified and have broad requirements for clinical laboratory vendors, the sale of clinical laboratory testing services to physician groups constitutes a relevant antitrust market.

24. The vast majority of physician groups operating under the delegated managed care model in Southern California contract with clinical laboratory vendors on a capitated basis. Capitated contracts allow physician groups to delegate the risk of uncertain testing utilization to clinical laboratories and allow physician groups to predict with certainty their clinical laboratory testing services expenses. Capitated contracts also save administrative costs for physicians because they allow the groups to avoid the burdensome process of billing and tracking every test. Finally, capitated testing is provided at deep discounts to fee-for-service testing because large clinical laboratory vendors consider capitated business to be an important part of their business model. Indeed, physician groups can achieve 50% or more in total cost savings by contracting on a capitated basis versus a fee-for-service basis. Thus, capitated contracts are much more advantageous to physician groups that operate under the delegated model than the purchasing of clinical laboratory testing services on a fee-for-service basis, and would remain so

even if capitated prices increased significantly. The absence of economic substitutes for capitated contracts means that the sale of clinical laboratory testing services under capitated contracts to physician groups constitutes a relevant antitrust market.

25. Despite the significant advantages of capitated contracts, a very small number of physician groups operating under the delegated model purchase clinical laboratory testing services on a fee-for-service basis. For the most part, these groups do so because they cannot obtain capitated contracts. Clinical laboratories often refuse to provide testing services to physician groups they deem too small or otherwise unattractive. In addition, some physician groups are affiliated with hospitals that they are required to support by purchasing clinical laboratory services from the hospitals' laboratories on significantly higher priced fee-for-service terms. The number of physician groups operating under the delegated model that purchase laboratory services on a fee-for-service basis, and the number of covered lives they represent, is extremely small. In contrast, for virtually all physician groups, the ability and willingness of a clinical laboratory vendor to sell its testing services on a capitated basis is the single most important criterion they consider when evaluating a laboratory services contract. Because so few physician groups purchase testing services on a fee-for-service basis, the inclusion of fee-for-service testing sold to physician groups in the relevant market would not affect the assessment of the Acquisition's impact on competition.

THE RELEVANT GEOGRAPHIC MARKET

26. For the purposes of this Complaint, the relevant geographic market in which to assess the competitive effects of the Acquisition is no broader than Southern California, consisting of the counties in California south of, and including, San Luis Obispo, Kern and San Bernardino counties.

27. LabCorp and Westcliff, together with Quest, compete for and serve physician groups throughout the Southern California region by virtue of their extensive networks of patient service centers and STAT laboratories, and their high-volume testing facilities in the region. Firms outside the region, including those operating in northern California (other than LabCorp, Westcliff and Quest) cannot and do not compete for physician group business in Southern California. Physician groups in Southern California require networks of patient service centers to provide convenient access for their managed care patients. For the largest physician groups, coverage across large parts of Southern California is required.

MARKET STRUCTURE AND THE PRESUMPTION OF ILLEGALITY

28. LabCorp is the second-largest independent clinical laboratory in the United States with total revenues of \$4.69 billion, of which \$174.6 million was derived from its Southern California operations. In Southern California, LabCorp is the second-most significant vendor of laboratory services to physician groups operating under the delegated model. With its extensive network of 104 patient service centers and 6 STAT laboratories throughout Southern California, LabCorp has the necessary scale to meet all of the requirements of physician groups that contract on a capitated basis. LabCorp has capitated contracts with 29 physician groups in Southern California covering nearly 1 million patient lives. Although LabCorp's capitated business represents only 8.9% of its Southern California revenues, it represents 43.1% of its total testing volume.

29. Prior to the Acquisition, Westcliff was the third-largest independent clinical laboratory in Southern California, which was the primary focus of its operations, with approximately [REDACTED] in total revenues, including [REDACTED] derived from its Southern California operations. Similar to LabCorp, Westcliff has an extensive network of [REDACTED] patient

service centers and [REDACTED] STAT laboratories throughout Southern California. Besides Quest and LabCorp, Westcliff is the only other clinical laboratory that routinely competes for, and wins, capitated contracts with physician groups throughout Southern California and is viewed by the vast majority of physician groups as the only competitive alternative to Quest and LabCorp in the region. Currently, Westcliff has capitated contracts with [REDACTED] physician groups in Southern California covering nearly [REDACTED] patient lives. Westcliff's capitated business represents [REDACTED] of its Southern California revenues, but [REDACTED] its total testing volume.

30. Quest is the leading national provider of clinical laboratory testing services and the leading vendor in Southern California, with a substantial share of the Southern California market. With [REDACTED] patient service centers and [REDACTED] STAT laboratories, Quest services about [REDACTED] capitated contracts with physician groups in Southern California covering approximately [REDACTED] patient lives. Although it has had operations in Southern California for many years, Quest expanded to its current size largely through its acquisition of Unilab in 2003.

31. Prior to the Acquisition, LabCorp, Westcliff and Quest together accounted for approximately [REDACTED] of the delegated HMO lives covered by capitated contracts. Quest's share of capitated patient lives is approximately [REDACTED] and LabCorp's share of capitated patient lives is approximately [REDACTED]. Westcliff, which only began competing for capitated contracts a little more than three years ago, covers approximately [REDACTED] of capitated patient lives in Southern California.

32. The remaining [REDACTED] of the market is accounted for by several minor clinical laboratories. The largest of these [REDACTED] is one-third the size of Westcliff in terms of capitated patient lives under contract, most of which it has had for years. Unlike LabCorp, Quest and Westcliff, [REDACTED] competes only in a limited geographic area in [REDACTED] rather than throughout the Southern California market,

and has been unable to expand into adjacent areas. The remaining laboratories are even smaller and more localized in their focus. For example [REDACTED] is a local laboratory in [REDACTED] that has serviced several small physician groups on a capitated basis for years. [REDACTED] has only been awarded one capitated contract since 2007 and [REDACTED]

33. The market for the sale of capitated clinical laboratory testing services to physician groups in Southern California is highly concentrated today. The Merger Guidelines measure concentration using the Herfindahl-Hirschman Index (“HHI”). Under that test, a merger is presumed likely to create or enhance market power (and is presumed illegal) when the post-merger HHI exceeds 2,500 and the merger increases the HHI by more than 200. Here, the Acquisition increases concentration in the relevant market by [REDACTED] points to a Herfindahl-Hirschman Index level of [REDACTED] creating a substantially more concentrated market. This post-merger market concentration level, as well as the increase in concentration produced by the Acquisition, is well above the range where a transaction is presumed to produce anticompetitive effects.

34. These market concentration figures, as well as Westcliff’s market share, likely understate the competitive significance of Westcliff in the relevant market as Westcliff did not enter the market until 2007, and has been growing rapidly since that time. Even though physician groups request bids for their business, or otherwise evaluate their clinical laboratory vendor options, relatively infrequently, LabCorp admits that Westcliff has been able to secure over [REDACTED] physician group contracts in Southern California in just over three years and that in the same time frame, LabCorp has won [REDACTED]. Westcliff’s impressive success rate demonstrates that it

has a much greater chance of winning upcoming business than would be implied by its current market share.

35. The market for the sale of all clinical laboratory testing services to physician groups is also highly concentrated and would become more so with the acquisition. Very few physician groups purchase clinical laboratory testing services on a fee-for-service basis, rather than on a capitated basis, and those that do are far smaller than the ones that are able to contract on a capitated basis. Thus, the market shares accounted for by Quest, LabCorp and Westcliff would not change materially if the lives delegated to physician groups that purchase clinical laboratory testing services on a fee-for-service basis were included in the relevant market.

ANTICOMPETITIVE EFFECTS

36. The Acquisition may substantially lessen competition in Southern California for the sale of clinical laboratory services to physician groups by eliminating an aggressive competitor, one of only three principal firms that compete for physician groups' capitated contracts. As Westcliff wrote in an email to a potential physician group customer: [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]” According to LabCorp’s Managed Care Executive for Southern California, “Over the past three years Westcliff has become aggressive in the marketplace underbidding many of the Quest and LabCorp contracts, which in turn held the California capitation rates to low levels.”

37. The Acquisition eliminates actual, substantial and direct competition between LabCorp and Westcliff in the sale of clinical laboratory testing services to physician groups in Southern California. LabCorp officials recognize that “Westcliff is [LabCorp’s] largest

competition besides Quest.” Numerous physician groups have leveraged the competition between LabCorp and Westcliff, and in the process have obtained lower prices. In several instances, LabCorp attempted to impose price increases on physician groups only to find its efforts thwarted when Westcliff offered capitated rates that were lower than those sought by LabCorp.

38. The Acquisition eliminates a price-cutting maverick. As an upstart competitor seeking to expand its share of physician group business, Westcliff had the incentive to win business by pricing capitated contracts aggressively, and did so. LabCorp believed that “[u]nfortunately, Westcliff has recently become very price competitive with a number of IPA deals in play, with the ultimate goal of driving top line revenues.” Westcliff also extended capitated contracts to physician groups that LabCorp and Quest would only service on significantly higher fee-for-service terms. In contrast, both LabCorp and Quest were seeking to increase prices and reduce services to physician groups in Southern California over the same time period. According to a 2009 LabCorp document, “[s]everal IPA Plans in Southern California [were] being evaluated for profitability” and “[s]everal groups [were being] contacted to negotiate higher cap rates.” Likewise, as recently as May 2010, LabCorp documents note that “client feedback is that [Quest is] raising cap rates; cutting services and increasing carve out testing for all IPA contract renewals.”

39. The Acquisition will enhance the likelihood of collusion and/or coordinated interaction between Quest and LabCorp, the only two remaining significant vendors of clinical laboratory testing services to physician groups in Southern California. A substantial increase in concentration in an already highly concentrated market facilitates coordinated interaction. Furthermore, the Acquisition eliminates a maverick firm in a market that is vulnerable to

coordinated conduct, which enhances the remaining firms' ability to collude and/or compete less vigorously for each other's customers, and increases their incentives to do so.

40. The Acquisition will also increase the likelihood that the loss of direct competition between LabCorp and Westcliff will lead to higher prices for clinical laboratory testing services in Southern California. LabCorp's due diligence documents prepared to evaluate the potential acquisition of Westcliff make it clear that LabCorp intends to increase prices to Westcliff's physician group customers. LabCorp noted that Westcliff's prices are "lower than what LabCorp typically accepts for IPA cap rates." Thus, among LabCorp's planned "Post Closing Activities" is to "Review all contracts for profitability. Negotiate new [higher] rates for poor performing IPAs [physician groups]." A top LabCorp executive even stated that "perhaps in 2011 we could go back and renegotiate rates as that would only leave us and Quest as viable options." Likewise, when LabCorp's Managed Care Executive learned about Westcliff's lower capitation rates she stated, "It looks like I will be very busy negotiating new rates."

BARRIERS TO ENTRY AND EXPANSION

41. Entry into the market for the sale of capitated clinical laboratory testing services to physician groups, or expansion by small fringe firms, is unlikely to alleviate the anticompetitive effects of the Acquisition. Smaller, fringe clinical laboratories, even those that already have some physician group business, have not grown significantly in the last ten years. In order to compete effectively for capitated physician group contracts, a clinical laboratory must have the scale necessary to offer deeply discounted capitated rates and an extensive network of patient service centers that provides convenient access for the physician group's entire patient membership. Only Quest, LabCorp and Westcliff have the scale necessary to compete for most capitated physician group contracts in Southern California. Smaller firms and new entrants

would have to expand significantly in order to replicate the competition that will be lost with the elimination of Westcliff.

42. LabCorp recognizes that economies of scale create significant advantages for larger laboratories and limit the entry and expansion of smaller laboratories. One LabCorp business planning document states: "The barriers-to-entry and economies of scale in the clinical market . . . are what allow LabCorp to sustain high profit margins with limited competition." The document elaborates that the clinical laboratory testing industry is difficult to enter because of "economies of scale" achieved by throughput on "large [automated testing] equipment" and an established "logistics and PSC [patient service center] network."

43. LabCorp recognizes that the clinical laboratory testing business is characterized by high fixed costs. Larger laboratories have significantly lower costs than smaller laboratories because they process a larger volume of tests through their existing infrastructure. Larger laboratories are also able to reduce incremental costs by negotiating volume discounts on supplies used to perform clinical laboratory testing. Finally, larger laboratories process far more tests in-house than smaller laboratories, and thereby are able to minimize the costly outsourcing of low volume tests. The cost advantages of larger laboratories are essential to effectively compete for low-priced physician group business, and cannot be matched by smaller, more local clinical laboratories.

44. Clinical laboratories assume substantial financial risk when contracting with physician groups on a capitated basis. Larger laboratories have experience predicting patient utilization with sufficient accuracy to determine the appropriate capitated rate, have the volume and cost structure to absorb any mistakes made in those predictions, and a large pool of capitated contracts over which to spread the risk. Smaller laboratories generally have experience in a

limited geographic area, and consequently they lack sufficient information about the patient populations in areas outside their traditional vicinities to accurately predict utilization rates for capitated contracts. Smaller laboratories do not have the cost structure or capital resources to absorb mistakes, nor the volume of capitated contracts over which to spread the risk of error. A mistake in estimating the proper rate or a significant variance in utilization can be financially catastrophic for a small laboratory.

45. Expansion into new localities is risky even for larger firms that already have a presence in adjacent areas and a low cost, high volume testing infrastructure. For smaller firms, the risk is enhanced because they have far fewer patient service centers to meet the needs of any given physician group, and therefore are faced with the added cost of building out their patient service center network when competing for capitated sales to physician groups. The risks associated with such a build-out are substantial, as it can take a significant amount of time for a new patient service center to become profitable and opening new patient service centers can rarely be justified on physician group business alone. The more patient service centers a laboratory is required to open to service a particular physician group contract, the more likely it is that the laboratory will not be able to offer a competitive capitated rate. Accordingly, smaller, more local laboratories rarely compete for capitated physician group business beyond their immediate vicinities, and would not be able to do so successfully even in the face of a significant increase in capitation rates.

46. Beyond the challenges that smaller laboratories face in assuming the delegated risk of physician group contracts, most smaller laboratories would have to significantly enhance their electronic data reporting and electronic medical record ("EMR") interfacing technologies in order to compete more broadly for physician group business. Although not all physician groups

require advanced electronic reporting and EMR capabilities, it is becoming increasingly important in light of recent healthcare reforms. Developing these capabilities is a capital-intensive endeavor that is relatively difficult for small laboratories to undertake.

Prevailing capitation rates would have to increase dramatically before it would be economically feasible for small laboratories to make the investment necessary to meet this competitive requirement in the relevant market.

47. De novo entry (and expansion by out-of-state laboratories) effectively is blocked by a moratorium issued by the state of California on the issuance of new Medi-Cal provider numbers. A laboratory is required to have a provider number in order to bill Medi-Cal, which is California's Medicaid program, for laboratory services provided to Medi-Cal patients. An inability to bill Medi-Cal limits the market opportunity for a clinical laboratory, especially in areas of Southern California where Medi-Cal covers a large portion of the population. The current moratorium is scheduled to expire on January 26, 2011, but has been regularly renewed since at least 2007. Even if the moratorium were to be lifted, the same difficulties limiting expansion by existing firms in the market for sales to physician groups would apply even more clearly to new entrants.

48. Entry into the market for the sale of all clinical laboratory services to physician groups, or expansion by small fringe firms, is also unlikely to alleviate the anticompetitive effects of the acquisition in that broader market. Because few IPAs contract on a fee-for-service basis, a new entrant would have to offer competitive capitated rates, among other things, in order to make a significant market impact. As smaller fringe firms face considerable barriers to competing for capitated contracts, they cannot expand sufficiently to replicate the competition that will be lost with the elimination of Westcliff.

EFFICIENCIES

49. Any procompetitive efficiencies from the transaction will not outweigh the anticompetitive effects that are likely to occur. Under the case law and the Merger Guidelines only efficiencies that would benefit consumers and competition are cognizable, and even then, the efficiencies must be verifiable and uniquely produced by the transaction. Here, many of the projected cost savings are not verifiable, quantifiable, or specific to the Acquisition. And whatever cost savings LabCorp once had hoped it would achieve are now diminished, as it now acknowledges that some of the efficiencies it originally predicted were dependent on immediate integration that now will not be realized.

50. There is no evidence that any portion of any cost savings will be passed on to physician group customers in the form of lower prices. In fact, LabCorp's post acquisition plans are to raise prices to physician groups, not lower them. Given the uncertainties surrounding LabCorp's purported efficiencies, and the improbability that they will be passed on to consumers in any part, it is unlikely that any efficiency claims could be sufficient to reverse the Acquisition's potential to harm consumers.

FAILING FIRM

51. LabCorp's acquisition of Westcliff is not immunized by the "failing firm" doctrine. That affirmative defense places the burden firmly on defendants to demonstrate that (1) the allegedly failing firm faced the imminent prospect of business failure at the time of the acquisition; (2) that the firm could not have been successfully restructured under Chapter 11; and (3) that the firm seeking to acquire the failing firm is the only available purchaser. LabCorp cannot meet these strict criteria.

52. At the time of the Acquisition, Westcliff was generating profits from its operations and had \$100 million in annualized revenue. Its financial difficulties stemmed primarily from approximately \$50 million in debt generated by a 2006 private equity deal. Despite that debt, Westcliff was an attractive business. It was the third-largest independent clinical laboratory in Southern California, and its revenues had increased 22 percent over the preceding two calendar years. As a result, Westcliff had significant enterprise value, and other firms were willing to acquire Westcliff throughout the time that the LabCorp deal was being negotiated. In these circumstances, LabCorp was not, as it would have to be, “the only available purchaser,” and Westcliff cannot be said to have made, as required, “unsuccessful good-faith efforts to elicit reasonable offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.” Merger Guidelines §11.

53. The fact that Westcliff was in Chapter 11 bankruptcy at the time the Acquisition closed does not affect the failing firm analysis. The bankruptcy was not an indicator that Westcliff was failing; rather, it was a specific condition imposed by LabCorp as part of the acquisition. Further, the fact that an auction was conducted after LabCorp was installed as the “stalking horse bidder” and that no bids were received shows nothing more than that there were no bidders willing to pay the stalking horse price of \$60 million or more for Westcliff. Even at that late date, there were a number of firms willing to purchase Westcliff for a consideration above liquidation value.

54. Under these circumstances, it is unreasonable to conclude that Westcliff would have been liquidated. Westcliff had “minimal” liquidation value, and virtually all of its value was as a going concern. The secured creditors realized that they would not receive any return on

their investments if Westcliff had been liquidated, and therefore believed that even if LabCorp did not purchase the company, Westcliff would have been sold to an alternative purchaser, albeit at a lower price.

**LIKELIHOOD OF SUCCESS ON THE MERITS,
BALANCE OF EQUITIES, AND NEED FOR RELIEF**

55. In deciding whether to grant interim, temporary relief, the Court must balance the likelihood of the Commission's ultimate success on the merits against the *public* equities, using a sliding scale. Equities inuring only to the defendant cannot tip the scale.

56. The Commission's complaint raises questions about the lawfulness of defendant's Acquisition under the Clayton Act and the FTC Act that are serious, substantial, difficult, and doubtful enough to make them fair ground for thorough investigation, study, deliberation, and determination by the Commission during the administrative proceeding in the first instance, and ultimately, by a U.S. Court of Appeals.

57. The Commission has reason to believe that the Acquisition violated Section 7 of the Clayton Act and Section 5 of the FTC Act, and that the Agreement violated Section 5 of the FTC Act. In particular, Complaint Counsel for the Commission (the formal term for Commission staff as the plaintiff in an administrative trial) is likely ultimately to succeed in demonstrating, among other things, that:

- a. the Acquisition has had or will have anticompetitive effects in the relevant markets;
- b. substantial and effective entry and expansion into these markets is difficult, and would not be likely, timely, and sufficient to offset the anticompetitive effects of the Acquisition;

- c. any efficiencies that defendant may assert will result from the Acquisition are speculative, not merger-specific, and are, in any event, insufficient as a matter of law to justify the Acquisition; and
- d. the Acquisition is not immunized by the failing firm defense.

58. Given the strength of the Commission's likelihood of success, the balance of the public equities would need to overwhelmingly favor LabCorp in order to warrant denial of the Commission's request for temporary and preliminary injunctive relief for the pendency of the administrative proceeding. The balance does not favor LabCorp. LabCorp's costs associated with separately maintaining the Westcliff assets are private and therefore not cognizable, and further, they are entirely self-inflicted. LabCorp proceeded with the acquisition of Westcliff with the full knowledge and understanding that the transaction was being reviewed by the FTC. After LabCorp closed the transaction – earlier than it was supposed to, in violation of its commitment to the FTC – LabCorp voluntarily entered into the existing hold separate agreement. LabCorp created the situation it now finds itself in, and under these circumstances, any costs it faces to preserve Westcliff as a divestible entity cannot tip the balance in its favor.

59. Should the Commission rule, after the full administrative trial, that the Acquisition is unlawful, completely reestablishing the *status quo ante* of competition would be difficult, if not impossible, if the integration of the Westcliff assets into LabCorp already has occurred, or if the Westcliff assets are not preserved.

60. Accordingly, the equitable relief requested here is in the public interest.

WHEREFORE, the Commission respectfully requests that the Court:

- a. temporarily restrain and preliminarily enjoin LabCorp from further integrating the Westcliff assets, either directly or indirectly;

- b. temporarily extend the terms of the hold separate agreement to which LabCorp agreed on June 25, 2010, and subsequently issue an order, substantially in the form attached hereto as Exhibit A, requiring LabCorp to preserve and maintain all Westcliff assets and prohibiting LabCorp from exercising direction or control over, or influencing or attempting to influence directly or indirectly, the conduct of the held separate business until the Commission can adjudicate the legality of the Acquisition;
- c. retain jurisdiction and maintain the *status quo* until the Commission can adjudicate the legality of the Acquisition; and
- d. award such other and further relief as the Court may determine is appropriate, just, and proper.

Respectfully submitted,

December 1, 2010

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EXHIBIT A

EXHIBIT B