MEMORANDUM OF LAW

DATE: March 25, 1994

TO: Maureen Stapleton, Assistant City Manager

FROM: City Attorney

SUBJECT: Hartson's Antitrust Allegations Against American Medical Services' Advanced Life Support Discount Program

Pursuant to a request from the City Manager's office, the following memorandum of law provides a legal analysis of Hartson's antitrust allegations aimed at American Medical Services ("AMS"). The conclusions and recommendations herein follow a careful review of the correspondence submitted by both Hartson and AMS.

BACKGROUND

On February 23, 1993, the City Council, through a competitive bidding process, selected AMS as the single provider for both Advanced Life Support ("ALS") and Basic Life Support ("BLS") emergency paramedic services. Subsequently, the Paramedic System Management Contract (the "Contract") was drafted, agreed upon and became effective on July 1, 1993. The Contract outlines the requirements and expectations of the City and the responsibilities and obligations of AMS. Pursuant to the Contract and as an independent contractor for the City, AMS is required to comply with applicable federal, state and local laws.

The Contract, however, does not address BLS "non-emergency" paramedic service. The BLS non-emergency market is therefore open to all ambulance companies, including AMS and Hartson, who compete for contracts with hospitals, nursing homes and HMOs (hereinafter "Payors") to provide such service. In soliciting contracts from various Payors, AMS offered a discount on emergency ALS service ostensibly as a reward for prompt payment. At least one contract negotiated by AMS, which includes this "prompt payment discount," also provides for the Payor to use AMS for all or most of its non-emergency BLS transports.

In December, 1993, Hartson brought AMS's ALS discount program to the City's attention and requested the City to enjoin AMS's discount program on grounds that it violates the Contract and state and federal antitrust statutes. Specifically, Hartson

contends the ALS discount program: (1) constitutes a "secret rebate" or "unearned discount"; (2) as a result of the secret rebate, the discount effectively reduces the sale price to an amount "below cost"; (3) AMS's agreements with Payors constitute unlawful "tying arrangements"; and (4) by using the ALS service as a basis for providing a discount, AMS is violating the "Competition Provision" of the Contract.

On February 2, 1994, our office, pursuant to the City Manager's direction, responded by letter to Hartson's allegations and their request that the City prohibit AMS's ALS discount program. Our office recommended to you there was insufficient evidence to conclude a violation of the competition provision or that AMS otherwise acted unlawfully. Therefore, Hartson's request for the City to prohibit AMS's discount program was effectively denied.

On February 28, 1994, Hartson submitted a more detailed analysis of the reasons for their allegations and again urged the City to prohibit AMS's discount program. AMS provided its official response to Hartson's allegations on March 8, 1994. Our office, pursuant to your request, was tasked with evaluating the merits of each parties' legal position and renders the following opinion.

QUESTIONS PRESENTED

Does AMS's pursuit of contracts with various Payors offering discounted ALS emergency service violate either of the following:

(1) The Unfair Practices Act ("UPA")(Cal. Bus. & Prof. Code Sections17000-17101);

(2) The Cartwright Act (Cal. Bus. & Prof. Code Sections 16700-16758);

(3) The Unfair Competition Act ("UCA")(Cal. Bus. & Prof. Code Sections 17200-17208); or

(4) The City/AMS Paramedic Services Contract.

SUMMARY

A. The Unfair Practices Act. The UPA establishes seven offenses, two of which ("sales below cost" and "secret rebates or unearned discounts") are relevant to this discussion. Cal. Bus. & Prof. Code Section 17043. Courts unequivocally require a clear anticompetitive intent exist before finding a "sales below cost" violation. See, e.g., E&H Wholesale, Inc. v. Glaser Bros., 158 Cal. App. 3d 728, 735 (1984). Although AMS's ALS discount can reasonably be construed as a below cost sale, the facts and available evidence also support several defenses that AMS may be able to successfully assert, including: (1) lack of anticompetitive intent or intent to injure competition; and (2) acting in good faith for the purpose of either promoting competition or meeting competitor's prices. Id., at 735 (holding

that a violation of section 17043 requires both act and intent); See also Ellis v. Dallas, 113 Cal. App. 2d 234, 240 (1952) (recognizing that where there is substantial evidence that sales were made in good faith for the purpose of promoting and encouraging the purchase of other merchandise and not for the purpose of injuring competitors, the court may properly deny injunctive relief); Cal. Bus. & Prof. Code Section 17050(d) (providing for a "good faith meeting competition" exception to the general proscription of sales below cost).

The allegation that the discount offered by AMS is a secret rebate or unearned discount rather than a discount linked to prompt payment is a difficult one to prove. Hartson's claim that the ALS discount program has caused them injury and tends to injure competition must be demonstrated. Hartson apparently still occupies a majority share of the non-emergency market. Even considering the expansive interpretation of the UPA's prohibition of secret rebates or unearned discounts, the analytical difficulties presented when applying the prompt payment discount rule in addition to the lack of conclusive evidence of injury to competition, indicate AMS's ALS discount program would not be condemned on these grounds. See Diesel Electric Sales & Service, Inc. v. Marco Marine San Diego, Inc., 16 Cal. App. 4th 202, 212 (1993).

B. The Cartwright Act (Tying Agreements). A "tying arrangement" is a requirement that a buyer purchase one product or service as a condition of the purchase of another. See Cal. Bus. & Prof. Code Sections 16720 and 16727. Tying agreements that are deemed expressly coercive are subject to review under the "per se rule" which ordinarily finds such restraints of trade to be per se illegal. Under the "per se rule," the "tie" is condemned without reference to justifications for the "tie" or its procompetitive effects. Mailand v. Burckle, 20 Cal. 3d 367, 380 (1978). However, courts are increasingly reluctant to apply the per se standard, even where the preconditions are met, unless the applicable case law forcefully or universally require such a result. Marin County Board of Realtors, Inc. v. Palsson, 16 Cal. 3d 920, 937 (1976); See also Town Sound and Custom Tops v. Chrysler Motors, 959 F.2d 468, 477 (3rd Cir. 1992). By contrast, under the "rule of reason," restraints of trade are only struck down if found to be unreasonable. People v. Santa Clara Valley Bowling Proprietors' Ass'n, 238 Cal. App. 2d 225, 234 (1965); See also Corwin v. Los Angeles Newspaper Service Bureau, Inc., 4 Cal. 3d 842, 854 (1971).

Because of the similarity between the facts of this case and those cases involving the use of economic coercion sufficient to support the imputation of a tie, the ALS discount program is

more likely subject to a rule of reason inquiry. Under this test, the procompetitive effects of AMS's conduct, including cost and market efficiency and their small percentage of the non-emergency market, are valid considerations when determining the "reasonability" of their ALS discount program. Kim v. Servosnax, 10 Cal. App. 4th 1346 (1992). Furthermore, the Cartwright Act expressly provides that agreements that have the purpose or effect of promoting or increasing competition in a given trade or industry are not unlawful. Cal. Bus. & Prof. Code Section 16725. Thus, AMS's conduct can arguably withstand scrutiny under the Cartwright Act.

C. The Unfair Competition Act. The UCA prohibits unlawful, unfair or fraudulent business practices. Cal. Bus. & Prof. Code Sections 17200-17208. Hence, if AMS's conduct is found to be otherwise unlawful, it will also be prohibited under the UCA. However, to be deemed "unfair," Hartson must establish that AMS's ALS discount program meets two essential elements: (1) that the discount program is a "business practice;" and (2) that the "practice" is unethical, oppressive or substantially injurious to consumers. People v. Casa Blanca Convalescent Homes, Inc., 159 Cal. App. 3d 509, 530 (1984); State ex rel. Van Kamp v. Texaco, Inc., 46 Cal. 3d 1147, 1169-1170 (1988).

Hartson did not provide any arguments or authority establishing the ALS discount program as meeting the definition of "unfair" as construed by applicable case law. Whether the ALS discount program meets the two prong test of unfairness is a question of fact. Therefore, AMS may be able to successfully defend against an allegation of unfairness by showing either: (1) a lack of a "pattern" with respect to offering ALS discounts or (2) under a balancing test applied by some cases construing "unfairness" for purposes of this UCA provision, that the impact of their conduct on Hartson is slight and therefore outweighed by the utility of their allegedly more cost efficient service. See, e.g., Motors, Inc. v. Times Mirror Co., 102 Cal. App. 3d 735, 740 (1980).

D. The Contract Provisions. This office does not adopt Hartson's position that the City and AMS are bound by the mistaken terms in the current version of the Contract. It appears, as AMS argues, that common law contract principles, codified in statutes which provide an equitable remedy of reformation for a mutual mistake resulting in a so-called "scribner's error," govern the current dispute. It is well settled law that "where parties come to an agreement, but by mistake the written instrument does not express their agreement correctly, it may be reformed or revised on the application of the party aggrieved." 1 Witkin, Contracts Section 382 (9th ed.

1987).

Even assuming, arguendo, that the unfair competition clause is still part of the Contract as Hartson suggests, the Contract language imposes no higher standard as to what is "unfair" than the law ordinarily provides. It is conceivable that Hartson's interpretation may result in a challenge under statutes prohibiting unreasonable restraints of trade, however the alleged source of the "unfairness" would be the conduct of AMS and not the City. Our office is unaware of any law which permits parties to a contract, absent express provisions defining certain terms, to attribute definitions to terms which are beyond their usual denotative and connotative meanings. A term is defined by its ordinary connotation or "plain meaning." With respect to "unfair competition," the plain meaning is the definition given that term as interpreted by applicable law. In short, Hartson's contentions and interpretations in this regard are unpersuasive.

E. Practical Considerations. First, the City's position as a party to a contract with one of two parties in a confrontational relationship with each other, makes clear the unsuitability of the City functioning as arbiter at the request of Hartson. Second, the City can not ignore its contractual obligations and exposure to potential liability for interfering with the City/AMS Contract. Third, as mentioned in the preceding summary, courts are increasingly reluctant to condemn conduct challenged under the antitrust laws as per se unlawful. Lastly, courts have also acknowledged that antitrust challenges are inherently factually intensive. Town Sound and Custom Tops, 959 F.2d at 481. Hartson's current challenge is no exception. In our opinion, the available evidence of unlawful conduct is anything but "clear." On the contrary, the evidence is largely inconclusive on many of the issues raised by Hartson. Hence, in our judgment, it is imprudent to act as Hartson urges.

CONCLUSION

Our analysis under each of the applicable antitrust statutes discussed above does not impel a determination that AMS's ALS discount program is unlawful.

It is apparent in some instances that the parties disagree or are themselves unclear as to what standard of review applies to the challenged conduct. In the midst of this uncertainty, coupled with our reservations with respect to Hartson's and AMS's conclusions of law, this office is now more convinced that any further affirmative steps in this regard are imprudent at this juncture.

Our recommendation to refrain from acting as Hartson's advocate does not represent our countenance of AMS's conduct. At the same time, however, we feel strongly that the evidence,

albeit substantial on various issues, does not sufficiently preponderate in either party's favor to warrant condemnation of AMS's conduct.

Finally, after analyzing the various issues that abound in this controversy and examining the courts' approach in similar situations, it has become clear that the City's suitability as arbiter under these circumstances is questionable. Hartson's interests may be better served in a forum, such as a court of law or equity, that is well equipped by virtue of its discovery and fact finding powers, to ferret out the complex legal issues implied by Hartson's allegations.

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