

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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UNITED STATES OF AMERICA,

Plaintiff,

-against-

Civil Case No.

VERIFIED COMPLAINT

LONG ISLAND JEWISH MEDICAL CENTER and
NORTH SHORE HEALTH SYSTEM, INC.,

Defendants.

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The United States of America, acting under the direction of the Attorney General of the United States, brings this civil action to enjoin defendants Long Island Jewish Medical Center ("LIJ Medical Center" or "LIJ") and North Shore Health System ("North Shore") from forming a third corporation that would jointly negotiate prices and other competitively sensitive terms for defendants and to obtain other equitable relief against these defendants.

1. North Shore University Hospital at Manhasset ("North Shore Manhasset") and LIJ Medical Center are each other's principal competitor by virtue of their premier reputations, comparable full range of high quality services, and their strategic location for serving Queens and Nassau Counties. Both are profitable, high occupancy hospitals that can continue to pursue their missions successfully if they remain independent. They compete head-to-head to be "anchor" or "flagship" hospitals in the networks of Long Island hospitals assembled by managed

care companies to provide health care to employers, individuals, families, and other purchasers. The proposed transaction would eliminate this beneficial competition.

2. Consumers buying managed care plans and living in Long Island, particularly in Queens and Nassau Counties, overwhelmingly want the option to go to either North Shore Manhasset or LIJ Medical Center if they become ill and require hospitalization. Even if Long Island residents might be willing to use other hospitals for certain procedures, they strongly desire the up-front option to be able to use these two premier hospitals. Managed care plans, therefore, must include either of these two hospitals in any network that covers Queens and Nassau Counties, or else they will be at a substantial disadvantage.

3. Today, managed care companies have a choice between North Shore or LIJ Medical Center as anchor hospitals to serve Queens and Nassau Counties, and the defendants compete to be included in the managed care companies' plans. They compete by offering the plans lower prices, agreeing to programs designed to eliminate inefficiency, and providing high quality care.

4. LIJ Medical Center has competed aggressively to attract business from managed care plans by offering a cooperative approach, competitive prices, and high quality services, recognizing that:

[T]he partnership between managed care companies and providers . . . will ultimately be best for the consumer community.

(Position paper from Joseph Drohan, LIJ Vice President Network Development & Managed Care, to LIJ President and Chief Executive Officer ("CEO"), David Dantzker, dated March 28, 1996).

5. On the other hand, North Shore seeks to "create market power through economic integration and joint contracting" (emphasis added)(Letter from Peter Stamos, a consultant to North Shore who has also served as a North Shore Senior Vice President for Strategic Planning, to Jackson Hole Group, Oct. 11, 1995).

As LIJ Medical Center itself has observed:

North Shore['s] position is not conducive to reducing medical costs on Long Island:

1. North Shore is not supportive of partnerships with managed care organizations and has used its hospital acquisition model as a method of banding against managed care organizations to keep medical costs on Long Island at a high level.

(emphasis added) (Position paper from Joseph Drohan, LIJ Vice President Network Development & Managed Care, to LIJ President and CEO, David Dantzker, dated March 28, 1996).

6. Unless blocked, the competitive pricing managed care plans have been able to negotiate because of the rivalry between LIJ Medical Center and North Shore Manhasset will be eliminated. The hospitals know this will be the impact of the transaction. Indeed, minutes reporting on a presentation by LIJ's President and CEO David Dantzker at a recent meeting, expressly recognize the impact: "Amalgamation [with North Shore] will free both hospitals from the stress of competition." This combination

would thus likely result in higher prices and would remove a principal incentive for these hospitals to eliminate inefficiency in their operations.

I.

JURISDICTION AND VENUE

7. This action is filed under Section 15 of the Clayton Act, as amended, 15 U.S.C. § 25, and Section 4 of the Sherman Act, 15 U.S.C. § 4, to prevent and restrain defendants' violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 1 of the Sherman Act, 15 U.S.C. § 1.

8. Both North Shore and LIJ Medical Center are New York not-for-profit corporations that transact business, maintain offices, and are found within the Eastern District of New York.

9. The defendants are engaged in interstate commerce and in activities substantially affecting interstate commerce. In providing inpatient hospital services, both defendants regularly receive substantial payments from outside New York from group purchasers and purchase equipment and supplies from outside New York.

II.

THE DEFENDANTS

10. North Shore, one of the largest hospital systems in the northeast, has grown through purchase or affiliation, as opposed to internal growth or expansion. Over the last two years, North Shore went from two hospitals (with 950 beds) to nine hospitals (with over 3,400 beds) in Queens and Nassau Counties and on

Staten Island. At the same time, North Shore's annual revenue increased from \$474 million to \$1.8 billion. North Shore's flagship hospital and the largest of its nine hospitals is North Shore Manhasset, a large, highly sophisticated, well known, and prestigious teaching hospital affiliated with the New York University School of Medicine and located two miles away from LIJ Medical Center. North Shore Manhasset has 729 acute, non-psychiatric inpatient licensed beds and had acute inpatient, non-psychiatric net revenue in 1996 of about \$400 million.

11. LIJ Medical Center is a large, highly sophisticated, well known, and prestigious teaching hospital affiliated with the Albert Einstein College of Medicine and located in Queens County, New York, bordering Nassau County. LIJ Medical Center has 591 beds licensed for acute, non-psychiatric inpatient care, with total acute inpatient, non-psychiatric net revenue of about \$325 million in 1996. One of the cornerstones of LIJ's strategic plan, according to LIJ President and CEO David Dantzker, has been

the development of effective relationships with managed care organizations. LIJ has a demonstrated ability to attract managed care contracts and referrals because of its strategic Queens/Nassau location and premier academic and medical care reputation.

(Attachment to Dec. 27, 1995 letter from LIJ President and CEO Dantzker to Ted Jospe, President, Southside Hospital).

III.

TRADE AND COMMERCE

A. HOSPITAL COMPETITION IN NEW YORK

12. The State of New York has recognized and promoted the benefits of competition among hospitals. In the past, the State had closely regulated hospitals' prices for inpatient care. In 1983, it imposed a regulatory scheme called the New York Prospective Hospital Reimbursement Methodology ("NYPHRM"). Since then, it has moved in two steps to eliminate regulation of hospital rates and to promote price competition as a means of lowering the cost and improving the quality of health care in New York State.

13. In 1991, the State took the first step toward eliminating this regulatory structure and promoting price competition among hospitals by allowing a type of managed care plan, health maintenance organizations ("HMOs"), to negotiate prices with hospitals. The rates hospitals charged to all other health insurance plans, however, remained subject to regulation under NYPHRM.

14. Effective January 1, 1997, the State took its second step to eliminate NYPHRM and promote competition among hospitals. In September, 1996, New York enacted legislation that, according to Commissioner of Health Barbara A. DeBuono, M.D., "will improve access to high quality cost-effective health care for all New Yorkers" by converting "the decades-old state hospital financing system from one regulated by government to one based on free

market competition." Effective January 1, 1997, as in 48 other states, all managed care companies can contract in New York with hospitals to determine hospital prices, a development that Commissioner DeBuono has characterized as "a change experience has shown will lead to greater operating efficiency and lower health care costs."

15. Competition among hospitals and other health care providers--as opposed to price regulation--is important to ensure appropriate use of health care services and to control costs. Historically, health care financing mechanisms such as private indemnity insurance and governmental payment regulation tended to encourage inefficient capital expenditures and medically unnecessary uses of health care, resulting in extremely high rates of inflation in the cost of health care services.

16. In place of those non-competitive financing approaches, employers, unions, and governmental bodies that provide insurance for the individuals and families (collectively "group purchasers") on Long Island, and elsewhere, are relying increasingly on a variety of managed care plans--such as preferred provider organizations ("PPOs"), HMOs, and point of service plans ("POSs")--that contract with hospitals and other providers on competitive terms to provide quality health care to their members ("enrollees") and their families.

17. Managed care companies compete by developing and selling plans primarily on the basis of the breadth and quality of their networks and on the basis of their premiums and benefits

structure. In significant part, group purchasers and their individual and family members essentially purchase access to a provider network that will provide them with a menu of physician and hospital options if diagnosis or treatment is required. Managed care companies, therefore, generally try to offer a network with a broad range of attractive, convenient physician and hospital services. Since group purchasers generally represent many individuals and families with diverse tastes and needs, a managed care company, to successfully market a plan, must provide an even broader menu of provider options than would be desired by an individual enrollee.

B. COMPETITION BETWEEN NORTH SHORE AND LIJ MEDICAL CENTER

18. To be attractive to group purchasers and their individual and family members, managed care plans on Long Island include in their networks a range of different hospitals that enrollees know they can use in the event of future illness. They include in the network numerous community hospitals that provide very convenient locations and are typically used for more routine, less complex cases. A more limited number of hospitals are candidates to serve as anchor hospitals, so as to provide enrollees with the option to use a reasonably convenient hospital that has a prestigious reputation and offers an extensive range of high-quality services. The premier reputation and accessibility of the anchor hospitals in such networks is vital to enhance the marketability of a plan to group purchasers and individuals. For example, LIJ's Vice President of Strategic

Planning, Jeffrey Kraut, has referred to LIJ as "the tertiary care anchor" for a network of community hospitals on Long Island.

19. Hospitals compete for inclusion in managed care plans' networks on the basis of quality, customer service, location, rates, and cost-effectiveness. Competition among hospitals for inclusion in those networks has lowered, and will continue to lower or constrain, the cost of health care services, ultimately lowering the costs to consumers and taxpayers, while continuing to make high quality health care available.

20. North Shore Manhasset and LIJ Medical Center are each other's closest competitor for the function of an anchor hospital serving Queens and Nassau Counties in a managed care plan's hospital network, for several reasons. Each offers a broad array of sophisticated services, a similarly broad and high quality medical staff, the prestige of their academic affiliations and research programs, and a strategic location that make them the only alternatives for the anchor of a plan serving these Counties. The defendants' own documents depict North Shore Manhasset and LIJ Medical Center as the two highest-quality institutions on Long Island and the premier institutions in the tri-county area of Nassau, Suffolk, and Queens.

21. Inclusion of either North Shore Manhasset or LIJ Medical Center (and physicians from their medical staffs) in a plan's provider network signifies quality and is thus key to the marketability of the plan to New York metropolitan area employers and other group purchasers who desire a network serving Queens

and Nassau Counties. Inclusion of either one of these hospitals signals the quality of the plan and gives enrollees and their families the option of receiving, if necessary, a full range of acute care inpatient services at a highly regarded, conveniently located, premier hospital. Thus, most managed care plans serving Long Island currently include one or both in their provider networks.

22. When negotiating, managed care plans currently have a choice of either North Shore Manhasset or LIJ Medical Center. Because there is a choice, a plan has the ability to contract with only one of those two hospitals--and exclude the other from its network--as some plans have done.

23. The nature of this competition is well understood. LIJ's President and CEO David Dantzker observed in one memorandum that a managed care plan called HealthFirst "has a significant need for a tertiary care hospital in the western Nassau/Queens area, and will contract either with us or with North Shore Hospital, but not with both." (Memorandum from Dr. Dantzker to Irving Schneider, Chairman of the LIJ Board, and Gedale Horowitz, Chairman Elect, February 8, 1995). And, at a March, 1996, meeting of the LIJ Board of Trustees, "Dr. Dantzker predicted the eventual development of two networks in the Queens-Long Island area -- one coalescing around North Shore and the other around the [LIJ] Medical Center." Indeed, LIJ Medical Center has competed aggressively for inclusion in managed care plans. For example, an internal North Shore memorandum, detailing managed

care contracting status and issues, reports concerning contracting with an HMO: "Apparently, LIJ substantially underbid us for the core network; therefore we are currently being offered inclusion in just the broad network." (North Shore Internal Communication from Stuart McLean, December 1, 1994).

24. This competition has lowered defendants' prices, while allowing them to operate profitably and at high occupancy levels. Thus, in transmitting LIJ's 1997 budget to LIJ's Finance Committee, Rick Annis, LIJ Vice President for Finance, noted the "favorable results" of LIJ's "greater emphasis on cost-effective management," and from LIJ's "becoming a major player in managed care. . . ." According to Annis, LIJ was "prepared for the market driven, cost conscious health care environment."

25. LIJ Medical Center and North Shore Manhasset have taken steps independently during the last few years to lower their costs and made plans for additional steps to reduce inefficiency in their operations. The consumer benefits resulting from competition between North Shore Manhasset and LIJ Medical Center demonstrate the soundness of New York's policy decision to promote competition among hospitals.

26. None of the community hospitals that dot Long Island, standing alone or in combination with more prestigious hospitals in Manhattan or Suffolk, are good substitutes to North Shore Manhasset and LIJ Medical Center as anchor hospitals for plans serving Queens and Nassau Counties. None of the other hospitals in Queens or Nassau County has the requisite combination of the

range and sophistication of services, the complementary medical staff, and the necessary reputation to be a good substitute for North Shore Manhasset or LIJ Medical Center as an anchor hospital for a plan's network. Hospitals in Manhattan and in Suffolk County are too far away and therefore are also not good substitutes for LIJ and North Shore Manhasset in plans serving Nassau and Queens Counties. Indeed, LIJ considered one of the Manhattan teaching hospitals a good potential merger partner because, in the words of Gedale Horowitz, Chairman of LIJ's board, LIJ and that Manhattan hospital did "not compete for patients on a geographic basis."

C. PAST ANTICOMPETITIVE PRACTICES

27. The proposed transaction would substantially further North Shore's longstanding efforts to obtain supra competitive prices. In 1991, when the State took its first step toward eliminating rate regulation for hospital services by permitting HMOs to negotiate hospital prices, North Shore orchestrated an agreement to prevent discounting with six other Long Island hospitals through a joint bargaining agent that they formed, called Classic Care Network, Inc. ("Classic Care"). The United States Department of Justice sued Classic Care, North Shore Manhasset, and the other participating hospitals, resulting in a consent judgment that this Court entered on May 1, 1995, enjoining implementation of the agreement.

28. In the wake of Classic Care, on June 29, 1995, Peter Stamos, who has served as a consultant to North Shore and as

North Shore's Senior Vice President for Strategic Planning, gave a presentation on North Shore's strategic plans. LIJ's Vice President of Network Development and Managed Care, Joseph Drohan, attended and reported to LIJ's President and CEO, David Dantzker, that:

The [North Shore] network is intended to preclude HMOs from leveraging hospitals and physicians against each other. Mr. Stamos shared his California experience where hospitals and physician groups were 'picked off' when not tied to one cohesive network.

* * *

Mr. Stamos suggested this as a long term strategy, similar to the 'Classic Care' network that was disbanded in response to an anti-trust complaint by the Department of Justice.

29. Indeed, in May, 1996, LIJ Medical Center told other Long Island hospitals that they should join with LIJ to present "a strong and 'friendly' alternative to [the] North Shore network . . . for physicians and HMOs." LIJ explained, "Physicians and HMOs need an alternative to the acquisitive and 'exclusivity-based' North Shore System."

D. RELEVANT MARKETS

30. The relevant product market for analyzing defendants' proposed transaction for antitrust purposes is anchor hospitals. Anchor hospitals serve two specific functions for managed care plans. First, they allow the plan to offer its enrollees the option of inpatient treatment at a hospital that has a broad array of sophisticated services, a similarly broad and high quality medical staff, and a prestigious reputation. Second, and

relatedly, inclusion of the anchor hospital signals the overall quality of the plan to group purchasers and individuals and families. Together, these two functions substantially enhance the marketability of these plans.

31. The relevant geographic market for analyzing defendants' proposed transaction for antitrust purposes is the area within Queens and Nassau Counties where managed care plans could look for an anchor hospital that would be a good substitute for LIJ or North Shore Manhasset. Anchor hospitals that are reasonably convenient for enrollees substantially enhance the perceived quality and marketability of a plan. Plans will fail to provide that reasonably convenient access to large segments of Queens and Nassau Counties if they were to offer a network including only anchor hospitals situated outside of Queens and Nassau Counties.

IV.

LIKELY ANTICOMPETITIVE EFFECTS

32. If the proposed transaction is consummated, LIJ Medical Center and North Shore Manhasset will cease to compete for the business of managed care health plans. Instead, the defendants will concertedly establish higher prices and other anticompetitive terms for health care purchasers. Given the lack of good substitutes for these two anchor hospitals, managed care plans will be deprived of their ability to obtain competitive rates and other terms from defendants, including terms that are aimed at reducing the incidence of medically unwarranted

procedures that inflate health care costs and undermine the quality of patient care. In short, as listed in an LIJ document as a reason to merge, the proposed transaction

[g]ives both parties more negotiating power with the managed care organizations. There is no longer the threat of going 'down the street' to the competition.

33. Moreover, if the challenged transaction were to go forward, then no managed care plan serving Queens and Nassau Counties could assemble an attractive hospital network without including all North Shore hospitals. Significantly, the plans would lose the option of using a competing network that includes LIJ Medical Center as an independent anchor hospital and other hospitals unaffiliated with North Shore. Thus, the proposed transaction is likely substantially to reduce competition among community hospitals. If the proposed transaction were to be consummated, what was once a concern of LIJ Medical Center would ironically well characterize the likely effects of this transaction: "North Shore has created a non-competitive environment by limiting the insurers access to multiple hospital systems." (Position paper from Joseph Drohan, LIJ Vice President Network Development & Managed Care, to LIJ President and CEO, David Dantzker, dated March 28, 1996).

V.

VIOLATION ALLEGED

34. The proposed transaction between North Shore and LIJ Medical Center would eliminate competition between North Shore Manhasset and LIJ Medical Center to serve as anchor hospitals in

a managed care plan's network. The transaction would thus substantially reduce the ability of managed care plans, seeking to offer marketable provider networks on Long Island, to bargain with North Shore Manhasset and LIJ Medical Center for competitive prices and other competitively significant contractual terms. The proposed transaction, therefore, would combine North Shore Manhasset and LIJ Medical Center and likely result in an increase of the prices at which they contract with managed care plans for acute inpatient hospital services and will deprive those plans and their members of the benefits of free and open competition for the purchase of those services. In short, the proposed transaction may tend substantially to lessen competition in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and will unreasonably restrain trade or commerce in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

VI.

REQUEST FOR RELIEF

Plaintiff requests:

1. That the agreement to implement the proposed transaction between North Shore and LIJ Medical Center be adjudged a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 1 of the Sherman Act, 15 U.S.C. § 1;
2. That preliminary and permanent injunctions be issued preventing and restraining the defendants and all persons acting on their behalf from entering into or carrying out any agreement, understanding, or plan, the effect of which would be to allow

North Shore and LIJ Medical Center to discuss or agree on terms offered to managed care plans or to negotiate or contract jointly with managed care plans;

3. That plaintiff has such other relief as the Court may deem just and proper; and

4. That plaintiff recovers the costs of this action.

Dated: June 11, 1997

For Plaintiff:

_____/s/_____
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