

significant costs associated with establishing the staffed PSCs, courier routes, and sales force and other infrastructure necessary to serve the needs of a physician group. New entry is unlikely to occur because a new entrant would have significantly higher incremental costs of serving a particular physician group than an independent clinical laboratory that has an existing infrastructure in or near the area served by the physician group. Also, it is difficult to recoup the required incremental investments through a single physician group contract without charging higher than current rates, and opportunities to bid on multiple physician group contracts in the same area do not occur frequently. Thus, bidding at current rates in the hopes of winning future business would be risky for a new entrant.

The risk for an entrant would be further increased because "pull-through" business is an important determinant of the profitability of capitated contracts. Physician groups that participate in capitated plans for some of their customers also frequently participate in fee-for-service plans for other customers. Under fee-for-service plans, physicians are paid for each procedure. When Laboratory Services are needed for a patient with a fee-for-service plan, the health plan pays the laboratory directly but the physician chooses which laboratory covered by the plan will be used. The Laboratory Services provider for the capitated business of a physician group frequently has a significant advantage in winning a substantial amount of the "pull-through" fee-for-service business of the group, because physicians are familiar with the laboratory and it is easier to deal with one laboratory for all patients. Laboratory Services providers take into account the potential for pull-through business when determining their bids for capitated contracts. A new entrant to an area would not have a reputation or relationships with the physicians in the group and thus may have difficulty achieving similar pull-through rates as incumbent firms. As a result, because a new entrant would be cost-disadvantaged in competing against independent clinical labs that already have an existing infrastructure, it would be unlikely to secure capitated contracts with physician groups at pre-merger price levels.

The Proposed Order

The proposed Order effectively remedies the Commission's competitive concerns about the proposed acquisition by requiring the companies to divest Laboratory Services assets in Northern

California to LabCorp, including 46 PSCs; 5 stat laboratories; all of Quest's, and one of Unilab's, capitated contracts with physician groups; and all related assets necessary for the provision of Laboratory Services to physician groups, including customer lists and information. With these assets and LabCorp's experience as a provider of Laboratory Services in Southern California and elsewhere in the United States, LabCorp will be able to replicate Quest's operations, thus replacing the competition that would be lost as a result of the proposed acquisition. The Commission required that the Respondents make all of Quest's Northern California outpatient Laboratory Services business available to prospective buyers but has approved LabCorp's proposed acquisition of a smaller package of assets because LabCorp will be able to replicate the competition that Quest represents today with the smaller package of assets. As a result, after the divestiture, competition in the market for providing Laboratory Services to physician groups in Northern California will remain virtually unchanged by the proposed acquisition. Furthermore, the proposed Order includes measures designed to help ensure an effective transition of the divested assets to LabCorp.

LabCorp is a well-positioned acquirer of the divested assets for several reasons. As the second largest provider of Laboratory Services in the United States, LabCorp offers an extensive range of more than 4,000 routine and esoteric clinical tests, as well as other services that physician groups require, such as patient encounter data and test result reporting information technology. LabCorp currently provides Laboratory Services throughout most areas of the country, but has a limited presence in Northern California, where its business consists primarily of providing clinical reference testing to hospitals and esoteric HIV-related testing. Due to its operations in Southern California, however, LabCorp has substantial experience satisfying the requirements of physician groups in California's managed care environment. Furthermore, LabCorp has the financial resources to purchase the assets and operate the business in a competitive manner.

Pursuant to the proposed Order, Quest is required to consummate its transaction with LabCorp within ten days of the date that Quest and Unilab consummate the Merger Agreement ("Acquisition Date") and to complete the transfer of the assets to LabCorp within six months of the Acquisition Date. If Quest fails to comply with either

of these obligations, the Commission may appoint a trustee to divest Quest's outpatient Laboratory Services business in Northern California or its entire Laboratory Services business in Northern California. In the event that Quest transfers some of the assets to LabCorp, but LabCorp abandons its efforts to complete the transfer of the remaining assets and the interim monitor so notifies the Commission, the Commission may require Quest to rescind the transaction with LabCorp and order Quest to divest its Northern California outpatient Laboratory Services business to a Commission-approved acquirer within six months. Should Quest fail to do so, the Commission may appoint a trustee to divest either Quest's outpatient Laboratory Services business in Northern California or its entire Laboratory Services business in Northern California. The purpose of these provisions is to assure the Commission's ability to secure an acceptable buyer—able to maintain and restore competition in the relevant market—in the event that LabCorp does not acquire the divested assets. The provisions require divestiture of a more extensive package of assets consisting of either Quest's outpatient Laboratory Services business or its entire Laboratory Services business in Northern California because a prospective buyer other than LabCorp may require additional assets to fully restore competition in the relevant market.

The proposed Order contains several provisions designed to ensure that the divestiture is successful. The proposed Order requires Quest to maintain the viability, marketability, and competitiveness of its Laboratory Services business assets in Northern California pending transfer of the divested assets. It also requires Quest to provide transitional services that the acquirer of the divested assets may need until the assets are completely divested and transferred. The proposed Order also prohibits Quest from interfering with the employment of any employees relating to the divested assets by the acquirer and requires Quest to provide incentives to certain employees to continue in their positions until the divestiture and to accept employment with the acquirer. For a period of one year following the date that the transfer of the divested assets is accomplished, Quest is prohibited from soliciting any employees of Quest or Unilab that accept offers of employment from the acquirer of the divested assets. Additionally, the proposed Order