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HIGHLIGHTS

WASHINGTON G-2 REPORTS

Will Direct Marketing Of High-Priced Esoteric Tests Break The "Healthcare Bank?"

Over the past few years several "niche" esoteric testing laboratories have found financial success by marketing high-priced proprietary tests directly to physicians and, more recently, directly to consumers. This trend flies in the face of the traditional method, whereby esoteric testing labs would first educate local pathologists and laboratories about their new tests and these pathologists and labs would then spread the word to their physician-colleagues.

But, today, more and more esoteric testing labs are seeking to drive the demand for their tests with marketing tactics copied from the pharmaceutical industry. Laboratory companies like Myriad Genetics, Prometheus Laboratories, and Athena Diagnostics are employing "detailing" teams that are canvassing physician offices around the country in the same way that Merck, Pfizer, and J&J sales reps have done for years.

What's more, Quest Diagnostics and LabCorp are seeking to get into the act by gaining exclusive licenses to high-priced tests from genomics companies like Correlogic Systems and Exact Sciences. As the introduction of high-priced proprietary tests moves from a trickle to a flood, the question will become: "Are hospitals, managed care companies, and Medicare ready, willing, and able to pay?" For details on this topic, see *Inside The Laboratory Industry*, pp. 5-8.

MEDex Files For Chapter 11; Chief Executive Resigns

A recent audit that uncovered surprising losses and millions of dollars of unauthorized bank loans has forced MEDex Regional Laboratories LLC (Kingsport, TN) to file for Chapter 11 bankruptcy protection. As a result, Mike Ladd, chief executive of MEDex, has resigned, effective immediately. MEDex, owned by Wellmont Health Systems and a local pathology group, is one of the largest independent labs in the South with approximately 500 employees and estimated revenue of roughly $50 million per year.

MEDex, which plans to reorganize and emerge from Chapter 11, is shutting down a number of facilities in Alabama and Tennessee, according to Dean Farmer, a lawyer at Hodges, Doughty, and Carson (Knoxville, TN), which is handling the company's bankruptcy. ➥ *p. 2*

MEDex Files For Chapter 11, *from page 1*

Meanwhile, Farmer says it appears that Ladd made "substantial misrepresentations" to the MEDex board of directors regarding the financial condition of the company.

Farmer tells *LIR* that MEDex's auditors had encountered a lot of "foot dragging" in their efforts to gain financial data from Ladd over the past two years. Finally, on March 27, a complete audit was presented to the board revealing that MEDex had lost approximately $2 million for each of the past three years, in large part because of overstatements in accounts receivables. This was in stark contrast to previous financial reports prepared by Ladd for the board, which had shown the company to be profitable.

In addition, the audit revealed that MEDex had borrowed $8.5 million from First Tennessee Bank and SunTrust Banks. The board had only authorized $2 million in bank debt.

Ladd resigned the same day that the audited financials were presented to the board. And MEDex filed for Chapter 11 at the United States Bankruptcy Court for the Eastern District of Tennessee (Knoxville) on April 8.

MEDex is now being run by a group of executives that includes Richard Ray, chief financial officer; Ed Bush, director of operations; and Gail Price, director of lab services

Farmer says Ladd appears to have used the extra $6.5 million in unauthorized loans to fund an aggressive expansion strategy at MEDex. The MEDex board had been led to believe the expansion was being funded from profits earned by MEDex, according to Farmer.

Over the past few years, Ladd opened new laboratories and patient service centers in Chattanooga, Knoxville, and Nashville, Tennessee, and Birmingham, Alabama. All of these facilities are now being shut down and 80 to 90 employees are losing their jobs, according to Andy McLamb, spokesman for MEDex. McLamb says that facilities in Kentucky and North Carolina may be closed as well.

The company is now focusing on its six labs in northeast Tennessee and southwest Virginia. Five of these labs are located at hospitals that are part of Wellmont Health Systems, including Bristol Regional Medical Center (Bristol, TN), Holston Valley Medical Center (Kingsport, TN), Lonesome Pine Hospital (Big Stone Gap, VA), Hawkins County Memorial Hospital (Rogersville, TN), and the Southwest Virginia Cancer Center (Norton, VA). A sixth laboratory is a freestanding facility located in Johnson City, Tennessee.

Farmer says the bankruptcy court has allowed MEDex to obtain an emergency loan of $1.5 million to maintain operations until the reorganization is completed. "This lab will continue to operate. Wellmont will see to that," says Farmer.

Farmer says that a deeper internal investigation is now under way to further clarify MEDex's financial condition and irregularities. He would not say whether a formal criminal or civil investigation would be launched. As it stands, Farmer says, there is no reason to believe the unauthorized borrowings by Ladd were used for anything other than to expand MEDex and fund operating losses. "But right now, we're not in a position to know all the circumstances. We are focusing on maintaining critical services," he adds.

RFPs Sent Out For Alliance Laboratory Services

Requests for proposals were mailed out to "several" potential bidders interested in Alliance Laboratory Services (ALS—Cincinnati, OH) in early April, according to Gail Myers, spokeswoman for Health Alliance (Cincinnati), the integrated delivery system that owns ALS. Bids are due back by the end of April. Myers says Health Alliance plans to come to a final decision on whether to keep ALS or proceed with one of the bidders by the end of June.

ALS is one of the largest hospital-owned laboratories in the nation with some 800 employees performing 7.5 million billable tests per year, nearly 50% of which come from outreach. Health Alliance had originally planned to make a decision on ALS by early February (*see LIR, December 2002, p. 1*), but the ironing out of details contained in the RFP held things up. Part of the delay was due to the formulation of performance-related criteria contained in the RFP, such as test turnaround time standards that any potential purchaser of ALS would need to meet.

LIR has learned from industry sources that potential bidders for ALS will probably include Quest, LabCorp and MDS. Another potential scenario involves the current management team at ALS, which could make an offer by itself or perhaps team up with one of the commercial labs to make a joint bid, according to an informed source.

Meanwhile, Chris Jahnle, managing director at Haverford Healthcare Advisors (Paoli, PA), anticipates that several hospital/commercial lab deals will close within the next 12 months. He notes that many hospital administrators are attracted to the idea of selling lab assets in order to raise funds for capital expenditures in more profitable areas of the hospital, such as outpatient surgery or diagnostic imaging centers. On the other side, Jahnle notes that Quest and LabCorp are running out of independent labs to acquire and must now turn to hospital partnerships or buyouts for growth.

The key to the completion of any hospital/commercial lab deal will be the ability of Quest and LabCorp to convince hospital medical staff and pathologists that they can meet or exceed the service levels of the hospital labs they intend to take over, observes Jahnle.

A Poor Track Record For Hospital/Commercial Lab Joint Ventures

Of course, skeptics can always point to the long list of failed joint ventures between hospitals and commercial labs and ask, "What will be different this time?" A quick review of the joint ventures and partnerships formed by hospitals and Quest (including AML), LabCorp (including Dynacare), and MDS Inc. shows that a significant number don't make it past the fifth year without being greatly restructured or outright terminated.

Most recent has been the collapse of Shared Laboratory Services Inc. (SLS—Fairfax, VA), which was developed by American Medical Laboratories (AML—now part of Quest) in the late 1990s in partnership with four hospitals in the Norfolk and Virginia Beach area.

SLS had been formed to provide core laboratory services to the four hospitals and to develop outreach services. AML had owned 49% of SLS with the hospitals sharing the remaining 51%. All five owners had equal voting power on day-to-day operating matters.

However, consistent operating losses, rising account receivables writeoffs, and disagreement among partners over operation of the partnership have led several of the hospital partners to pull out.

Another partnership that has been terminated in recent years has been Clinical Laboratories of Lincoln Inc. Under this agreement, Quest provided inpatient testing services from a core lab to a group of hospitals in eastern Nebraska. In late 2001, however, the hospitals chose to end the contract with Quest and took back the management of their laboratories.

Meanwhile, sources tell *LIR* that LabCorp's partnership with Swedish Hospital (Seattle, WA) may be headed for a restructuring. LabCorp inherited this relationship when it acquired Dynacare last year. The partnership generates some $18 million of revenue annually and had accounted for approximately 6% of Dynacare's total U.S. revenue of $300 million per year.

Partnerships "Restructured" Or Terminated, 2000-2003

Hospital/Partnership Name	*Location*	*Commercial Lab Partner*
Allegheny Hospital	Pittsburgh, PA	LabCorp/Dynacare
Clinical Laboratories of Lincoln, Inc.	Lincoln, NE	Quest Diagnostics
Ellis Hospital	Schenectady, NY	LabCorp/Dynacare
MDS Hudson Valley Labs	Poughkeepsie, NY	MDS Inc.
Memorial Hermann	Houston, TX	LabCorp/Dynacare
Unity Health System	St. Louis, MO	Quest Diagnostics
Shared Laboratory Services	Fairfax, VA	Quest Diagnostics/AML

Source: *LIR*

Under the agreement, LabCorp leases a 33,000 sq. ft. laboratory facility on the campus of Swedish Hospital. The lab employs some 500 people who perform primary patient care testing for Swedish Hospital, provide reference lab testing for the Hutchinson Cancer Center, and operate a substantial outreach testing business that serves surrounding physician offices.

The agreement with Swedish Hospital is due to expire in 2005, and *LIR* has learned that the hospital has retained Nichols Management Group (York Harbor, ME) to reevaluate the relationship.

Possible scenarios could include bringing lab services back under hospital management, signing a new deal with another commercial lab, or negotiating more favorable terms with LabCorp. A spokeswoman from LabCorp would only say that "LabCorp is working hard to maintain the relationship."

Esoteric Labs Seek To Replicate Pharma's Profitable Business Model

In general, there are few studies that quantify the healthcare savings or costs associated with performing the high-priced proprietary tests marketed by niche esoteric laboratories

For years, healthcare payers have treated clinical laboratory testing services as a commodity. Payers argue that a lipid panel, PSA test, or Vitamin B-12 are the same whether performed at a local hospital, independent lab, or out-of-town commercial lab, so why not just have it done by the lowest bidder. Outside of competing based on turnaround time, labs have had little opportunity to distinguish themselves from one another. The result has been cut-rate pricing that has made lab profit margins among the lowest throughout the entire healthcare industry.

On the opposite end of the spectrum is the pharmaceutical industry. In a nutshell, the business model there works like this: invest 10 years and $1 billion to develop, patent, and bring to market a prescription drug; then spend heavily on sales and marketing, and reap the rewards for the next 20 years.

Despite the tremendous amount of money spent to bring a new drug to market, this business model works because of exclusivity. Patent protections make each new drug unique and allow for high pricing.

The drug makers have taken advantage of these simple economics for decades and now some niche esoteric testing companies are seeking to replicate this strategy in the lab business. These companies are developing proprietary specialty tests that can only be performed at their own laboratories. This gives them the ability to charge prices ranging anywhere from $100 to several thousand dollars per test vs. average pricing levels of approximately $12 for the typical routine test.

Rather than rely on local pathologists and laboratories to educate physicians on the merits of their tests, these niche esoteric testing companies are employing huge national sales teams that are going door-to-door to physician offices to drum up demand. In addition, some companies have begun direct-to-consumer marketing campaigns that include TV and magazine advertising.

A Sample Of Proprietary Tests From Niche Esoteric Testing Labs

Laboratory	*Test*	*Purpose*	*Price*
Athena Diagnostics	NeoComplete	neurological disorders	$1,175
Athena Diagnostics	OtoDx	hearing loss	695
Exact Sciences	PreGen-Plus	colorectal cancer	500-700
Liposcience	NMR LipoProfile	heart disease	100-200
Myriad Genetics	BRACAnalysis	breast/ovarian cancer	2,760
Myriad Genetics	Colaris	colorectal cancer	1,950
Prometheus Laboratories	Pro-PredictRx Metabolites	drug toxicity	270
Prometheus Laboratories	FibroSpect	liver fibrosis	350
Targeted Diagnostics	GCC-B1	colorectal cancer	495

Source: *LIR* from companies

These new and expensive tests are performed on an analyte specific reagent, or "home brew" basis. Most have no plans of seeking FDA approval for sale on a kit basis because that would eliminate the proprietary nature of the tests and probably result in a collapse in pricing.

In addition, these tests generally have not been assigned specific Medicare CPT codes, so labs must bill using a combination of existing codes. Obtaining reimbursement from managed care companies can also be difficult. Often physicians, after hearing the sales pitch from an esoteric sales rep, will order one of these tests from their local hospital or independent lab. The local lab, which can't run the test in-house, must ship it to a niche esoteric testing company, and often the local lab gets stuck with the bill *(see p. 12 for more details on this topic)*.

An overview of the operations at six of the largest niche esoteric testing labs begins below:

Myriad Genetics (Salt Lake City, UT) employs a sales force of 106 people who market the company's group of patented gene-based tests to oncologists across the country. In addition, the company has an exclusive sales and distribution agreement with LabCorp whereby LabCorp's 500-person sales force markets Myriad's tests to primary care physicians throughout the United States.

All testing is performed at Myriad's laboratory facility in Salt Lake City. These tests include Myriad's BRACAnalysis, which is used to assess a woman's risk of developing breast and ovarian cancer, and is priced at $2,760.

Other proprietary tests include Colaris, which is used to determine a person's risk of developing colon cancer and is priced at $1,950. Revenues from Myriad's proprietary tests grew approximately 57% in the fiscal year ended June 30, 2002 to $26.8 million.

In addition to going door-to-door to specialists and primary care physicians across the country, Myriad recently completed a direct-to-consumer advertising campaign in Denver and Atlanta. It was the first campaign for a genetic test to use television, radio, and magazine advertisements. Myriad spent $3 million to run commercials on "The Oprah Winfrey Show," "Live with Regis & Kelly," and other TV shows and to run ads in *Better Homes and Gardens* and *Ladies' Home Journal*.

Among the general population of women, the chances of carrying one of the genetic mutations detected by BRACAnalysis is approximately 1 in 500 (or about 0.2%). Nonetheless, Myriad's ads were designed to reach each member of the target audience (any women age 25 to 54) an average of about 17 times each over the course of the five-month campaign. A Myriad spokesman says the ad campaign boosted Myriad's Website and phone inquiries by a factor of 40.

But, the Office of Genomics and Disease Prevention (OGDP) at the CDC is concerned that the campaign for the test alarmed some women unnecessarily and is investigating the ad campaign. Muin Khoury, M.D., Ph.D., director of OGDP, tells *LIR* that findings could be used to inform future policy decisions on direct-to-consumer marketing of genetic tests.

Prometheus Laboratories (San Diego, CA) employs 53 salespeople who market a combination of proprietary esoteric tests and pharmaceutical products specifically to gastroenterologists and rheumatologists. Last year, the company increased its revenue by 36% to $68 million, which included $30 million from esoteric testing and $38

million from pharmaceuticals.

Among Prometheus's proprietary tests is Pro-PredictRx Metabolites, a pharmacogenomic test (priced at $270) that helps physicians monitor toxicity levels and individualize dosing for patients on the drug Imuran. This drug is made by Prometheus and is prescribed to treat severe, active, and erosive rheumatoid arthritis that is unresponsive to conventional therapies.

Other proprietary tests made by Prometheus include FibroSpect, a serum test (priced at $350) that helps physicians detect liver fibrosis in patients with hepatitis C.

Exact Sciences (Maynard, MA) anticipates that LabCorp will begin marketing its PreGen-Plus test for early detection of colorectal cancer this summer. LabCorp has an exclusive five-year agreement to market Exact's test. A LabCorp spokeswoman says the company is in the process of formulating its marketing strategy for PreGen-Plus, which may include direct-to-consumer ads.

PreGen-Plus has been developed for use in patients at average risk for developing colorectal cancer (male and female, 50 years and older). The test works by isolating DNA that is shed in the colon every day and exits the body in stool. The DNA is analyzed for mutations associated with colorectal cancer.

PreGen-Plus is expected to be priced at between $500 and $700. This compares with Medicare reimbursement of $4.54 for the fecal occult blood test, which is the most common colon cancer screening test, but has been criticized for low sensitivity and specificity.

LipoScience Inc. (Raleigh, NC), which generates an estimated $25 million in annual revenue, sells the NMR LipoProfile at an average selling price of approximately $80 per test. The NMR LipoProfile, which can only be performed at the company laboratory in Raleigh, helps physicians diagnose coronary heart disease risk more accurately and determine, on an individual basis, the most cost-effective therapy for risk reduction.

Athena Diagnostics (Worcester, MA), which is owned by the venture capital firm Behrman Capital (New York City), specializes in tests for neurological disorders. The company offers approximately 75 tests to the nation's 9,000 clinical neurologists, including tests for Alzheimer's disease, Huntington's disease, and multiple sclerosis.

Athena's average price per test is roughly $200 to $500, although some tests such as NeoComplete (a profile for detecting cancer autoantibodies that attack the body's nervous system) are listed as high as $1,175. Athena generates an estimated $35+ million in annual revenues and employs more than 50 sales reps.

Targeted Diagnostics & Therapeutics (TDT-West Chester, PA) says it has begun marketing a new blood test (called GCC-B1) that it has developed for the detection of recurrent colorectal cancer. The "home brew" test is now being performed exclusively at TDT's CLIA-certified laboratory in West Chester. TDT is charging patients $495 for the test, which is currently not covered by Medicare or most third-party payers.

Marketing efforts are being directed at the nation's 6,000 oncologists. The test most commonly used today for monitoring patients for recurrent colorectal cancer is carcinoembryonic antigen (CEA), which is reimbursed by Medicare under CPT code 82378 with a national limitation amount of $26.51.

Comparing Efficiency: Quest, LabCorp, And Independent Labs

Survey data collected by *LIR* from 20 independent labs across the nation show that their efficiency is in line with that of the two major commercial labs—Quest Diagnostics and LabCorp.

To make the comparison, *LIR* surveyed 20 independent labs with a combined total of $330.5 million in 2002 revenue, 26.3 million billable tests, and 3,037 full-time employees. These labs ranged in size from 31,000 billable tests per year up to 4.4 million, and came from 12 different states.

Overall, employees at these 20 independent labs performed an average of 8,675 billable tests per year and generated average net collected revenue of $113,160 each.

On a daily basis, employees at the 20 independent labs surveyed performed an average of 33 billable tests per workday (i.e., 26.3 million billable tests/3,037 FTEs/260 days). Average revenue generated per day per independent lab employee was $435.23.

These statistics compare favorably with those from Quest and LabCorp. For example, Quest reported $3.946 billion of clinical testing revenue in 2002, and the company's 33,200 clinical lab employees performed an estimated 306 million billable tests last year. This equates to an average of 35 billable tests per employee per day. Average revenue per employee per day was $457.20.

LabCorp reported $2.508 billion of revenue in 2002, and the company's 24,000 employees performed an estimated 206 million billable tests last year. This equates to an average of 33 billable tests per employee per day. Average revenue per employee per day was $401.88.

Of course this simple analysis does not indicate how profitable the independent labs are compared with Quest and LabCorp. But it does seem to indicate that independent labs remain viable competitors.

Comparing Efficiency

	***Quest*[1]**	***LabCorp***	***Combined total for 20 independent labs***
Clinical testing revenue	$3,946,600,000	$2,507,700,000	$330,495,416
Billable tests[2]	306,020,000	205,660,000	26,344,792
Full-time employees	33,200	24,000	3,037
Revenue per billable test	$12.90	$12.19	$12.55
Annual revenue per FTE	$118,873	$104,488	$113,160
Annual billable tests per FTE	9,217	8,569	8,675
Daily revenue per FTE[3]	$457.20	$401.88	$435.23
Daily billable tests per FTE[3]	35.45	32.96	33.37

[1]Data for Quest are for clinical testing operations only and exclude clinical trials, diagnostic kit manufacturing, and software businesses
[2]Billable test volumes for Quest and LabCorp are based on reported requisition volume from each company and a *LIR* estimate of 2.6 billable tests per requisition
[3]Assumes 260 work days per year (i.e., 52 weeks multiplied by 5 workdays per week)
Source: *LIR* from companies

AmeriPath Is Taken Private By Welsh Carson

Despite objections from at least one major shareholder, AmeriPath (Riviera Beach, FL) has completed its sale to the investment management firm Welsh, Carson, Anderson & Stowe (New York City).

Welsh Carson paid $795 million, including $113 million in assumed debt, or approximately 18 times AmeriPath's net income of $44.6 million for 2002 and 1.7 times its revenue of $479 million. Close of the deal makes AmeriPath a privately held company and leaves just one publicly traded pathology company left—Impath (New York City). The transaction had been opposed by MMI Investments (New York City), which owned about 4.5% of AmeriPath and had argued that the price Welsh Carson was paying was too low (*see LIR, February 2003, p. 4*).

As a private company, AmeriPath is expected to continue its current operations without major change. James New, chief executive of AmeriPath, will remain CEO and nearly all other management will stay on board as well. Meanwhile, *LIR* speculates that Welsh Carson will probably seek to put AmeriPath back on the auction block in a couple of years—either selling the company to Quest or LabCorp or back to the public through an IPO.

Summary Of Laboratory & Pathology Group Transactions *($MM)*

Date	*Buyer*	*Target*	*Purchase Price**	*Acquired Revenue*	*Price/ Revenue*
Mar-02	Quest	American Medical Laboratories	500	300	1.67
Apr-02	AmeriPath	Empire Pathology	NA	NA	NA
May-02	LabCorp	Cytology Screening Inc.	NA	NA	NA
Jul-02	AmeriPath	O'Quinn Medical Pathology	NA	NA	NA
Jul-02	LabCorp	Dynacare	700	238	2.94
Aug-02	LabCorp	Immunodiagnostic Labs	NA	NA	NA
Dec-02	Lab*One*	Central Plains Laboratories	12.6	13	0.97
Dec-02	AmeriPath	Dermatopathology of Wisconsin	NA	NA	NA
Jan-03	LabCorp	Dianon	544	210	2.59
Jan-03	AmeriPath	Nuclear Medicine and Pathology	NA	NA	NA
Jan-03	AmeriPath	Reference Pathology Associates	NA	NA	NA
Feb-03	LabCorp	N. Calif. lab assets of Quest/Unilab	4.5	27	0.17
Feb-03	Quest	Unilab	887	425	2.09
Mar-03	Welsh Carson	AmeriPath	792	479	1.65

*Purchase prices include assumed debt
Source: *LIR*

Impath To Close California Lab And Lay Off 149 Workers

Impath (New York City) has announced plans to lay off 149 employees, or approximately 12% of its 1,200-person workforce. Most of the layoffs (80 people) are occurring at the company's regional histology lab in Cypress, California, which is being shut down effective May 13. Another 69 employees are being let go as part of a general cut throughout the company.

The facility shutdown and layoffs come as Impath struggles to regain profit growth and overcome a recent expense-account scandal that forced Anu Saad,

Ph.D., to resign her position as chairman and chief executive (*see LIR, March 2003, p. 1*).

Speaking at a recent investors' conference held by Wachovia Securities in New York City, Impath's new CEO, Carter Eckert, said that Impath was now "tightening up on its capital expenditures and expenses" and demanding that each of its three divisions "stand on their own."

Eckert noted that over the past few years, Impath had entered several new lines of business that took management's attention away from its core business of pathology services. For example, Impath purchased the software maker Tamtron Corp. (San Jose, CA) in January 2002 for $29 million. Eckert noted that although Tamtron has a good product, PowerPath software for pathology groups, it has no synergy with Impath's core pathology services business. He also indicated plans to scale back capital expenditures directed toward Impath's "predictive oncology" business, which was formed a few years ago to assist biotechnology and pharmaceutical companies with their preclinical and clinical development stages of drug development.

Impath At A Glance *($MM)*

Revenues:	*2002*	*2001*
Pathology services	$191.3	$168.8
Predictive oncology	22.4	16.1
Information services	12.7	4.7
Total revenues	226.4	189.6
Pretax income	18.4	19.5
Net income	10.5	11.0

Source: Impath

McDougal Sues Over Mistaken Mastectomy

Linda McDougal, who had a double mastectomy last June after she was mistakenly told she had cancer (*see LIR, March 2003, p. 3*), recently filed a lawsuit against the pathologist who made the diagnosis, Margaret Cochrane, and her employer, Hospital Pathology Associates (HPA—St. Paul, MN).

The case gained national attention earlier this year when McDougal testified before Congress along with other victims of medical errors in opposition to a White House proposal to limit jury awards in medical malpractice cases.

The lawsuit, filed in Ramsey County District Court (St. Paul, MN), alleges that McDougal had the procedure performed at United Hospital (St. Paul) because she was told a biopsy had determined that she had cancer cells in a breast. The diagnosis was based on a lab mix-up that confused her tissue with another woman's.

McDougal is seeking damages in excess of $50,000 for physical and mental injuries that, the suit said, have "destroyed her ability to fully enjoy life and perform normal activities." She also is seeking damages for lost earnings capacity and medical costs resulting from the surgery. Her husband, Gerald McDougal Jr., is also seeking damages in excess of $50,000 for loss of the aid, consortium, and companionship of his wife.

Cochrane and HPA have each apologized to McDougal for the mistake. Richard Bland, an attorney for Cochrane and HPA, has said that he is hopeful that a settlement can be reached.

Lab Stocks Up 19% In Latest Five Weeks

Stock prices for the 12 companies in the G-2 Laboratory Index rose an unweighted average of 19% in the five weeks ended April 17, 2003, with eight stocks rising in price and four falling. So far this year, lab stocks are unchanged, while the S&P 500 is up 2%, and the Nasdaq is up 7%.

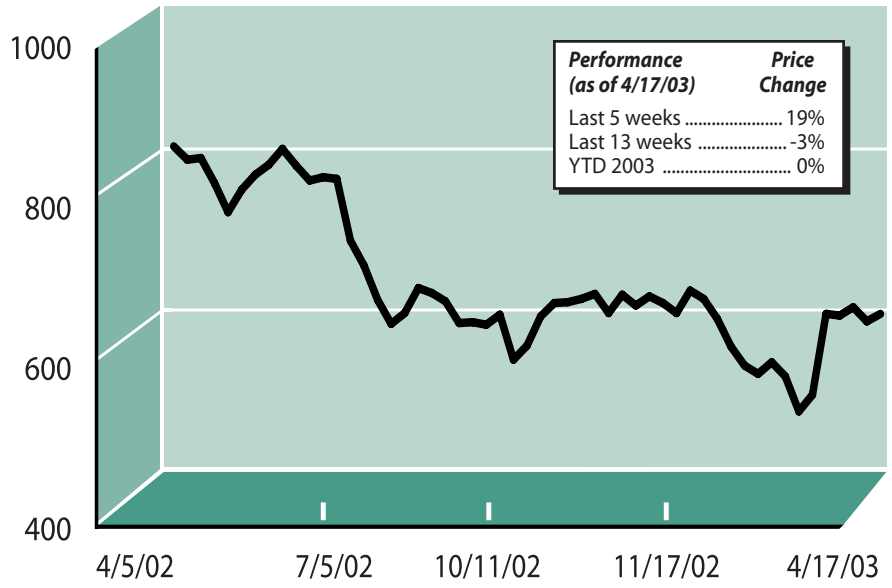
AmeriPath (Riviera Beach, FL) was acquired by the investment management firm Welsh, Carson, Anderson & Stowe (New York City) for $21.25 per share on March 27. AmeriPath originally went public at $16 per share back in October 1997. Thus, in its five and a half years as a publicly traded company, AmeriPath generated a paltry 5% average annual return to shareholders.

The thinly traded **PharmChem** (Haltom City, TX), which specializes in drugs-of-abuse testing, jumped 117% to $0.26 per share for a market cap of $1.5 million. That's a fraction of the company's annual revenue of $30.1 million and book value of approximately $10 million. Meanwhile, **Medtox** (St. Paul, MN), which also has a focus on DOA testing, was up 18% to $5.45 per share for a market cap of $27 million, or roughly 0.5 times revenue.

Specialty Laboratories (Santa Monica, CA) was up 29% to $8.41 per share for a market cap of $183 million, or approximately 1.3 times its revenue of $140.2 million for 2002.

Meanwhile, **Quest Diagnostics** (Teterboro, NJ) was up 11% to $58.56 per share for a market cap of $6.2 billion and **LabCorp** (Burlington, NC) was down 1% to $26.97 per share for a market cap of $4 billion.

G-2 Laboratory Stock Index



Source: The G-2 Laboratory Stock Index is tabulated weekly by *Laboratory Industry Report* from the average percentage change in the price of 12 laboratory testing service stocks.

% price change, 5 weeks ended 4/17/03

UP	Price	% Chg
AmeriPath	$21.25	1
Enzo Biochem	13.54	7
Impath	13.60	8
Medtox	5.45	18
Myriad	10.40	12
PharmChem	0.26	117
Quest	58.56	11
Specialty	8.41	29
DOWN		
Bio-Reference	4.60	-1
LabCorp	26.97	-1
Lab*One*	18.98	-1
MDS	12.60	-9

INDUSTRY buzz

Direct marketing of high-priced proprietary tests to physicians is stimulating demand and often it's the local hospital that's on the hook for the bill. Take Joint Venture Hospital Laboratories (JVHL—Allen Park, MI), for example. This contracting network of some 100 hospitals has eight capitated contracts covering more than one million lives throughout Michigan.

"We believe it's the local lab and pathologist who should be educating physicians about new tests, not the junior salesperson from Myriad or Athena," says Jack Shaw

Jack Shaw, executive director, tells *LIR* that JVHL collects an average of approximately $2 per commercial member per month (or $24 per year) for its capitated contracts in return for covering all lab testing for physician offices and outpatient clinics (including Pap smears and nearly all esoteric tests). Average utilization is roughly 3.5 tests per year. This means JVHL hospital members are collecting an average of about $6.86 for each test they perform under the capitated contracts (i.e., revenue of $24 per member per year/3.5 tests per year=$6.86).

This low level of reimbursement does not leave much room for error. All it takes is one BRACAnalysis test at $2,760 and the economics of JVHL's capitated contract begin to look terribly wrong, *LIR* observes.

Shaw says that the marketing reps from Prometheus, Liposcience, and Myriad are emphasizing the clinical benefits of their tests to physicians and downplaying the costs. The result is overutilization. And, JVHL is the one that foots the bill. "Local labs used to be the first ones to get a demonstration for a new test, but now we're being looked at simply as a source of payment," notes Shaw.

To remedy the situation, JVHL's hospital pathologists are spending a lot of time talking with physician clients to teach them when it is appropriate to order a high-priced test. JVHL is also directing its patient service centers to be on the lookout for high-priced test orders so specimens can be routed directly to the esoteric lab companies before being inputted in hospital LIS systems.

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LipoScience 877-547-6837
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Myriad Genetics 801-584-3600
Prometheus Labs 858-824-0895
Quest Diagnostics 201-393-5000
Targeted Diagnostics & Therapeutics 610-431-0800

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