

IN THE MATTER OF

DAMON CORPORATION

*Docket C-2916. Show Cause Order, March 29, 1983*ORDER TO SHOW CAUSE WHY ORDER REQUIRING COMMISSION APPROVAL
FOR CERTAIN ACQUISITIONS SHOULD NOT BE MODIFIED

On June 2, 1982, respondent Damon Corporation ("Damon") filed a petition requesting that the Commission reopen the proceeding in Docket No. C-2916 and eliminate that portion of the Order requiring Damon to obtain prior Commission approval for acquisitions of independent laboratories in twelve geographic markets and to notify the Commission of any other acquisitions of independent laboratories. The petition was placed on the public record pursuant to Section 2.51 of the Commission's Rules of Practice, 16 C.F.R. 2.51. Although Rule 2.51 and Section 5(b) of the Federal Trade Commission Act, 15 U.S.C. 45(b), require that the Commission decide petitions to reopen within 120 days, Damon voluntarily waived that deadline in this case. On January 31, 1983, the Commission denied Damon's petition, concluding that the petition failed to demonstrate that either changed conditions or the public interest required elimination of the prior approval requirement. However, the Commission believes that it may be in the public interest to exempt small laboratories from the requirement, and is therefore issuing this order to show cause why a partial modification should not be ordered.

*A. Complete Elimination Of The Prior Approval
Requirement Is Not Warranted*

As described in more detail in the letter denying Damon's petition, the Commission found that Damon had not demonstrated any harm to competition such that the public interest would require complete elimination of the prior approval requirement. In considering petitions to reopen under Rule 2.51, the Commission balances the reasons for modifying an order against the reasons for its retention. Damon's principal argument was that the order, as a practical matter, prevented acquisitions that were necessary to permit Damon to compete effectively. However, Damon's petition did not provide any evidence that its allegations in this regard extended beyond smaller acquisitions only.

Damon also alleged that the order served no valid purpose because no acquisition of medical laboratories could possibly injure competition. Were this true, then even limited evidence of injury to Damon

might justify eliminating the prior approval requirement. However, Damon's petition did not adequately address possible differences between large, automated laboratories (and the mix of tests they perform) and other types of laboratory facilities. Thus, not only did Damon fail to prove that acquisitions of large laboratories were necessary to its ability to compete or were in any way hampered by the prior approval requirement, it also failed to prove that acquisitions of large laboratories would no longer raise any antitrust concern. Damon's showing on both sides of the balancing test was limited primarily to small acquisitions.

The Commission also found that Damon's petition had not demonstrated changed conditions of fact that would require elimination of the prior approval requirement. Much of the petition attempted to show that the complaint had misstated Damon's market shares, and that it was based on an erroneous market definition. However, Damon had the opportunity to contest the allegations of the complaint but chose not to do so, and is not now entitled to an order modification on this theory alone. In any event, for the reasons just discussed, the market conditions that were alleged in the petition would not support a total elimination of the prior approval requirement for all acquisitions, large and small. Finally, the Commission found that its failure to challenge acquisitions of other medical laboratories or its recent statement on horizontal mergers did not constitute a "change of law" sufficient to justify the requested modification.

B. Grounds For Modification Of The Prior Approval Requirement

However, the Commission does find that the public interest may require some modification of the order. The prior approval provision appears to impede acquisitions of small laboratories, an activity which seems to be an important competitive tool for large laboratory companies. At the same time, acquisitions of small pathologist-owned laboratory businesses appear to present little probability of harm to competition since these laboratories are numerous and entry at this small scale of manual operation is frequent.

First, because of the character of acquisitions in the medical laboratory industry, the prior approval provision may place Damon at a critical disadvantage in persuading individual owners of small target laboratories to sell their businesses to Damon. Thus, despite the technical availability of the prior approval procedure, the order may effectively bar some acquisitions. Damon has shown that the publicity, delay, uncertainty, and expense of seeking prior approval can often impede its efforts to reach an agreement. This is because the industry is characterized by frequent and quickly consummated sales to larger laboratory companies of small pathologist-owned laboratory busi-

nesses, the primary value of which lies in the good will existing between the pathologist owners and their physician clients. By interfering with the practical transferability of this good will, the prior approval procedure may destroy the value of an acquisition.

Second, Damon has demonstrated that acquisitions are a particularly important competitive tool in the laboratory industry. Thus, to the extent the order prevents acquisitions, it may hinder effective competition by Damon. Damon has shown that sales volume is subject to continual erosion in the laboratory business due in part to the formation of new pathologist-owned laboratories whose owners have professional relationships with the physician clients of larger firms, and in part to decisions by physicians and hospitals to do some testing "in-house." At the same time, such professional relationships make it difficult to rely on ordinary sales efforts to win new customers. Damon has presented facts demonstrating that other large national competitors rely heavily on numerous acquisitions of small pathologist-owned laboratories, often hiring the former owners as sales representatives, and that Damon has not been able to compete as effectively in this manner.

Therefore the public interest appears to require the exemption of small laboratories from the order's acquisition approval provision. An exemption for laboratories with less than approximately \$1 million in annual revenues seems appropriate for consideration for several reasons.¹ No laboratory acquired by Damon since the order was issued (in markets not covered by the order) exceeded \$1 million in total annual revenues. Moreover, the Commission understands that over 90% of the laboratories in the country do fewer than 250,000 tests per year. The average price for all types of medical laboratory tests is somewhere between \$2 and \$3 per test, depending in part on the size of the laboratory and the sophistication of its equipment. Assuming that most of these smaller firms perform tests to a great extent manually and therefore applying the greater average price figure, it is reasonable to conclude that over 90% of the laboratories do less than \$.75 million in business annually. Thus, a \$1 million exemption would allow Damon to acquire, without prior approval, well over 90% of the laboratories in any given area.² This should substantially eliminate any harm to competition possibly resulting from the order.

Balancing the need for this modification against the reasons not to make it, the Commission believes that acquisitions of laboratories

¹ The proposed order modification specifies a limit of \$250,000 per quarter in each of the four quarters preceeding the acquisition. This will assure that the acquired laboratory was not undergoing recent substantial expansion.

² Damon's petition is in accord with these figures. Of 286 non-hospital laboratories in the Chicago market, the petition estimates only 16 generated over \$1 million in revenues in 1981. The corresponding figures for Philadelphia are 110 of which 11 exceeded \$1 million. Petition at 10. Indeed, it appears that as many as half the non-hospital laboratories test fewer than 50,000 specimens annually. Affidavit of Thomas Hansen (attached to petition) at Tables 5 and 6.

with less than \$1 million in annual revenues would be very unlikely to raise significant antitrust concerns for several reasons. First, there exist numerous small laboratories in every major metropolitan area throughout the country. Second, smaller laboratories are less frequent providers of highly sophisticated or "esoteric" test services. Third, there appears to be actual frequent entry of laboratories on a small scale by pathologists.

In sum, the Commission believes that it may be in the public interest to exempt laboratories with less than \$1 million in annual revenues from the acquisition approval provision in order to relieve any impediment to effective competition that may result from the order. Moreover, because acquisitions of such laboratories are so unlikely to raise antitrust concerns, there appears to be little reason not to order such relief.

Finally, it should be noted that any modification of the consent order by the Commission would operate only prospectively. The substantial interest in preserving the enforceability of Commission orders dictates that Damon remain liable for civil penalties or other equitable relief if any previous violation of the original order should be discovered. This is so regardless of whether the violation involves an acquisition that would have subsequently qualified for the exemption proposed by this order to show cause, if the exemption had not been granted at the time the acquisition was made.

For the foregoing reasons, the Commission hereby issues this order to show cause why the order should not be modified by adding, to Part II thereof, the following paragraph E:

E. Acquisitions consummated after [the date at which this modification becomes effective], of any Independent Laboratory which, during each of its four most recent fiscal quarters preceding the acquisition, has had less than two hundred and fifty thousand dollars (\$250,000) in Net Sales of Medical Laboratory Tests and Test Services performed on all specimens (from wherever originating) are exempt from the provisions of Paragraphs A through C of this Part II.

In accordance with Commission Rule 3.72, Respondent has 30 days from the date of service of this Show Cause Order to file an answer hereto. The Commission further directs that the Bureau of Competition shall file its reply to any answer filed by Respondent within 30 days from the date such answer is filed.

Commissioner Pertschuk dissented.

DISSENTING STATEMENT OF COMMISSIONER MICHAEL PERTSCHUK

I dissent from the Commission's decision to issue this Order to Show

Cause. The petition to modify Damon's 1978 order should simply be denied.

At issue here is the order's "prior approval" provision, requiring Damon to get Commission approval of any future acquisitions in twelve narrow geographic markets for a period of ten years.

Prior approval provisions, of course, have been a common fencing-in feature in decades of Commission orders. By requiring firms who have engaged in illegal mergers to get Commission approval before making future acquisitions, a prior approval provision serves both as a prophylactic measure designed to prevent future law violations by the same firm and as a deterrent to other firms which might violate the antitrust laws. As such, a prior approval provision is a modest and sensible restraint on firms that have demonstrated a propensity to violate the law.

Nevertheless, Damon contends that the prior approval provision prevents it from aggressively competing with its competitors. Apparently, by "aggressive competition," Damon means buying up smaller independent laboratories. Damon does not argue that competition would be harmed because of the possibility that the Commission would deny approval of procompetitive mergers. Instead, it argues that the publicity and delay involved in the prior approval process scares off potential acquisition candidates and makes Damon a less attractive suitor than its competitors. On this slender reed, it wants the prior approval requirement dropped entirely.

In justifying an order modification, a petitioner has the burden to demonstrate that "changed conditions of law or fact," or the "public interest," "requires; such a modification. I agree with the other Commissioners that Damon has not shown any changed conditions of law or fact to justify lifting the prior approval provision. But I disagree that the more nebulous alternative "public interest" standard, which is rapidly becoming the main standard for relief cited by the Commission in our recent spate of order modifications, provides any other ground for the requested relief.

While the Commission is not willing (correctly, in my view) to lift the prior approval provision altogether, it is willing to waive the requirement for acquisitions of independent medical laboratories with under \$1 million in sales. It's estimated that this change would exempt over 90% of the laboratories in the covered markets from the prior approval requirement.

The Commission's rationale for this partial exemption rests on the assumption that the public interest is better served by permitting Damon to gobble up smaller companies faster and more cheaply than it can under the existing order. In turn, that assumption can only be justified by a finding that the modest burdens of brief delay and the

risk of some publicity, which are inherent in *any* prior approval clause, so frustrate Damon's ability to compete that, on balance, the existing order is anticompetitive. I fail to see how one could draw this conclusion, particularly given the very weak evidence of injury presented by Damon. In my view, Damon has failed to show how this relief is required by the public interest, and accordingly I would deny the petition in its entirety.

SEPARATE STATEMENT OF COMMISSIONER GEORGE W. DOUGLAS

By issuing this order to show cause, the Commission wisely corrects an order whose provisions may well be anticompetitive. Trends in entry and expansion in the market for medical testing services since the Commission entered its order in 1978 indicate that the contemplated modification is far more likely than not to stimulate competition and benefit consumers. The proposed adjustment will afford Damon more freedom to pursue acquisitions which, the historical record strongly suggests, promise to yield valuable cost- and price-reducing scale economies without a corresponding growth in market power.

For the longer term, our experience in this matter suggests the pitfalls of intervening too swiftly to prevent acquisitions in industries marked by rapid innovation and growth. The Commission entered its original order as Damon had just begun to reap the fruits of a pioneering effort to consolidate small, higher-cost testing facilities into more efficient central operations. The Commission's initial concern with Damon's early, seemingly large market shares in Philadelphia and Chicago now seems seriously misplaced in light of the speed with which large-scale, subsequent entry by several major firms dramatically reshuffled market shares and changed Damon's relative standing in the industry. In short, sudden, dynamic change soon rendered the Commission's intervention virtually irrelevant and possibly counterproductive.

For these reasons, it is hard to take seriously Commissioner Pertschuk's suggestion that the proposed modification serves only to enable Damon "to gobble up smaller companies faster and more cheaply than it can under the existing order." If anything, this case reveals how an indiscriminately "aggressive" enforcement posture can deprive consumers of the superior performance that the antitrust laws are designed to promote. There is little to say for a merger policy that fails completely to account for the procompetitive role acquisitions can play in achieving efficiencies and encouraging desirable entrepreneurial enterprise. The troubling question is not whether the Com-

mission should modify this order, but rather why it accepted it in the first place.

IN THE MATTER OF
ETHYL CORPORATION, ET AL.

Docket 9128. Interlocutory Order, April 1, 1983

ORDER EXTENDING IN CAMERA TREATMENT

On March 16, 1983 the Commission provided notice to respondents that it intended to issue an opinion in this matter containing certain information contained in the *in camera* record. Respondents have filed various objections to the release of some of this information. In addition to information contained in the opinion, the record, including the initial decision by the administrative law judge, contains information which has been kept *in camera*.

Upon consideration of the objections filed by respondents to release of this information and the public interest in having access to a public record, *it is hereby ordered* that the opinion in this matter will be released with certain portions excised. To the extent that previously *in camera* information is released in the opinion as to which release one or more respondents have objected, the Commission has determined that release will not result in a "clearly defined serious injury." *H.P. Hood & Sons, Inc.*, 58 F.T.C. 1184, 1188 (1961); *Bristol-Myers Co.*, 90 F.T.C. 455, 456-457 (1977). As to information excised from the opinion and the remaining *in camera* information, the Commission plans to release some or all of this information no earlier than 30 days from the date of this order subject to any additional particularized showing by respondents of the need for confidentiality, such showing to be made within 30 days.