

ATTORNEYS AT LAW

JAMES S. MATTHEWS
612-371-3265

June 13, 1995

Honorable Anne K. Bingaman
Assistant Attorney General
Department of Justice
Antitrust Division
10th Street and Constitution Avenue, N.W.
Washington, D.C. 20530

**Re: Merger of the Itasca Clinic and Grand Rapids Medical Associates -
Request for a Business Review Letter**

Dear Ms. Bingaman:

We are writing on behalf of two medical clinics in northern Minnesota that are planning to merge -- the Itasca Clinic and Grand Rapids Medical Associates. We respectfully request the Antitrust Division of the United States Department of Justice, pursuant to the provisions of 28 C.F.R. § 50.6, to review and state its present enforcement intentions with respect to the proposed Itasca Clinic - Grand Rapids Medical Associates merger.

Background and Purpose of the Merger

The Itasca Clinic is a Minnesota business trust that employs five family practice physicians, two internists and one general surgeon. Grand Rapids Medical Associates is a Minnesota professional corporation that employs ten family practice physicians, two internists and one general surgeon. The Itasca Clinic and Grand Rapids Medical Associates are both located in Grands Rapids, Minnesota, which is a city in northern Minnesota with a population of approximately 8,000 people. Grand Rapids is in Itasca County, which has a population of approximately 41,000. The Itasca Clinic and Grand Rapids Medical Associates draw most of their patients from northern Minnesota, specifically Itasca County and portions of St. Louis, Aitkin and Cass Counties. This is a rural, remote, sparsely populated and medically underserved area of Minnesota. (Attached to this letter as Exhibit A please find a map of Minnesota, a map of the Itasca County area, and a Minnesota counties map.)

The purpose of the proposed merger is to develop a multi-specialty medical group offering a comprehensive range of services needed to meet the health care needs of the community. It is expected that the merger will allow the Itasca Clinic and Grand Rapids Medical Associates to establish secondary care services in the Itasca County area which

Letter to The Honorable Anne K.

Bingaman

June 13, 1995

Page 2

would otherwise not be available. In addition, the clinic merger will allow the development of new managed care products for purchasers of health care in northern Minnesota which will allow the provision of high quality care in a cost-effective manner. Finally, the clinic merger will enable the provision of comprehensive medical services, both primary and surgical care, that are needed to support a high quality hospital on a local level in the Itasca County area.

Relevant Product Market and Geographic Market

With respect to mergers, the general focus of the antitrust law is the merger's effect on consumer welfare within the relevant market. Specifically, the law seeks to determine whether the merger will have an anticompetitive effect. That is, whether the merger will substantially lessen competition in the relevant market, either by (1) creating a single entity with sufficient market power alone to restrict output or increase prices above competitive levels, or (2) by increasing the level of concentration in the relevant market to the extent that the remaining firms might collude to the same effect. Market power is defined as the ability of one or more firms "profitability to maintain prices above competitive levels for a significant period of time." See U.S. Department of Justice and FTC 1992 Horizontal Merger Guidelines, § 0.1.

The first step in analyzing the competitive effects of a merger is to define the relevant market. Market power has meaning only in the context of an economically meaningful market. The judgment as to whether an entity has power over market prices and competition can be made only if one first determines what forces will strain the entity's freedom to act as it pleases. The most likely and most important restraining force is competition from other entities and their products or services. All the firms and products that exert this restraint are considered to be within the relevant market.

Under the antitrust laws, the relevant market has two components, a relevant product market and a relevant geographic market. A relevant product market includes those products or services that are reasonably interchangeable from the perspective of consumers. Products need not be identical to be in the same relevant market as long as they compete meaningfully with one another. In the present case, the relevant product can be identified as primary health care services. Primary health care services are provided by general practitioners, family practitioners, pediatricians, internists, and obstetricians/gynecologists (hereinafter "family practice physicians"). In addition, nurse practitioners and physician assistants provide certain types of primary health care services within their permitted scope of practice, and may function independently from physicians and compete with physicians. Finally, many people, particularly in rural areas, turn to chiropractors for their primary health care needs.

Letter to The Honorable Anne K.
Bingaman
June 13, 1995
Page 3

The geographic area in which sellers of a particular product or service operate and to which consumers can realistically turn for such products and services is considered the relevant geographic market. The purpose of defining the relevant geographic market is to identify the competitors that operate as a constraint on the ability of a seller to exercise market power.

A variety of factors can be used to assess the relevant geographic market in a merger between two medical clinics. These factors include, among other things, the perception of the merging parties, the perception of payors (e.g. health insurance companies), patient flow data and patient travel preferences. Considering all of these factors, the relevant geographic market in the present case is the area within approximately a 40-mile radius of Grand Rapids. This area of Minnesota is the western portion of what is generally referred to as the Iron Range (due to the iron ore mining that has taken place here). Thus, in this letter we will refer to the relevant geographic market as the Western Iron Range market area. The Western Iron Range market area includes most of Itasca County and portions of St. Louis, Aitkin and Cass Counties. It includes the cities of Hibbing and Chisholm, as well as Grand Rapids.

The Western Iron Range is the relevant geographic market area in this matter for a number of reasons. First, it is the geographic area in which the Itasca Clinic and Grand Rapids Medical Associates primarily market their services, and from which the clinics believe they compete for most of their patients. Second, it is roughly the market area that Blue Cross/Blue Shield of Minnesota, a significant health insurance payor, has identified when analyzing the relative amount of payments it makes to Grand Rapids Medical Associates, the Itasca Clinic and the Itasca Medical Center (the local community hospital in Grand Rapids). Third, patient origin and destination patterns support the Western Iron Range market area as the relevant geographic market. The Western Iron Range market area is the area from which the Itasca Clinic and Grand Rapids Medical Associates draw most of their patients, and the area within which consumers can reasonably turn for other clinics or health care providers. Finally, this geographic market area is consistent with the information gathered by the Office of Rural Health and Primary Care ("ORHPC") of Minnesota Department of Health regarding the provision of primary health care services in rural Minnesota. The ORHPC's 1994 Primary Care Access Plan designates Itasca County as a health professional shortage area and reports that in Itasca County it is common for consumers to travel more than 20 miles to receive primary health care services.

Letter to The Honorable Anne K.
Bingaman
June 13, 1995
Page 4

Competition and Structure of the Market

Based upon the 1995 Minnesota Medical Association Directory and the ORHPC's 1994 Primary Care Access Plan, there are approximately 60 family practice physicians practicing within the relevant geographic market -- the Western Iron Range market area. The Itasca Clinic has five family practice physicians and two internists, and Grand Rapids Medical Associates has ten family practice physicians and two internists. Thus, the Itasca Clinic - Grand Rapids Medical Associates combination will employ 19 family practice physicians. Thus, the merged clinics will employ approximately 32% of the family practice physicians practicing within the Western Iron Range market area.

The clinic created by the Itasca Clinic - Grand Rapids Medical Associates merger will face significant competition in the provision of primary health care services from the other family practice physicians in the area. This includes competition from several other primary care clinics that employ multiple physicians, including: the Adams Clinic in Hibbing, which employs five family practice physicians; the Mesaba Clinic in Hibbing and Chisholm, which employs 14 family practice physicians (and which was recently acquired by the University of Minnesota Hospitals and Clinics in Minneapolis/St. Paul); and the Deer River Community Hospital in Deer River, which employs three family practice physicians (and which recently entered into a long-term lease of space to the Duluth Clinic, a very large multispecialty clinic based in Duluth and operating throughout northeastern Minnesota). In addition, although not included in our definition of the Western Iron Range market area, Virginia, Minnesota, one of the few small cities in this remote area, is only 61 miles from Grand Rapids and there are approximately 25 family practice physicians practicing in that area, primarily clustered in the East Range Clinic, a multi-specialty group practice. These physicians may also compete to a certain extent with the Itasca Clinic and Grand Rapids Medical Associates' family practice physicians for patients on the fringe of the market area. Finally, as discussed above, nurse practitioners, physician assistants and chiropractors may also compete with family practice physicians for patients on the fringe of the service area. Although we have no current data regarding the number of these types of health care providers in the Western Iron Range market area, we believe that such providers are present in the market and do provide some additional competition.

There is no reliable data available showing the market shares of the Itasca Clinic, the Grand Rapids Medical Associates and other health care providers with which they compete. However, claims data reported by Blue Cross/Blue Shield suggests that physicians within Itasca County are receiving only 27% of Blue Cross/Blue Shield payments for patients originating in the Grand Rapids area. The remaining 73% of such payments are going to physicians located out of Itasca County. This data, although

Letter to The Honorable Anne K.
Bingaman
June 13, 1995
Page 5

incomplete, again suggests that the Itasca Clinic and Grand Rapids Medical Associates face significant competition from other providers in the Western Iron Range market area, and from providers in other parts of Minnesota.

The fact that the Itasca Clinic - Grand Rapids Medical Associates merger will employ a relatively small percentage of the family practice physicians in the Western Iron Range market area and that the merged clinic will face competition from a broad range of other clinics and health care providers strongly suggests that the merger will not be anticompetitive. Moreover, the percentage of family practice physicians in the merged clinic will be only slightly above the antitrust safety zones for physician network joint ventures set by the 1994 Department of Justice and Federal Trade Commission Statements of Enforcement Policy and Analytical Principles Relating to Health Care and Antitrust.

Independent Market Analyses

There have been several recent studies conducted concerning health care services in Itasca County. These include two studies done at the request of the Board of Directors of the county owned Itasca Medical Center (hereinafter the "Hospital") concerning governance, management, and operations of the Hospital -- one by the Benedictine Health Service and the other by Hamilton/KSA, a health care consulting group. In addition, two health care studies have been done on behalf of the Itasca Partnership for Quality Health Care (IPQH), a group made up of local health care providers, employers, businesses, payors and consumers. One of these studies was done by the Minnesota Center for Rural Health and the other was done by a private consulting firm, Health Planning and Management Resources, Inc. Only the Benedictine Health Service study specifically addressed a possible merger of the Itasca Clinic and Grand Rapids Medical Associates, and it supported such a merger. All of the studies, however, indicated that there is significant outmigration of patients from Itasca County, that the Hospital is in a difficult financial situation, that there is real need to recruit additional health care providers, particularly specialists, to the Itasca County area, and that there needs to be a collaborative effort to prevent essential health care services from eroding in Itasca County. Thus, all of the studies have identified the very problems with health care delivery in Itasca County that the Itasca Clinic - Grand Rapids Medical Associates merger is designed in part to address. We will briefly discuss each of these studies.

Letter to The Honorable Annie K.
Bingaman
June 13, 1995
Page 6

The Benedictine Health Service completed a study at the request of the Hospital Board. It concluded that there is a demand for, and that the population numbers support, additional physician specialists in the Itasca County area, specifically in the field of obstetrics, gynecology, urology, ENT, pediatrics and orthopaedics. The Benedictine Health Service was asked specifically by the Hospital's Board of Trustees to comment on the merits of a potential merger between the Itasca Clinic and Grand Rapids Medical Associates. Their conclusion was that the community would be better served if the clinics merged, since that would provide a stable base from which needed specialists could be recruited to the area.

Hamilton/KSA also recently prepared a report, at the request of the Hospital Board, concerning issues facing the Hospital. Hamilton/KSA interviewed key people associated with the Hospital to prepare its report and then presented it at a Hospital Board meeting. Hamilton/KSA focused its review on issues concerning the management and governance of the Hospital and on the possibility of a merger between the Itasca Clinic and Grand Rapids Medical Associates with the Hospital. Hamilton/KSA concluded that there were significant concerns with the financial condition of the Hospital related to the high costs and its declining patient volume. In addition, Hamilton/KSA concluded that there was significant outmigration from the Western Iron Range market area for health care services due to a lack of specialty physicians. Finally, Hamilton/KSA concluded that the Hospital needs to network with the area physicians. In summary, Hamilton/KSA concluded that the Hospital is facing a crisis which could threaten its survival if not addressed immediately. Hamilton/KSA suggested that the Itasca Clinic and Grand Rapids Medical Associates join with the Hospital in a physician-hospital organization (PHO). While the parties seeking review have not concluded that a further integration with the Hospital is either necessary or desirable, Hamilton/KSA believes that the best way to meet the needs of the entire community is for the Hospital and clinics to work together in a formal organization. Hamilton/KSA concluded that in a managed care framework, contractors must have quality physicians, primary care capacity, efficient specialists, geographic coverage, contracting ease, care management, and risk sharing.

The IPQH collected a variety of data concerning where Itasca County citizens are obtaining various types of health care services, and then arranged with the Minnesota Center for Rural Health in Duluth, Minnesota, to assess the data, and to provide a neutral interpretation and summary. The data included the results of a local pharmacy, consumer and physician surveys, claims data from Blue Cross/Blue Shield and from two large local employers, and utilization data from Miller Dwan Medical Center and St. Mary's Medical Center, which are both located in Duluth, Minnesota. The study concluded that there is significant outmigration from Itasca County for health care

Letter to The Honorable Anne K.

Bingaman

June 13, 1995

Page 7

services. The study indicated that Itasca County patients are seeking care for a diverse range of conditions, including those which can be categorized as primary care needs, from a wide variety of out-of-town providers. Moreover, the study concluded that there is a perception on the part of consumers that the quality of care in Itasca County is not particularly strong and that this may be a factor contributing to the outmigration for health care services. Finally, the study suggested that there is a need to recruit specialty physicians to provide services in Itasca County. The study concluded that if the status quo is maintained, the Itasca County health care community will continue to see an erosion of the services provided and further outmigration.

Finally, the IPQH also contracted with Health Planning and Management Resources, Inc. to complete a random telephone survey of residents of the Itasca Medical Center market area to learn about how and why persons used health care services. This survey concluded that the Grand Rapids health care delivery system is reasonably accepted for routine primary care services although there is room for customer service improvements. The survey also concluded that a significant number of people leave Itasca County for services because of a desire for specialty care or a level of capability that either is not available or adequately available within Grand Rapids. The survey identified a number of strategic issues for the delivery of health care services in Itasca County. First, the survey indicated that if the status quo is maintained, the Grand Rapids health care community will retain basic primary care services, but continue to see an erosion of the primary services provided and of the number of health care dollars spent in Itasca County. Next, the consistent theme throughout the survey was that more specialists and better quality physicians are needed to improve the health care delivery of the system in Itasca County, and the existing medical community must come together to develop such resources within the local community. Finally, the survey concluded that the Hospital must be updated and that this must be part of an overall strategic plan to improve and enhance health care services in the community.

Procompetitive Benefits of the Proposed Merger

While the relevant product market for technical antitrust purposes is primary health care services, the purpose of the proposed merger between the Itasca Clinic and Grand Rapids Medical Associates is to develop a multi-specialty medical clinic offering a comprehensive range of services to meet the needs of the community. The merger will help resolve many of the health care delivery problems identified in the above-described studies, and will provide significant procompetitive benefits to consumers in the Itasca County area.

Letter to The Honorable Anne K.
Bingaman
June 13, 1995
Page 8

It is extremely difficult to recruit physicians to a remote, rural area such as Itasca County. This is due to physician preferences, salary issues, availability of call coverage, and other similar factors. In addition, it is difficult to recruit specialists into a rural area because of the need for a base of primary care physicians to provide adequate referrals to the specialist. This is particularly true in an HMO-managed care setting as exists in Minnesota, even in rural areas such as Itasca County, where there has been a longstanding managed care demonstration project for local Medicaid recipients. The Itasca Clinic - Grand Rapids Medical Associates merger will provide a stable primary base to be able to recruit additional specialists to Itasca County. This will address a problem that was consistently identified in the above-described studies (i.e., the need for more specialists to improve the rural health care system in Itasca County).

Moreover, the multi-specialty clinic created by the merger will be better able to compete effectively with other multi-specialty clinics in the area, such as the East Range Clinics, the Duluth Clinic and the Mesaba Clinic. The provision of multi-specialty services may itself be a separate market, and the creation of the Itasca Clinic - Grand Rapids Medical Associates combination will enhance competition within that market in northeastern Minnesota. As noted, certain major health care providers have recently entered the health care market in northern Minnesota. The University of Minnesota in Minneapolis/St. Paul acquired the Mesaba Clinic in Hibbing; and the Duluth Clinic has acquired a clinic in International Falls, has undertaken the management of several other rural clinics, has reportedly entered into affiliation negotiations with several additional clinics, and has entered into a long lease arrangement with the Deer River Clinic, which is in the immediate Western Iron Range market area. These transactions suggest that there are low barriers to entry and it is relatively easy to enter the health care market in northern Minnesota. This, of course, undermines any ability the merged clinic might have to exercise market power because any price increase would be met by a new entrant in the market.

As discussed above, the merger will allow the Itasca Clinic and Grand Rapids Medical Associates to recruit additional specialists and establish secondary care services in the Itasca County area. These are services which would otherwise not be available to residents of the Itasca County area. The addition of new specialists and secondary care services to Itasca County will also enable the Hospital to improve its utilization rates and quality of service. Thus, the merger of the Itasca Clinic and Grand Rapids Medical Associates will bolster a local hospital that otherwise, by all accounts, may very well fail. In short, the clinic merger will enable the provision of comprehensive medical services, both primary and surgical care, that are needed to support a high quality hospital on a local level in the Itasca County area. Moreover, without additional specialists the Hospital's financial situation will continue to decline eventually diminishing the ability of

Letter to The Honorable Anne K.
Bingaman
June 13, 1995
Page 9

even the existing primary care clinics to keep going. Without a strong hospital, primary care services in Itasca County will erode in a type of downward spiral that has afflicted other rural areas. Finally, the clinic merger will allow the development of new managed care products for purchasers of health care in northern Minnesota which will allow the provision of high quality care in a cost effective manner. All of these procompetitive benefits strongly support the Itasca Clinic - Grand Rapids Medical Center merger and greatly outweigh any anticompetitive concerns.

Conclusion

As indicated above, the proposed merger between the Itasca Clinic and Grand Rapids Medical Associates will not cause anticompetitive effects. Instead, it will have significant procompetitive benefits for consumers in the Itasca County area by offering the opportunity for additional locally provided specialty care and by preserving and enhancing the quality of the local hospital. Therefore, we respectfully request that the Antitrust Division issue a business review letter indicating that it has no present enforcement intention with respect to this transaction. We will, of course, be happy to provide any reasonably available additional information that may be necessary to evaluate the proposed transaction.

Respectfully submitted,



James S. Matthews
Richard Ihrig
Steven M. Pincus