

pregnancy tests. Most of these high-volume, "routine" tests are performed by automated equipment and the results are generally reported electronically to the physician within a 24-hour period. Other tests, including most immunological and genetic tests, are performed less frequently and require more sophisticated and specialized knowledge or equipment. Two examples of such "esoteric" tests are immunoelectrophoresis (used for the diagnosis of autoimmune disorders and myelomas) and polymerase chain reaction tests for hepatitis C.

Delivery of health care in California is distinguished by high penetration by managed health care. Under the managed care model prevalent in the state, health plans often delegate the financial risk for providing primary, specialty, and ancillary medical services to physician groups, such as independent practice associations and medical groups, under a capitated arrangement, pursuant to which the physician group receives a prospective payment to care for the enrollees of the health plan. That is, rather than receive payments for each service provided by the physician group, the physician group receives a per member per month ("PMPM") payment designed to cover the expected costs of care by the physicians. The physicians then bear the risk of whether the capitation payments will cover the actual costs of care—including, in many cases, the cost of providing Laboratory Services.

Physician groups in Northern California that assume the financial risk for Laboratory Services under this California delegated model constitute a significant category of purchasers of Laboratory Services. Generally, these physician groups pursue exclusive or semi-exclusive contracts with laboratories to purchase such services, most often under a capitated arrangement in which the physician group pays a set amount (PMPM) to the laboratory to perform Laboratory Services for the physician group's patients who are affiliated with pre-paid health plans.

In general, three types of providers may perform clinical laboratory testing: independent clinical laboratories, such as Quest and Unilab; hospital-affiliated laboratories; and physician office laboratories. While individual physicians can perform a limited number of relatively simple diagnostic tests in their own offices, this testing is not a substitute for the clinical testing performed in a laboratory. Physician groups require that a clinical laboratory offer, among other things, a comprehensive menu of routine and

esoteric tests; stat testing capabilities; and an extensive field collection and distribution system that includes conveniently located patient service centers and courier networks.

Hospital laboratories that supply physician groups in Northern California are treated as market participants in the proposed complaint. Most acute-care hospitals maintain on-site laboratories to provide quick-response testing for patients in the hospital. In addition, many hospital laboratories have established outreach programs to obtain additional business by providing outpatient Laboratory Services to physicians in the communities surrounding the hospitals. In some instances, hospital laboratory outreach programs in Northern California supply Laboratory Services under capitated arrangements to physician groups. Hospital laboratories have been most successful when competing to supply physician groups that are affiliated with the hospital and whose physicians are located in medical buildings on or near the hospital campus.

The proposed complaint alleges that the relevant market does not include physician office laboratories. Some medical groups operate laboratories that perform many stat and routine tests exclusively for doctors in the medical group. Physician groups do not view these physician office laboratories as viable substitute suppliers of Laboratory Services, because these laboratories do not offer the array of tests, capabilities, and services that are offered by independent clinical laboratories, including convenient patient access through PSCs. Furthermore, physician groups that do not have their own clinical laboratories are unlikely to develop such capabilities, even in the event of a significant increase in the price of Laboratory Services.

The draft complaint alleges that the relevant section of the country (*i.e.*, the geographic market) within which to analyze the effects of the proposed acquisition is Northern California. The relevant geographic market is local in nature because physician groups prefer to have specimens collected at PSCs located where they are convenient and accessible to all plan enrollees. Physicians also require prompt reporting of routine test results, generally within 24 hours. In addition, physicians require even more rapid reporting of results for stat testing, generally within a few hours. For these reasons, a clinical laboratory must have stat testing facilities and PSCs proximate to the physicians' offices. Physician groups in California have service areas that vary from a single

town to multiple counties; however, none has a service area that spans both northern and southern California.

Quest and Unilab are the two leading providers of Laboratory Services to physician groups in Northern California, based on the total patient lives covered under physician group capitated contracts. If the proposed merger were to be consummated, Quest would have a market share of more than 70 percent. Quest's next largest competitor in the relevant market is a hospital laboratory that would have a market share of about 4 percent. The proposed acquisition would increase concentration in the relevant market by more than 1,500 points to a Herfindahl-Hirschman Index level above 5,300.

Quest and Unilab compete vigorously against each other for contracts to supply Laboratory Services to physician groups, and this competition has benefitted customers in Northern California. Many physician groups in Northern California regard Quest and Unilab to be the closest competitors bidding for their Laboratory Services business in terms of both price and service offerings. The proposed acquisition would thus allow the combined firm to exercise market power unilaterally by eliminating competition between the two largest, and frequently lowest-cost, providers of Laboratory Services to physician groups in Northern California. As a result, the proposed acquisition would increase the likelihood that physician groups in Northern California would be forced to pay higher prices for Laboratory Services.

Substantial and effective expansion by smaller competitors, as well as new entry, sufficient to deter or counteract the anticompetitive effects of the proposed acquisition in the market for providing Laboratory Services to physician groups in Northern California, is unlikely. Expansion by hospital laboratories or small independent clinical laboratories located in Northern California is unlikely to be sufficient to avert the anticompetitive effects from the merger. In general, large regional and national independent clinical laboratory companies like Unilab and Quest enjoy significant cost advantages over hospital laboratories and small independent clinical laboratories. As a result, the large independent laboratories are able more effectively to compete for and service price-sensitive customers such as physician groups seeking services under capitated arrangements.

It is also unlikely that new independent clinical laboratories will enter the relevant market. There are