UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF IOWA
EASTERN DIVISION

UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	Civil Action No. C94-1023
	)	
v.	)	Hon. Michael J. Melloy
	)	
MERCY HEALTH SERVICES and	)	
FINLEY TRI-STATES HEALTH	)	
GROUP, INC.,	)	
	)	
Defendants.	)	

United States' Motions in Limine

- and -

Memoranda in Support

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Introduction

Defendants own and operate the only two general acute-care hospitals in Dubuque: Mercy Health Center ("Mercy") and The Finley Hospital ("Finley"). Mercy and Finley are each other's only competitor in the sale of all but the most advanced inpatient hospital services to Dubuque-area health care consumers. The vigorous competition between Mercy and Finley has created two outstanding, financially-viable hospitals and benefitted health care consumers through the nearly $3 million or more in price concessions Mercy and Finley have given to managed care health plans (such as health maintenance organizations, or "HMOs," and preferred provider organizations, or "PPOs").

After the parent corporations of Mercy and Finley--the Sisters of Mercy Health Corporation ("SMHC"), based in Michigan, and Finley Tri-States Health Group, Inc. ("Tri-States")--announced their intention to form the Dubuque Regional Health System ("DRHS"), several managed care plans and others voiced their concerns about losing their freedom to choose between the two Dubuque hospitals and their ability to negotiate competitive rates with Mercy and Finley. Following its investigation, the United States filed a civil complaint challenging this transaction under Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1.

To expedite the trial of this case, the United States is filing these motions in limine to: (i) exclude certain evidence and arguments defendants are likely to raise at trial that we believe are irrelevant or otherwise inadmissible; (ii) exclude certain evidence defendants are likely to offer at trial as a result of their discovery; (iii) limit certain inferences that defendants may attempt to make from evidence that is admissible; and (iv) establish certain procedures at trial that may expedite and facilitate each party's presentations.

We understand that these motions will be considered at the September 19 final pretrial conference. For the convenience of the Court and the parties, we have packaged these motions in one filing. We believe that the time spent before trial on the issues raised by these motions should produce significant benefits. Thus, it is our hope that these motions will help to shorten and focus the trial, and help to avoid digressions that will not aid in the adjudication of this case.

Motion No. 1
Community Sentiment About DRHS

The United States moves for an order excluding evidence of purported "community sentiment" concerning the creation of DRHS.

Memorandum

A. Pertinent Background.

Defendants have asserted, in justifying the creation of DRHS, that "the community supports the idea," and may seek to introduce at trial various kinds of testimonial evidence concerning purported support for the merger. We have found strong opposition to the merger. However, whatever may be the "community sentiment" about this transaction, it has no bearing on the statutory issues to be tried.

B. Applicable Law.

It is not surprising that the people in the Dubuque area have different views about whether this merger should proceed. But however interesting it may be to find out who "supports" and who "opposes" the merger, or to hear testimonials concerning how "the community" feels about the

matter, such evidence is not relevant.This case is controlled by two federal statutes--the Clayton Act and the Sherman Antitrust Act. Whether this merger violates either statute is not a matter subject to vote or strawpoll. While defendants certainly may introduce evidence from people who support the merger if their substantive testimony bears on an issue, limited available trial time should not be taken up with assertions of community support. Presentation of such evidence could be time-consuming, and, in the end, the Court undoubtedly would face a conflicting record showing substantial sentiment on both sides. We are aware of no case that has recognized favorable "community sentiment" as a reason to allow a merger. And, in the only case we know of that has accepted such evidence, the court made clear that the determination of the merger's legality would not turn on such evidence, emphasizing:

> "[T]he public interest is not necessarily a function of public opinion. As Judge Posner observed in the Rockford case ...: 'Most people don't want to compete' and this is true. 'The public interest is served by competition and a free enterprise economy is built, grounded and planted in the concept of competition. The public demands and requires it and individuals seek to avoid it whenever and wherever possible.'"

FTC v. University Health, Inc., 1991-1 Trade Cas. (CCH) ¶ 69,444 at 65,836 (S.D. Ga.) (refusing to enjoin the merger), vacated on other grounds, 938 F.2d 1206 (11th Cir. 1991) (directing that the merger be enjoined) ("University Health").

Apart from its lack of relevance and time-consuming nature, such evidence should be excluded under Fed. R. Evid. 403 because much of defendants' purported community "support" appears to have been generated by a misleading promotional campaign. That campaign repeatedly emphasized that: the creation of DRHS was a "partnership," "not a merger"; the two facilities would retain their identities; and consumers' "choice" would be "preserv[ed]." [Appendix ("App.") A (DRHS promotional materials)] Not only does the creation of DRHS represent the elimination of "choice" in every meaningful sense, the only way consumers would have even a semblance of "choice" after the creation of DRHS is if defendants (contrary to their representations in this lawsuit that, to save money, they will consolidate services at Mercy or Finley) did not consolidate services at one of the hospitals--in which event, their purported cost savings would vanish.

Relief Requested

The Court should enter an order excluding evidence and argument of purported community sentiment, support, or opposition concerning the creation of DRHS.

Motion No. 2
"Safety Zones" for Hospital Mergers

The United States moves for an order precluding defendants from presenting arguments regarding a prosecutorial "safety zone" for certain hospital mergers contained in the Statements of Antitrust Enforcement Policy in the Health Care Area ("Policy Statements") in an attempt to justify this merger on the basis of the supposed "smallness" of the defendants, particularly Finley.

Memorandum

A. Pertinent Background.

On September 15, 1993, the Antitrust Division joined with the Federal Trade Commission

in issuing Policy Statements regarding "their antitrust enforcement policies regarding mergers and various joint activities in the health care area." [App. B (Policy Statements at 1)] "The policy statements give health care providers guidance in the form of 'antitrust safety zones,' which describe the circumstances under which the Agencies ["absent extraordinary circumstances"] will not challenge conduct as violative of the antitrust laws as a matter of prosecutorial discretion." [Id. at 1-2] The first safety zone applies to hospital mergers satisfying certain criteria.

Defendants' merger does not fall within the safety zone for hospital mergers, and defendants have so stipulated. [App. C] Indeed, it is undisputed that Mercy and Finley, both of which are financially viable, are both significantly larger than the limit set by the Policy Statements, and, hence, do not qualify for safety zone treatment.

B. Applicable Law.

In no hospital merger case has the court's analysis included an evaluation of the prosecutorial guideline set forth in the Policy Statements. Nor have defendants pled any defense based on an alleged abuse of the Government's prosecutorial discretion in bringing this case. Even if they had made such allegations, it is settled that exercises of prosecutorial discretion are not judiciable (except in limited circumstances not remotely applicable here). Wayte v. United States, 470 U.S. 598, 607 (1985); United States v. Jacob, 781 F.2d 643, 646-47 (8th Cir. 1986).

Relief Requested

The United States does not object to the introduction of background evidence concerning the size (and other features) of Mercy, Finley and other medical facilities. Defendants should not be allowed, however, to prolong the trial in exploration of, and argument about, a prosecutorial safety zone policy that defendants admit does not apply to them. The Court should enter an order excluding

argument regarding the safety zone for hospital mergers, and declaring such prosecutorial policy irrelevant to a determination of this case.

Motion No. 3
Defendants' Non-Profit Status

The United States moves for an order precluding defendants from attempting to justify their merger on the discredited defense that they are non-profit entities.

Memorandum

A. Pertinent Background.

Defendants apparently will seek to present evidence or argue that their legal status as "non-profit" entities rebuts or is relevant to rebut any presumed anticompetitive harms that will flow from this merger. It is unclear whether they will argue that position as a blanket matter (i.e., the antitrust laws should not apply to non-profits) or as supporting an evidentiary inference (i.e., non-profits are less likely to act anticompetitively).

B. Applicable Law.

Regardless of which argument defendants ultimately advance, defendants' non-profit legal form is not relevant:

First, a defendant's non-profit status is not a blanket defense to the antitrust laws. As the court in University Health, 938 F.2d at 1213-14, 1224, explained in reversing the district court on this point: "[T]he appellees argue, as the district court held, that University Hospital's nonprofit status supports their position that the proposed acquisition would not result in substantially less competition. We disagree." This holding, the court elaborated, followed from the decision in NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85, 100 n.22 (1984), where "the Supreme

Court has rejected the notion that nonprofit corporations act under such a different set of incentives than for-profit corporations that they are entitled to an implicit exemption under the antitrust laws." Id. at 1224.

Second, a defendant's non-profit status is not even a factor to be considered in determining how defendants will act after the merger. United States v. Rockford Mem. Corp., 717 F. Supp. 1251, 1285-87 (N.D. Ill. 1989), aff'd, 898 F.2d 1278, 1285 (7th Cir.) (rejecting argument that non-profit hospitals might behave differently than proprietary hospitals), cert. denied, 498 U.S. 920 (1990) ("Rockford"); Hospital Corp. of Am. v. FTC, 807 F.2d 1381, 1390-91 (7th Cir. 1986) (same) ("HCA"); cf. University Health, 938 F.2d at 1213-14 ("the district court's assumption that University Hospital, as a nonprofit entity, would not act anticompetitively was improper").

The teaching of these cases (and experience) is clear: Non-profit hospitals are no different than for-profit hospitals and other businesses--they compete on price when faced with competition, but act far differently (raising prices and lowering quality) when freed from competition. The antitrust laws do, and should, apply equally to them.[1]

Relief Requested

The Court should enter an order excluding evidence and argument regarding defendants' non-profit status, and declaring that DRHS' non-profit status is irrelevant to the determination of this case.

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[*] One district court decision [United States v. Carilion Health Sys., 707 F. Supp. 840, 849 (W.D. Va. 1989), aff'd in an unpublished opinion on other grounds] suggested to the contrary, and was properly criticized. See Rockford, 898 F.2d at 1286 (explaining that these decisions were "unpersuasive as well as inconsistent with our analysis in" HCA, "a case cited by neither the district court or the court of appeals," and even noting that the decision of the court of appeals "did not want its decision to have precedential effect," and hence designated it "not-to-be published").

Motion No. 4
"Community Representatives"
on the Governing Board of DRHS

The United States moves for an order precluding defendants from attempting to justify their merger on the grounds that they will have "community representatives" on the governing board of DRHS.

Memorandum

A. Pertinent Background.

Defendants are likely to assert that the DRHS' governing board will not act "anticompetitively" because it will be composed of various representatives of the Dubuque community, who purportedly will be aligned with, and hence protect, the "community interest." Even if a "community representative" defense were legally cognizable under the antitrust laws (which it is not), defendants could not realistically assert it here.

In actuality, it will be SMHC (Mercy's out-of-state parent corporation) and Tri-States, the partners to the Partnership Agreement, and not the DRHS board, that effectively will control the two hospitals. The Partnership Agreement specifically prohibits DRHS from taking any of the following actions unless SMHC and Tri-States specifically ratify or approve the action beforehand: amend the Partnership Agreement; appoint or remove the CEO of DRHS; prepare strategic plans; prepare an annual budget; make a capital expenditure of $300,000 or more; incur any debt, capital, leases or guarantees; grant any liens or encumbrances; develop any major new programs; determine DRHS services; approve managed care contracts; join any community networks, or any alternative or integrated delivery systems, or other forms of reorganization; and dispose of assets worth $100,000 or more. [App. D (Partnership Agreement § 2.14)] In each of these areas, the role of the DRHS

"Governing Board" is limited to "initiating" the proposed action, which it may do only upon a two-thirds vote of its members. [Id.][2]

The "community representation" on the governing board, moreover, is minimal and, as structured, ineffectual. For example, the Partnership Agreement provides for only three such members out of an eighteen-member board, not a sufficient number to initiate any substantive action, much less to block the remaining members from acting. [Id. § 2.01(A)] Indeed, ten of the eighteen members of the board must be "representatives" of the two partners (SMHC and Tri-States), giving them effective control over the DRHS board in addition to their retained powers to make all substantive decisions. SMHC and Tri-States chose the initial three community representatives, will have control over the selection of any successors, and will retain the power to ratify or remove all board members. [Id. § 2.03(B-C)][3]

SMHC and Tri-States also will select and effectively control the Chief Executive Officer of DRHS, the person who will run the organization's day-to-day operations. Although the CEO technically will report to the DRHS board, the Partnership Agreement requires that the CEO be an employee of SMHC.

The Partnership Agreement defines the terms "approve" and "ratify." Where the Agreement calls for approval by the partners, they have the authority to accept, reject or impose an alternative action. [Id. § 1.01(D)] Where the Agreement calls for ratification, the partners have the authority to accept or reject a proposed action. [Id. § 1.01(U)]

Defendants may contend that there will be more than three community representatives on the DRHS board because they will name individuals who already are designated as community representatives on the boards of Mercy or Finley. Nothing in the Partnership Agreement, however, requires that the representatives of the defendants be chosen from the community members of their boards. Thus, even if defendants initially name such individuals to the governing board, nothing precludes them from later replacing them. The possibility of just this type of post-transaction manipulation to avoid antitrust liability makes the initial naming of such additional community representatives irrelevant. HCA, 807 F.2d at 1384.

Finally, whatever "community representation" might appear on the DRHS board, that cannot change what defendants accurately represented to the IRS: "Tri-States and SMHC have substantial authority over the operations and activities of DRHS"--indeed, "[t]he presence of community representatives on the Governance Board does not reflect a relinquishment of control over the operations of the hospital." [App. E (Honigman Letter [on behalf of DRHS] to IRS)]

B. Applicable Law.

The court in Rockford, 717 F. Supp. at 1285-86, considered the same contentions defendants have said they will make here, namely, that: (i) "any attempt by management to implement anticompetitive practices would be swiftly terminated by the boards" which "are composed primarily of people aligned with consumer interests"; and (ii) "board members of a community hospital could not act anticompetitively since they owe a fiduciary duty to the community, and hence consumers, to provide quality care at the lowest possible price." It then expressly rejected those contentions, explaining that "defendants' 'consumer-aligned' boards and not-for-profit status will not necessarily prevent the defendants from engaging in anti-competitive activity." 717 F. Supp. at 1287; cf. University Health, 938 F.2d at 1224 ("although public scrutiny may reduce University Hospital's ability to commit undetected violations of the antitrust laws, it would not eliminate altogether the risk that it might act anticompetitively"--"[f]or example, while public pressure might inhibit it from raising prices, 'similar pressure might inhibit [it] from expanding capacity to take on additional patients attracted by lower prices'"). In any event, the composition of a hospital's board of directors seems hardly relevant at all, because it typically is the hospital's management, not its board, that controls pricing and other competitive matters [see generally HCA, 807 F.2d at 1387], and, here, the board clearly is subservient to the partners' management , as reflected in the Honigman letter to the

IRS [see App. E].

Relief Requested

The Court should enter an order excluding all evidence and argument regarding community representatives on the DRHS board, and declare that this issue is irrelevant to the determination of this case.

Motion No. 5
Defendants' Purported "Procompetitive Behavior"

The United States moves for an order precluding defendants from introducing evidence of any purported "procompetitive" or other "good" behavior by Mercy or Finley in the past to show that DRHS will not act anticompetitively after the merger.

Memorandum

A. Pertinent Background.

Defendants might assert, as they did during the investigation, that one way to determine whether DRHS would exercise market power is to examine the hospitals' past behavior in pricing services for which they supposedly face no current competition in Dubuque. Specifically, defendants will point to: (i) Mercy's being the only Dubuque hospital offering psychiatric and inpatient rehabilitation services, and yet, in 1993, Mercy allegedly lost money on both those services, despite its overall $1.2 million profit for its general/medical business; and (ii) Mercy's psychiatric service charges allegedly being lower than seven of sixteen Iowa hospitals surveyed in 1993. Apparently, defendants will contend that these facts show that Mercy and Finley, if they acquire market power through the creation of DRHS, will not exercise it.

B. Applicable Law.

In University Health, defendants sought to prove that they would not act anticompetitively--

by introducing past instances of "procompetitive" conduct and other "good" behavior, coupled with their status as non-profit hospitals and their boards composed of community representatives. In rejecting that attempt, the court explained:

> "The appellees argue that University Hospital's prior history of service to the public and procompetitive behavior, added to its nonprofit status, removes their argument from the realm of speculation. We cannot agree. University Hospital's business decisions are not mandated by law; rather, its governing body is free to decide where to set prices and output. While University Hospital's prior practices may suggest future conduct, such evidence has limited probative value."

University Health, 938 F.2d at 1224.

Moreover, it is impossible to draw any conclusions by comparing psychiatric or rehabilitation services with the general acute-care inpatient services at issue in this case. First, the geographic markets appear to be quite different (e.g., unlike for general acute-care services, people often want to be a significant distance from home for psychiatric institutionalization to avoid any stigmatization). See Rockford, 717 F. Supp. at 1261 n.7 (excluding psychiatric and rehabilitation services from the relevant market "because they are not good alternatives for patients who require inpatient hospital services for treatment of an acute condition; nor could those services easily be transformed into services for treating patients needing acute inpatient care"). Second, the barriers to new entrants' competing appear to be quite different (e.g., it is far easier to establish a rehabilitation center than an inpatient hospital), so there may be far more potential competition and price discipline than at first appears . Third, there are highly plausible alternative explanations for defendants' supposedly "losing money" on these services (e.g., such services often serve as "loss

leaders" and patient insurance coverage often is lower). In short, permitting defendants to proceed in this fashion would raise collateral, irrelevant issues that would take up significant trial time for no purpose.

Relief Requested

The Court should enter an order excluding evidence and argument regarding any supposed "procompetitive" or other "good" behavior by Mercy or Finley in the past to show that DRHS will not act anticompetitively after the merger, and declaring that such behavior is irrelevant to the determination of this case.

Motion No. 6
Alleged "Efficiencies"

The United States moves for an order precluding defendants from asserting their "efficiencies defense" (purported cost savings from this transaction), because, in accordance with Supreme Court precedent, the "special circumstances" that have led some lower courts to entertain that defense are not present here. Even if this Court were not to apply the Supreme Court's stated rule, and consider such a defense, an order should be entered (consistent with those lower court decisions) excluding such evidence unless defendants make a threshold showing, under the requisite "clear and convincing" standard, that the claimed efficiencies: (i) are not speculative; (ii) can be achieved only through this transaction, as opposed to some other, less anticompetitive alternative; (iii) will be passed on to DRHS' consumers; and (iv) will "outweigh" the competitive harm from the merger (e.g., higher prices or lower quality).

Memorandum

A. Pertinent Background.

We expect that much of defendants' case and our rebuttal case will be spent on defendants' efficiencies claims. There is ample precedent to hold that defense unavailing in this case, and to preclude it entirely. Even if permitted, however, defendants would have a very heavy burden of proof on this issue, and none of their evidence that we have seen thus far meets this burden. Therefore, significant trial time can be saved by entering an order precluding defendants from introducing evidence that, by its very nature or severely debilitated probative value, does not satisfy a threshold evidentiary burden.

B. Applicable Law.

To date, no court has approved the use of efficiencies as a legal defense in any merger case, much less in a "merger to monopoly" case such as this one, under Section 7 of the Clayton Act. Indeed, the Supreme Court has stated that "[p]ossible economies can not be used as a defense to illegality" in Section 7 merger cases. FTC v. Proctor & Gamble Co., 386 U.S. 568, 580 (1967); see also United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 371 (1963) ("We are clear ... that a merger the effect of which 'may be substantially to lessen competition' is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial"). Although there has been some "debate[on] the meaning of this precedent" [University Health, 938 F.2d at 1222], even the cases that have taken evidence on an "efficiencies defense," none of which involved a merger-to-monopoly, have done so only where there were "certain circumstances" [University Health, 938 F.2d at 1222] not present here--namely, there was a substantial reason to believe that the "net economic benefit" would "outweigh" any competitive harm. Thus, it would be appropriate, and consistent with the decided cases, to exclude the defense.[2]

Should the Court nevertheless decide to allow defendants to assert this defense, under the cases that have found "circumstances" to warrant taking evidence, defendants would face a "very rigorous standard" for satisfying that defense. Rockford, 717 F. Supp. at 1289. Specifically, defendants must prove, with "clear and convincing evidence," Rockford, 717 F. Supp. at 1289, that their claimed efficiencies:

(i) actually will be achieved and are not based on "speculation,"

The Department of Justice 1992 Horizontal Merger Guidelines provide that the Government may exercise its prosecutorial discretion not to challenge a merger because of overriding efficiencies. [App. F] Obviously, the Government here does not see that to be the case.

University Health, 938 F.2d at 1223;

(ii) can be achieved "only through the merger and in no other manner," Rockford, 717 F. Supp. at 1289;

(iii) will be passed on, and produce a "significant economic benefit to consumers," Rockford, 717 F. Supp. at 1289; and

(iv) will outweigh the merger's anticompetitive effects and, therefore, provide "a net economic benefit for the health care consumer," Rockford, 717 F. Supp. at 1291.[3]

Based on the evidence we have seen to date, defendants cannot meet their burden on this issue (just as no defendant in any of the cited cases met its burden--albeit the evidence there was stronger than that presented here):

First, defendants' efficiencies are very speculative: Most of the savings are projected to occur years in the future, if at all. Indeed, defendants concede that no decisions have been made to implement any of the clinical program consolidations (i.e., consolidating services at one hospital or the other), which constitute a major percentage of their total claimed savings. [App. I (stipulation)] Moreover, that judicial admission reflects reality, as defendants still have not outlined the specifics of any purported clinical "savings" to the public or to the medical staffs of either hospital, which means that there might well be significant opposition among physicians and others whose cooperation ultimately is necessary to achieve defendants' supposed changes. Compare University Health, 938 F.2d at 1223 ("The appellees simply concluded that the intended acquisition would reduce 'unnecessary duplication'" and "they then approximated, in dollars, the savings these efficiencies would produce"--"[t]hey did not specifically explain, however, how these efficiencies

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[3] It is appropriate to apply such strict standards because, as Judge Posner has noted, "[t]he measurement of efficiency ... [is] an intractable subject for litigation." R. Posner, Antitrust Law: An Economic Perspective 112 (1976).

would be created and maintained").[4]

Second, a large percentage of the claimed savings could be achieved through some other, less anticompetitive, method. For example, roughly one quarter of all savings claimed by defendants derive from the hospitals' adopting "best practices" standards for economizing on resources used in treating patients. Yet defendants already were beginning to adopt those standards unilaterally before entering into this transaction. [App. J (Steele Dep. 82-84)] Likewise, much of their administrative savings could be achieved by the less anticompetitive alternative of merging with a hospital with which there is no competition, as other Iowa hospitals are doing.[5]

Third, defendants cannot meet their burden of showing that any savings will be passed on to consumers. At the outset, because Mercy and Finley no longer will face the competitive pressure they currently exert on each other, DRHS will not have any incentive to pass on to consumers any savings that are achieved. In that regard, defendants have given substantial (20% or more) price concessions to managed care plans where Mercy and Finley had to bid against each other [App. J (Steele Dep. 235-40)], but acknowledge that they would prefer not to give any price concessions [App. K (Guetzko Dep. 180 ("I would like all our payers to pay charges," i.e., full-price))], and hence likely would not do so after the merger. Moreover, Mercy's transfer of $1.5-2 million every

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The Chairman of Mercy's Board of Directors (Lynn Fuller), a would-be DRHS board member, during his deposition in response to a question from his own counsel about whether he believed service consolidations would take place, admitted that his "guess that most people would be in favor of that" was "speculation" on his part. [App. G (Fuller Dep. 176); App. H (Chesterman Dep. 98-99) (there is no structure or process in place to decide on any consolidation of services--"I guess I just picture in general that it would go through the DRHS board, possibly I suppose conceivably initiated by a board member")]

For example, St. Luke's Hospital in Cedar Rapids recently announced a merger with the Iowa Health System, which owns and operates two general acute care hospitals in Des Moines.

year to SMHC, its corporate parent in Michigan, and the Partnership Agreement's requirement that these transfers continue after DRHS is created [App. G (Fuller Dep. at 50-51, 82)], demonstrate that, if any substantial efficiencies were achieved, they would not benefit DRHS' consumers.

Finally, because on the one hand this is a merger to monopoly (or, at the least, to a near-monopoly), and thus is likely to result in the maximum possible anticompetitive harms, and on the other there is defendants' judicial admission that no "consolidation cost savings" have been determined, it is difficult to understand how defendants can prove that any savings will "outweigh" those harms. Cf. University Health, 938 F.2d at 1223 n.32 ("Nor did the appellees compare the benefits they expect to realize from the alleged efficiencies with the costs the intended acquisition may exact on competition. It is difficult, then, to conclude with any reliability that the acquisition ultimately would aid, rather than hinder, competition and consumers").

Relief Requested

An order should be entered precluding the "efficiencies" defense. In no event should defendants be allowed to take up undue trial time by offering evidence of potential savings that are either speculative or achievable through other means. So, at the very least, the Court should enter an order: (i) precluding defendants from introducing evidence of alleged efficiencies from this transaction unless defendants can make a threshold showing that such efficiencies: (a) are not speculative; (b) can be achieved only through this transaction, as opposed to some other, less anticompetitive, alternative; and (c) will produce savings that will be passed on to DRHS' consumers; and (ii) requiring defendants to provide a rationally based, non-speculative quantification of the "net economic benefit for the health care consumer," i.e., a quantification of the competitive harm that must be subtracted from the claimed efficiencies.

Motion No. 7
Affidavits, Declarations and Depositions

The United States moves for an order precluding defendants from introducing affidavits and declarations, as well as inadmissible deposition excerpts, as evidence at trial.

Memorandum

A. Pertinent Background.

Defendants have gathered affidavits and declarations from employers (and perhaps others), and apparently will seek to introduce them as evidence at trial, either directly by moving their admission as exhibits, or indirectly through an expert who allegedly read and relied on them. Defendants also might attempt to introduce inadmissible deposition excerpts.

B. Applicable Law.

The affidavits and declarations are hearsay, not subject to any exception and, hence, are inadmissible. Fed. R. Evid. 801; Stokes v. City of Omaha, 23 F.3d 1362 (8th Cir. 1994); see generally 4 Weinstein's Evidence ¶ 802[02] at 5-6 (1994) (use of affidavits authorized in a number of specific instances, none of which is applicable here: to prove service; on motion, including motion for summary judgment, for a temporary restraining order and to show probable cause; and where provided by Act of Congress); 6 Wigmore, Evidence § 1709 (Chadbourn rev. 1976).[6]

To our knowledge, all the persons who signed affidavits or declarations for defendants would be available to testify at trial. Indeed, defendants identified some of these persons as trial witnesses.

In Stokes, the district court admitted under the residual exception to the hearsay rule the affidavit of a police officer who died after execution of the affidavit but before trial. The Eighth Circuit reversed, holding the affidavit to be inadmissible hearsay; if the party offering the affidavit believed that affiant's testimony was important, the affiant should have been deposed. 23 F.3d at 1365.

They should not now be allowed to introduce the hearsay testimony of all other persons that they just as easily could have identified as trial witnesses. Berry v. Battey, 666 F.2d 1183 (8th Cir. 1981) (report of faculty committee was inadmissible hearsay where nearly all the committee members were available and could have testified).

Moreover, the affidavits were in the main prepared by defense counsel, and virtually all of them read alike. While the number of affidavits and declarations collected by defendants (over fifty) made depositions of all, or even many of, these people infeasible, it should be noted that, where depositions have occurred, statements in the affidavits and declarations were recanted or modified at the depositions. As one unaffiliated non-party witness candidly testified, defendants' lawyers drafted his declaration, as a result of which it did not accurately reflect his views. [App. L (Freihoefer Dep. at 62, 72, 92-94) (explaining that the "characterization words" in his declaration were put there by defense counsel, and that he would like to strike those words because "I never like to use adjectives that are too gross on either side")] Thus, even if this were a proceeding where affidavits or declarations could appropriately be received (e.g., a TRO or summary judgment proceeding), defendants' declarations are inherently untrustworthy and should be excluded.

To avoid these rules, defendants might try to have their expert testify that he read and relied on these affidavits, and then move their introduction. Whatever other difficulties might be created by an expert's reliance on inadmissible evidence (particularly evidence later modified or recanted), such reliance does not make that evidence admissible or justify its introduction. Boone v. Moore, 980 F.2d 539, 542 (8th Cir. 1992) ("Unless the particular evidence [relied on by the expert] is otherwise admissible ..., it may not come in as substantive evidence"); In re James Wilson Assocs., 965 F.2d 160, 172 (7th Cir. 1992) (same: "the judge must make sure that the expert isn't used as a

vehicle for circumventing the rules of evidence").

Finally, while deposition statements of a party are not hearsay and, hence, admissible (when offered by the opposing party) [Fed. R. Civ. P. 32(a)(2); Fed. R. Evid. 801(d)(2)], deposition statements of a non-party are hearsay [Fed. R. Evid. 804(b)(1)] and are not admissible at trial unless the witness is unavailable (e.g., outside the subpoena power of the court) [Fed. R. Civ. P. 32(a)(3)].

Relief Requested

The Court should enter an order precluding defendants from introducing affidavits and declarations as evidence at trial, as well as deposition statements from persons who would be "available" to testify.

Motion No. 8
Inferences From Data That Are
Overstated by an Unknown Amount

The United States moves for an order precluding defendants from arguing certain inferences from data that are misleading and overstated by an unknown amount. Specifically, defendants intend to introduce evidence relating to: (i) services offered by the small, rural hospitals as categorized by Diagnosis Related Group ("DRG"); and (ii) where patients residing in certain zip codes have gone in the past for hospitalization. Because of certain flaws in these data, they do not support the arguments or inferences for which defendants might introduce them. Relatedly, defendants' "patient shifting" argument ultimately turns on its computation of "contribution margin," which also appears to be overstated, but that issue cannot be resolved until trial. Accordingly, the United States moves for an order excluding defendants' "patient shifting" argument in the event defendants' asserted "contribution margin" is determined to be flawed.

Memorandum

A. Pertinent Background.

We understand defendants will seek to offer certain data, and to devote considerable trial time during the examinations of their economist and Mercy and Finley witnesses, to support certain arguments relating to the geographic market and competitive harm issues. These data may be probative of contentions other than those for which defendants will be offering them, so they should not be excluded entirely. Because of the cumulative effect of various severe limitations in these data, however, defendants should be precluded from making certain inferences based on them.

1. DRG Comparisons. Defendants are likely to argue that the small, rural hospitals surrounding Dubuque are comparable to, and good substitutes for, Mercy and Finley because they offer services in 60-70% of the same DRGs as do Mercy and Finley. DRGs are very general classifications of medical conditions that were established to simplify reimbursement amounts for the federal government's Medicare program. Each of the thousands of different procedures performed by acute-care hospitals are categorized into one of 494 DRGs, and each patient discharged from a hospital is classified into one of those 494 DRGs.

The "60-70% DRG overlap" between Mercy and Finley and the rural hospitals necessarily overstates the degree to which the rurals offer the same services as the Dubuque hospitals. Thus: (i) While some DRGs are narrow (e.g., DRG 235, femur fractures), most (e.g., DRG 75, major chest procedures) are very broad and encompass a number of different services, none of which are substitutes for each other; (ii) DRGs do not distinguish patient acuity or severity differences very well because, for example, a patient's DRG classification is made based on the patient's primary diagnosis; and (iii) other than distinguishing between adults and children, DRGs also do not account

for a patient's age. [See Apps. M (Noether Report ¶ 17) and N (DRG Working Guidebook excerpts)] Illustratively, a patient with palpitations might be treated at a rural hospital, but would go to a Dubuqe hospital for a complication relating to a cardiac inplant, both of which are under DRG 138 (cardiac arrhythmia and conduction disorders with cc); conversely, a patient requiring reattachment of the upper arm more likely will go to the University of Iowa, but would go to a Dubuque hospital for replacement of a shoulder joint, both of which services are under DRG 491 (major joint and limb reattachment procedures). [App. N] As a result, DRG classifications are too crude to support a conclusion that hospitals whose patients fall into the same DRGs are close substitutes for each other. Finally, Mercy has provided no records "below the DRG level," and, therefore, defendants cannot quantify the degree to which their 60-70% figure overstates the comparability.[7]

2. Patient-Origin Data. Defendants apparently will introduce "patient-origin data," which shows where the residents of certain zip codes have received their hospital care in the past. While these data may be useful in determining which hospitals consumers see as competitors under current conditions, they do not provide direct evidence of how consumers would react to alternative price and quality conditions. [Id. ¶ 15] We expect defendants, however, to use these data to try to argue how consumers will react to a possible post-merger price increase. Specifically, defendants' economist likely will assert that DRHS, if it attempts to increase prices, would be at risk of losing any patients residing in a zip code in which 20% or more of those residents have used a non-Dubuque hospital in the past for any reason. Essentially, defendants' economist will claim that,

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In addition, the range of services offered by a hospital is only one factor managed care payors use in determining with which hospitals to contract. Factors such as location, reputation for quality of care, and price also are important. Thus, even if DRGs were an accurate proxy for range of services, a 100% DRG overlap between two hospitals would not mean that those hospitals were adequate substitutes for each other.

because 20% of the people in a zip code have gone to a hospital other than Mercy and Finley in the past, the other 80% are likely to do the same if DRHS tries to increase prices.

This inference cannot be supported by the patient origin data. It assumes that the only relevant factors in a person's choice of a hospital is location and price. In fact, people also choose hospitals based on where their family and jobs are located, where their doctors have staff privileges, a hospital's size, its reputation for quality of care, its range of services, and the kind of medical procedure required, among other factors. Most importantly, the patient origin data does not explain why the residents of a particular zip code have used the hospitals they have in the past (e.g., it would not take into account that a person might go to the University of Iowa for a procedure, such as an organ transplant, not available in Dubuque, or that a person might to a rural hospital for a minor procedure but not for any surgery), and, therefore, it cannot predict their future behavior with any degree of accuracy. Therefore, defendants should not be permitted to infer from historical patient origin data how many consumers are "at risk" to DRHS if it attempts to raise prices in the future.[8]

3. Contribution Margins. Defendants have said they will argue that a "shift" of even a relatively few people from DRHS to other hospitals is enough to "discipline" DRHS' pricing. A linchpin of this "patient shifting" argument is Mercy and Finley's "contribution margins," defined as the percentage of revenue from each patient that contributes to a hospital's fixed costs and profit. In short, defendants claim that Mercy and Finley have such high fixed costs that their contribution margins also are high, meaning they have much to gain (or lose) from incremental patient volume.

It may well be that in some zip codes between Dubuque and Manchester, for example, 20% of the residents use Manchester hospitals because that is where they work and where their doctors practice. Conversely, 80% of the residents may use Dubuque hospitals for the same reasons. A post-merger price increase will not change those factors and is therefore unlikely to change where a patient chooses to be hospitalized.

If DRHS attempted to raise prices after the transaction, defendants assert, the loss of a small percentage of their patients would make such a price increase unprofitable.

Beyond the other problems with defendants' "patient shifting" argument, one major problem is that defendants' calculations of the contribution margins are substantially overstated. Thus, while defendants' economist appears to be using a contribution margin of 60%, the actual contribution margin likely is far lower. Even computing the margin based on the hospitals' own accounting system classifications produces a margin of 45% for all commercial (i.e., non-government) payors and 30% if all patients are used--defendants' 60%-figure was derived by ignoring the hospitals' accounting system and "reclassifying" certain variable costs as fixed costs.

We understand that the Court cannot resolve the conflict in the contribution margin calculation issue before hearing the evidence. However, because defendants' "patient shifting" argument depends on their contribution margin calculation, the Court should make clear now that, if defendants' contribution margin evidence is fatally flawed, then defendants' "patient shifting" argument will not be entertained.

B. Applicable Law.

While some of the DRG and patient-origin evidence described above may be probative for other contentions than those discussed above and, therefore, should not be excluded entirely, it does not support the inferences that defendants wish to make with it. Because this evidence does not have any tendency to make the existence of these arguments more or less probable, defendants should be precluded from drawing these inferences from this evidence. Fed. Rs. Evid. 401-02.

Relief Requested

The Court should enter an order precluding defendants from: (i) drawing an inference that

the rural hospitals offer a comparable range of services as do Mercy and Finley from the fact that they offer services in 60-70% of the same DRGs as do Mercy and Finley; and (ii) drawing an inference from the patient origin data that DRHS, if it attempts to increase prices, would be at risk of losing any patients residing in a zip code in which 20% or more of those residents have used a non-Dubuque hospital in the past for any reason. In addition, it should enter an order that, if defendants' contribution margin calculations are flawed, then defendants' "patient shifting" argument will not be heard.

Motion No. 9
Limitations as a Result of Discovery

The United States moves for an order to preclude defendants from introducing evidence or making argument on certain issues as a result of their discovery.

Memorandum

A. Pertinent Background.

Defendants' Answer (at ¶ 17) said: "If these [DRHS'] prices were to become uncompetitive, ... these patients have many alternatives for hospitalization." Interrogatory 21(iii) asked defendants to explain "how could one determine whether DRHS' prices were 'uncompetitive,' against which other hospitals (by name) would the comparison be made, and for which services would the comparison be made." [App. O (interrogatory and responses)] Plainly, this interrogatory sought information that was highly relevant to defendants' contention that people would "switch" hospitals upon determining that DRHS' prices were not competitive.

While defendants did not object to this interrogatory, their initial response did not even attempt to supply the requested information. They did not name any of the hospitals or the services

against which such a comparison would be made. Rather, defendants summarily responded, "[s]uch a comparison would involve a comparison of, among other things, relative charges, applicable discounts, if any, lengths of stay and levels of service." [Id.]

With a motion to compel looming, defendants sent us a letter stating that the hospitals against which one could make a comparison "may include" several listed hospitals and that "[t]he services may include those which those hospitals and Mercy and Finley provide. Thus, defendants refused to give a conclusive answer as to which hospitals would be used in making price comparisons (by use of the phrase "may include") and refused to list the services to be considered (again, by use of the phrase "may include"). [Id.]

This interrogatory goes to the issue of whether the proposed consolidation of Mercy and Finley will lessen competition and what competing hospitals and services are in the market. It also addresses the defense that consumers will "switch" from a Dubuque hospital to a non-Dubuque hospital should DRHS raise prices.

B. Applicable Law.

The rules of discovery, particularly the new rules, are intended to require full disclosure before trial. Auerbach v. Rival Mfg. Co., 879 F.2d 1196, 1201 (3d Cir. 1989). In this way, they insure that the parties, and ultimately the court, are informed fully and that there is no "trial by ambush." Id.

Toward this end, the rule is that a party is bound by its interrogatory answers. Basch v. Westinghouse Elec. Corp., 777 F.2d 165, 175 (4th Cir. 1985). As a corollary of that rule, a party is, and should be, precluded from introducing evidence or making arguments that go beyond their interrogatory answers. Grogen v. Garner, 806 F.2d 829, 837-38 (8th Cir. 1986). Thus, the most

common way to fulfill the promise of the disclosure rules, and the appropriate way to do so in this instance, is to prevent defendants from introducing evidence or making argument that goes beyond their interrogatory answers on these two topics, i.e., to present matters at trial that could have, and properly should have, been disclosed in those answers. See 1993 Amendment Commentary to Fed. R. Civ. P. 37(c)(1) (explaining that rule 37 now is "self-executing," so that such an exclusion of evidence should be the effect even without an order).

Relief Requested

The Court should enter an order precluding defendants from introducing evidence or making argument that should have been disclosed in response to Interrogatory 21(iii).

Motion No. 10
Trial Procedures

The United States seeks guidance from the Court as to certain possible procedures that might be followed at trial to expedite and facilitate the presentations. We have raised them with defendants, who agree in part and object in part.

Memorandum

We believe that, if certain procedures are adopted, it might make the trial presentations go more quickly and result in other benefits as well.

1. Narrative Presentations. If direct testimony (in whole or even in part) could be introduced in narrative or semi-narrative form (either written narrative or a spoken narrative), the available trial time could be maximized. We do not propose requiring any witness to so testify, but rather, that both parties have this option available to use as they deem appropriate. It could be accomplished by entry of order saying that "calling for a narrative" response will not be heard as a

basis for objection, while preserving the right to move to strike any testimony that otherwise is inadmissible.

2. Witness Introductions. If the Court thinks it might be useful, a few minutes could be devoted at the beginning of each day (or otherwise as appropriate) for counsel to summarize the immediately upcoming testimony. In that way, to the extent the Court has any guidance or questions, they could be addressed, and perhaps time would be saved on the examinations.

3. "Off-the-Record" Sessions. If the Court thinks it might be useful, sessions could be conducted where the Court could explore with counsel ("off the record" or even on the record) the issues that have been raised to that point as well as upcoming issues. In that way, to the extent counsel have an understanding of the Court's concerns as the trial unfolds, counsel may be able to make adjustments that would expedite and focus the trial presentations.

We raised these three proposals with defendants. As to the previews of testimony and "off-the-record" sessions, defendants said they have "no objection to taking one of these steps if the Judge thinks it would be helpful," although "we don't see how this will necessarily provide any significant benefit to the Court." As to waiving objections to narrative answers, defendants voiced concern because "[a]llowing narrative testimony," in their view, "might permit ... testimony without foundation to be introduced"--which concern we believe we addressed in our proposal by allowing for motions to strike inadmissible evidence (on foundation or any other ground). We continue to believe this is a worthwhile procedure to adopt, especially for experts, because it likely will result in a less choppy and more coherent presentation.

Relief Requested

The Court should enter an order preventing objections on the ground that a question "calls

for a narrative," without prejudice to both parties' right to object to or move to strike otherwise inadmissible evidence. With respect to the other two points raised in this motion, we believe further discussion at the pretrial conference might be useful.

Conclusion

We look forward to discussing any questions the Court might have on these motions at the September 19 final pretrial conference.

September 9, 1994.

Respectfully submitted,

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