

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	)	RESPONSE TO DEFENDANTS'
GROUP, INC.,	)	MOTION IN LIMINE (re out-of-
	)	state money transfers)
Defendants.	)	

**Overview**

Defendants' motion in limine, seeking to exclude all evidence of Mercy's out-of-state money transfers, argues that such evidence is not relevant to prices charged by Mercy and, therefore, not relevant to what the Government must prove to prevail in this case. There are two fundamental flaws in this motion:

First, even assuming that the out-of-state money transfers had no relevance to Mercy's pricing or anything in the Government's direct case, it is indisputable that such evidence is highly relevant to at least two defenses raised by defendants (the "efficiencies defense" and the "non-profit status defense"). Thus, while we believe that those defenses should be excluded before trial (as set forth in our motions in limine on the point (nos. 3 and 6)), if they are not, defendants' motion necessarily must fail.

Second, the motion's selective citations from the record on the question of the money transfers' "effect on pricing" are incomplete and inaccurate. Indeed, they ignore: (i) the unequivocal documentary evidence (including the budget guidelines where the out-of-state parent tells Mercy in Dubuque what percentage Mercy will send out-of-state so that Mercy can factor that into its operating plan and budget); and (ii) the testimony of Mercy's board chairman and a future DRHS board member (Mr. Fuller), who candidly admitted that these money transfers do affect pricing. In

that regard, Mr. Fuller's testimony clearly explains why the motion's logic on the pricing issue (to the effect that, because the transfers occur "after" the hospital sets its prices, they cannot affect prices) makes no sense: Whatever pricing decisions a transfer follows, it necessarily precedes all subsequent pricing decisions.

This response addresses these two principal defects in the motion. If we are right as to either, the motion must be denied.

### **Discussion**

#### **A. Relevance to the "Efficiencies" and "Non-Profit Status" Defenses.**

The "relevance" argument raised by the motion, that the only issue to which the out-of-state money transfers relate is hospital pricing, was wrong when defendants' raised it during the September 1 status hearing and is wrong now. This evidence is highly relevant to two completely separate issues--the so-called "efficiencies defense" and the "non-profit status defense."

**1. The "Efficiencies Defense."** Our motion in limine no. 6 treats the efficiencies defense in some detail, and explains why it should not be entertained in this case. But, if it is entertained, then defendants will be arguing, and will have the burden of proving, that the merger will result in cost savings that will be passed on and produce a "significant economic benefit" to DRHS' consumers. Rockford, 717 F. Supp. at 1289. The out-of-state money transfers go to the heart of that issue.

Defense counsel conceded during the September 1 hearing that such money transfers occur at the rate of \$1.5-2 million per year. While there may be some dispute as to some amount that "returns" in some way to benefit Dubuque, or some amount that is in exchange for goods or services, even defendants' motion does not dispute that some substantial amount leaves Dubuque each year never to return. Conversely, there can be no genuine dispute that, if such sums did not leave Dubuque, they would be available to the hospital for any purpose, including being passed on to the hospital's consumers. Thus, to say the money is transferred out-of-state is to say that it is not being passed on to Dubuque consumers, which at the very least, is relevant to negate the "passing on" element of the efficiencies defense.

Nor is this matter just a question of Mercy's past or present behavior. Under the DRHS partnership agreement [see App. G to motions in limine], Mercy will continue to transfer money out-of-state. And that necessarily will be money that otherwise could have benefitted Dubuque-area consumers. Accordingly, the Court, as the trier of fact, will need to determine whether any cost savings will go to consumers or will go out of state and, if the latter, then the efficiencies defense must be rejected. Hence, the money transfers are highly relevant.

**2. The "Non-Profit Status Defense."** Defendants may contend that DRHS' non-profit status should be taken into account in determining the legality of the proposed merger. In addition to the legal and economic deficiencies with that defense [see motion in limine no. 3], their transferring money out-of-state goes to negate the defense as a factual matter. Specifically, if DRHS has an incentive to generate surplus funds for purposes other than to benefit its consumers, then DRHS: (i) would not be acting, as defendants allege, solely for the benefit of the Dubuque community; and (ii) would have the impetus to act just as any for-profit would act. And here, as the DRHS partnership agreement provides, and as defendants have testified, the out-of-state money transfers will continue after the creation of DRHS [see motion in limine no. 6 and App. G], thereby providing precisely such an impetus.

### **B. Effect on Pricing Decisions.**

Even if the money transfers were not relevant to the efficiencies and non-profit status defenses, the response's contention that these transfers do not affect pricing (because they supposedly are done "after" the pricing decisions are made) makes no sense, nor does the cited testimony to that effect from defendants' purported rule 30(b)(6) witnesses (who had limited authority and limited knowledge). Whatever pricing decision is made "before" a money transfer, the next pricing decision necessarily is made "after" that money transfer. And that "next" pricing decision necessarily is a function of how much money is "in the bank." Indeed, Mercy's chairman's testimony (given less than a month ago), which the motion omits to mention, could not be clearer on this point:

"Q. [W]here does the money specifically come from Mercy Health Center that

goes to this corporate account in Michigan?

"A. Comes out of cash--paid in cash, it comes out of cash reserves, it comes out of what you suggested would be profit after operations.

"Q. Okay. So does it come, I'm just trying to get a feel, does it--do you take it out of money that would otherwise go towards building projects or capital purchases?

"Mr. Iwrey. Objection, vague.

"A. Comes out of where I said it comes out of. It comes out of retained earnings.

"Q. So comes out of retained earnings?

"A. Retained earnings or profits or cash. It is up to interpretation where you say it really comes from. You write a check, right, so it comes out of your checking account.

"Q. When the board of directors determines what budget to pass for the coming year, does it take into--and how much profit the hospital will need, does it take into account this payment to Detroit?

"A. It's lumped into the budget, sure. It's all part of that.

"Q. So is this payment taken into account in determining the size, for instance, of the increases in charges that the hospital will implement for the following year?

"A. It is all part of the budget, so I suppose you could say yes.

"Q. Do you take it into account?

"A. Yes. It's an expense."

[Fuller Dep. 46-47 (attached behind Tab A)]

That testimony comports with reality and makes sense. It also comports with the corporate written policy, as reflected in the 1995 Budget Guidelines [see Tab B], where the corporate parent: (i) explains how the amount of the money transfer will be set ("[t]he

corporate development fund obligation for 1995 will be calculated under the same methodology as in prior years, i.e., as a percentage of the division's adjusted cash flow"); (ii) sets the amount for 1995 (at twenty-four percent or more); and (iii) makes clear that "each division/subsidiary should reference" these "summary guidelines ... in developing their 1995 operating plan/budget."

Another document omitted by the motion explains these money transfers in terms no one could fail to appreciate [attached behind Tab C (with emphasis by the author)]:

"The Corporate Development Fund (formerly called the Corporate Capital Fund) is the means through which Mercy Health Services extracts cash and equity from the SMHC hospital operating divisions and redeploys these funds elsewhere for system purposes.

"Note that this usage is not necessarily for capital expenditures; for example, the planned FY 1994 funding of Medicaid HMO start up expenses. Also, this is not simply the pooling of cash; all division cash is 'swept' daily into corporate accounts for investment purposes. Rather, it is the concurrent transfer of equity with this cash that has significance. Essentially, the Corporate Development Fund is a means to redeploy financial resources from the divisions to corporate, including shifting of the designated authority to spend and accountability for its usage.

...

"The use of these funds is directed by system executive management and the SMHC Board."

The memorandum then explains the "uses" to be "'collaboration' system growth opportunities," "new community healthcare system (non-hospital) growth opportunities," "'definitive resolution' of division operating problems," and "activities other than above (for example, new ventures)."

Finally, the motion's suggestion, that because the money transfers purportedly derive from net cash flows they have no impact on pricing, ignores the testimony of Mercy's chief financial officer (Mr. Guetzko). As he explained [Tab D at 72], "a lot of capital [for equipment purchases and building programs] is taken from ... that operating general fund," which is precisely where accumulated cash flows go. Thus, even if the motion were right about "net cash flow," it would mean that Mercy's equipment purchases and building programs have no

impact on its pricing.\*

### **C. Some Common Sense.**

The response, while acknowledging its irrelevance, describes the "good works" that may be done with the transferred money. So there is no misunderstanding, we do not contend here that the transferred money is squandered or used for bad purposes. Rather, we say, the money transfers are direct evidence of savings that are not passed on to DRHS' customers, and they necessarily affect DRHS' prices. If General Motors were to give \$10 billion in college scholarships, no one would say that is a bad thing. But likewise, no one would say that GM's decision to spend its money in that way was not some evidence of what it did with cost savings or that such money had no affect on GM's pricing decisions (e.g., choosing to use the money for scholarships instead of offering customers rebates or discounts on its cars).

### **D. Additional Factual Errors and Omissions in Defendants' Motion.**

Omitting to mention Mercy's chairman's testimony and the two key documents should be dispositive of the pricing prong of the motion. But that is not the only factual problem with the motion. Indeed, the motion does not come close to giving a fair representation of the record. Thus, it is meet to note the following:

a. the motion's citation (at 4) to the Grotnes deposition (at 234 (attached to the motion)) to the effect that Mercy had not increased prices as result of the transfers is not supported by that citation--all it says is that Mr. Grotnes was unaware of any discussion of prices;

b. the motion's citation (at 4) to the Guetzko deposition (at 98-99 (attached to the motion)) concerning sources for the transfers stretches his actual

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Mr. Fuller's deposition resumed this week (after the motion was filed). Near the end of this resumed session, defense counsel asked Mr. Fuller a series of questions apparently intended to have him retract the above testimony. While the determination of which version of Mr. Fuller's testimony should be believed will have to await trial, for purposes of the motion, two points remain: (i) on at least one occasion, the chairman of Mercy's board did testify that the money transfers necessarily impact pricing decisions; and (ii) the motion's statement (at 4) that "[i]t is beyond dispute that any intracorporate payments that may occur between MHC and MHS will have no impact whatsoever on the prices charged by MHC" is not quite accurate.

testimony beyond fair recognition; and

c. the motion ignores that, in the past few years, the transfers have represented approximately thirty percent of Mercy's "profits" [see Tab E]--although a precise quantification cannot be determined from the documents produced to date nor do the witnesses produced by defendants know--and most of this money (measured in the millions) has been used to cover losses at Detroit hospitals [Tab C] or spent on the corporate offices in Michigan [see attachment to Tab C].

**Relief Requested**

Defendants' motion in limine should be denied.

September 15, 1994.

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