Bureau of Competition
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

September 24, 1985

Michael L. Denger, Esquire
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1666 K Street, N.W.
Washington, D.C. 20006

Dear Mr. Denger:

This letter responds to your request for a staff advisory opinion concerning the legality under the laws enforced by the Federal Trade Commission of the formation, marketing, and operation of Private Healthcare Systems ("PHS"), formerly Private Health Care Systems Limited, a preferred provider organization. The founders of PHS are the Great-West Life Assurance Company, a commercial health insurer, and the Health Data Institute, a firm specializing in the analysis of health care utilization and quality.

According to the materials accompanying your request, "PHS is a limited partnership formed with the purpose of developing and operating a proprietary national network of managed health care systems." PHS will seek to attract other health insurance companies as subscribers to its services. Some of the insurers may also choose to become limited or general partners in PHS. PHS intends initially to accept only insurers as partners or subscribers, though, in time, it may accept self-insured employers and companies administering health benefit programs as subscribers. It will, in effect, function as a joint purchasing agent for commercial health insurers.

PHS plans to market it services nationwide, beginning with Denver, Colorado, and from there to approximately 20 other major cities. It will market its services to insurance companies whose combined share of the commercial health insurance business (i.e., not counting, inter alia, Blue Cross-Blue Shield plans and health maintenance organizations) in any given geographic area will range between 10 and 20 percent. Nothing in the program will prohibit or limit participating physicians or hospital providers from participating in other alternative delivery systems. Nor will PHS contracts prohibit providers from giving other purchasers discounts greater than those offered through PHS. Similarly, PHS subscribers will be free to establish or contract with other preferred provider organizations and alternative health care financing entities.

PHS will set up a panel of selected physicians and hospitals to represent 25 to 35 percent of the physicians and hospitals in each of its market areas. PHS will select physicians for possible inclusion on the panel based on non-price criteria with respect to practice/utilization patterns, education, specialty, location, malpractice insurance, disciplinary/complaint history, and other factors. PHS will select hospitals for possible inclusion on the panel based on certain non-price criteria with respect to quality/reputation, range of services, location, and medical staff. To be included on the panel, each hospital and physician provider will individually negotiate with PHS a mutually acceptable proposed reimbursement rate "offer." These offered rates will stand for twelve months and will, it is expected, vary among providers. Participating physicians will agree to be reimbursed on a fee-for-service basis according to a fee schedule, with a prohibition on balance billing. PHS may base the fee schedule on a relative value scale to which a conversion factor will be applied. Participating hospitals will agree to be reimbursed on the basis of a Diagnostic Related Grouping ("DRG") price index for most services, and on a charge-based reimbursement system where there is no DRG. Each insurer subscriber will select those panel hospitals and physicians to which it wishes to offer a contract. The insurer may accept the negotiated offering price of any or all of the selected hospitals and physicians or, alternatively, may make counter offers to some or all of them. In this regard, PHS may act as an intermediary on behalf of a particular insurer. In formulating its offer, each insurer will have access to hospital data analysis furnished by PHS.

Participating providers will agree to comply with utilization review standards and quality control measures adopted by PHS. PHS' utilization control system ("UCS"), described as the Patient Assistance Service in your submission, relies on a telephone-based program whereby a team of nurses and physicians provide pre-treatment review, discharge planning, and catastrophic claims management services. Prior to all medical and surgical hospital admissions and all non-emergency outpatient surgery performed outside a physician's private office, PHS will evaluate and certify the medical necessity of the treatment, the appropriateness of the location, and planned length of any stay. In its discharge planning, PHS will also seek to ensure appropriate hospital length of stay and will recommend "cost-effective after-care facilities as an alternative to extended hospital stays." To facilitate utilization control, insurer subscribers, by the terms of their agreement with PHS, will contribute claims data to a consolidated data base maintained by the Health Data Institute. This data, together with data accumulated through the operation of UCS, will be the raw material for data analysis used in cost control efforts. Participating providers in PHS will also agree to a patient hold-harmless provision with respect to any hospital or physician services determined not to be medically necessary.

Each insurer will establish the benefit design of its health care program to encourage the use of preferred providers through

deductibles and copayments. Each carrier's plan is expected to be different. It is anticipated that each will permit enrollees to retain the right to receive care from non-participating providers, although this choice may cause enrollees to incur additional out-of-pocket expenses.

Based on the description of PHS you have provided to us, I am of the opinion that the formation, marketing, and operation of PHS, as proposed, is not likely to violate the Federal Trade Commission Act, or any provision of the antitrust laws enforced by the Commission. 1/

The PHS program contemplates that competing insurers will be jointly involved as partners in operating PHS and that PHS, in turn, will negotiate reimbursement rates with providers. Thus, the program will likely involve some agreement among competing insurers regarding prices to be paid to purchase providers' services, even though the insurers will retain the flexibility to depart from proposed rates negotiated by PHS. In itself, this type of agreement would not appear to constitute naked price fixing. Under most circumstances, joint buying ventures perform a legitimate and procompetitive function. Joint buying agencies generally are lawful enterprises that render markets more, rather than less, competitive by permitting achievement of economies of scale and other efficiencies not available to individual competitors. Although serious antitrust questions can arise with regard to joint purchasing activities, and per se analysis can apply in some cases, a joint purchasing arrangement should normally be evaluated and found lawful under the rule of reason if it does not possess market power, exclude competitors from access to an element essential to effective competition, impose restraints on competition among the participating purchasers that are broader than reasonably necessary to efficient operation, serve to fix prices or restrict output in the joint venturers' own sales, or seek other anticompetitive ends. See Northwest Wholesale Stationers v. Pacific Stationery & Printing Co., 105 S. Ct. 2613, 2620 (1985); NCAA v. Board of Regents of the University of Oklahoma, 104 S. Ct. 2948, 2961-62, 2965 n.39 (1984); Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219 (1948); National Macaroni Manufacturers Association v. FTC, 345 F.2d 421 (7th Cir. 1965); Associated Greeting Card Distributors, 50 F.T.C. 631, 633-34 (1954); Zenith Radio Corp. v. Matsushita Electric Industrial Co., 513 F. Supp. 1100, 1147 (E.D. Pa. 1981), aff'd and rev'd in part on other grounds sub. nom. In re Japanese Electronic Products Antitrust Litigation, 723 F.2d 238 (3d Cir. 1983), cert. granted in part sub. nom. Matsushita Electric

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1/ This advisory opinion is limited to the proposed program described both in your request for advisory opinion and in your submissions. It does not constitute approval for actions that are different from those described, or for those not specified in the request.

Industrial Co. v. Zenith Radio Corp., 105 S. Ct. 1863 (1985); see generally L. Sullivan, Handbook of the Law of Antitrust 206-10, 292-94 (1977).

On the basis of the information you have provided, the proposed formation, marketing, and operation of PHS should be evaluated under the rule of reason, and would not appear illegal under that standard. It does not appear that PHS currently has or is likely to obtain substantial market power in any geographic market. 2/ There is no indication of any anticompetitive intent on the part of PHS. The proposed program contains no suggestion of a specific intent to monopolize either the physician or hospital services market or the insurance/prepaid health care market in any geographic area. PHS also does not possess exclusive access to any input necessary for other insurers or prepaid health care programs to compete in the market. PHS subscribers will be free to deal with providers without going through PHS, and within the program retain flexibility to strike individual bargains with providers. Also, it does not appear that PHS' operations will unreasonably restrain competition among its insurer participants in their marketing and sales of insurance. Therefore, PHS does not appear to be an unlawful joint buying agency. In fact, the proposed program may be procompetitive, both by generating increased competition among participating and non-participating providers and by increasing competition among third party payers.

You have stated during telephone conversations that should PHS subscribers' share of the commercially insured population in a particular area reach 20 percent, PHS would refuse to allow additional insurers to join its program for that area. I do not believe that such action would constitute an unlawful boycott or concerted refusal to deal since there is no indication of anticompetitive intent on the part of PHS, and PHS and its subscribers apparently lack, and appear unlikely to obtain, market power in any market.

The proposed PPO program also does not appear to be an unlawful price-fixing agreement or boycott insofar as it affects competition among providers. The PHS program will set only the

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2/ Even if PHS subscribers reach the twenty percent maximum projected share of the population covered by commercial health insurance companies in any given geographic market, it appears unlikely that they will have acquired substantial market power. Given the number of sellers of health insurance/prepaid health care in any geographic area, and other factors, it appears unlikely that PHS and its subscribers will have the ability to successfully restrict output, raise prices, or exercise monopsony power. In the event, however, that payer/subscribers are able, through PHS, to exercise market power in any geographic market, the conclusions reached in this advisory opinion would not apply.

price of services between individual providers and the insurer purchasers of those services. The agreements between PHS and providers will not contain any provisions relating to the rates that providers may charge patients who are not covered by the program. Also, decisions by PHS and by individual insurers to exclude certain providers, limit payments, or deny reimbursement using criteria established in the PHS program would not appear to be unlawful in the absence of evidence of anticompetitive purpose or effects. In particular, PHS' quality assurance and utilization review program would not appear to violate the antitrust laws. On the contrary, this program could be procompetitive, with the potential to promote efficiency and cost savings.

This office retains the right to reconsider the questions involved and, with notice to the requesting party, to rescind or revoke its opinion if implementation of the proposed program results in substantial anticompetitive effects, if the program is used for improper purposes, or if it would be in the public interest to do so.

Finally, as I am sure you are aware, the above legal advice is that of staff of the Bureau of Competition only. Under the Commission's Rules of Practice § 1.3(c), the Commission is not bound by this advice and reserves the right to rescind it at a later time and take such action as the public interest may require.

Sincerely,

Arthur N. Lerner
Assistant Director