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October 21, 1992

HAND DELIVERED

The Honorable Charles A. James
Acting Assistant Attorney General
Antitrust Division
Department of Justice
Room 3107
10th and Constitution Avenue, N.W.
Washington, D.C. 20530

Re: California Chiropractic Association --
Request for a Business Review

Dear Mr. James:

This letter, on behalf of the California Chiropractic Association (the "CCA"), requests a statement of the enforcement intent of the Department of Justice with respect to a Managed Care Organization (an "MCO") in the form of either a Preferred Provider Organization (a "PPO") or a Health Maintenance Organization (an "HMO") that the CCA proposes to establish. A memorandum describing the proposal is appended to this letter.

The objectives of the CCA in establishing the MCO are (i) to allow MCOs of chiropractors to achieve economies of scale. For example, in California, an HMO, no matter how small, must prepare and pursue an application for a permit. The cost of the process ranges from \$50,000 to \$100,000. Other MCOs do not need to prepare applications for permits, but they incur similar costs in preparing to commence operations. Also, any MCO, no matter how small, must have administrative staff and incur marketing costs. Such costs can easily run to \$100,000 per year even for a small MCO; (ii) to allow MCOs to meet the administrative requirement of the state-wide or region-wide third-party payors with whom MCOs contract. To hold down their own costs, many third-party payors, e.g., some insurance companies and labor unions, prefer or insist on contracting with MCOs whose members can deliver services throughout California or a large sub-part thereof. Small MCOs

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therefore cannot compete for the business of such payors. By creating a statewide MCO, California Chiropractors will provide a vehicle whereby individual chiropractors can participate in competition for statewide business while maintaining their freedom and flexibility to continue to compete for more localized business; (iii) to help reduce over-utilization in the delivery of chiropractic care in California; and (iv) to reduce the cost of negotiating a multiplicity of separate contracts of reimbursement with third-party payors. According to the proposal, CCA will create an MCO and name its board of directors to provide oversight to its professional staff. The staff will negotiate separate reimbursement contracts with individual third-party payors. In addition, the staff will determine whether applicants and members meet objective standards relating to accreditation and over-utilization. Over-utilization or lack of accreditation will be grounds for denial of an application for membership and for termination of an existing membership.

Any chiropractor in California may join the MCO, subject to meeting an objective utilization standard. Any member may also offer services outside the MCO, and any third-party payor may contract with any member or any other PPO for reimbursement outside the CCA's MCO.

The structure described above insulates the chiropractors of CCA from exercising a common control over the setting of rates. A professional staff will conduct the process, subject to review only by the MCO's board. A majority of the PPO's board will not be chiropractors, and the board will be precluded from communicating with the members of the CCA with respect to any negotiation with any third-party payor, or otherwise with respect to reimbursement rates or terms. Since the structure will insulate the MCO from control by the CCA members on matters relating to the reimbursement (price-setting) process, the structure is not governed by Arizona v. Maricopa County Medical Society, 467 U.S. 332 (1980). Rather, it resembles the structure in Barry v. Blue Cross of California, 805 F.2d 866, 868-69 (9th Cir. 1980). Accordingly, the structure is outside the scope of the rule of per se illegality and should be judged by the rule of reason.

The structure accords with the rule of reason: (i) Membership is readily available to all chiropractors in California, (ii) membership does not preclude or limit practice outside the MCO, (iii) nothing impairs the opportunities of third-party payors to deal with the members of the CCA's MCO or others independently of the CCA's MCO.

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As a consequence, the structure will allow chiropractors to spread among a large group of small and independent entrepreneurs the high transaction costs that each would have to incur to negotiate reimbursement contracts with dozens or hundreds of third-party payors and to administer and market their MCOs. Thus, chiropractors' services will be provided in a more efficient manner to the general benefit of patients and third-party payors.

The CCA's MCO will not have the power to enhance prices above the competitive level. To construct a relevant product (service) market in any geographic market in California, account must be taken of the competition between medical doctors, physical therapists, and chiropractors. Thus, even if the services of chiropractors were considered a relevant service market, the share represented by CCA members in any relevant geographic market should be "shaved", as in United States v. Philadelphia National Bank, 374 U.S. 321, 364, n. 40 (1963); 374 U.S. at 331, to account for such competition. It is impossible to say precisely how much the market share for an area should be shaved. In Philadelphia National Bank, the Supreme Court shaved of the market share by 16.67 percent to reflect competition from banks outside the local area. The Court's action suggests that a shave of much more than 16.67 percent would be appropriate here. In Philadelphia National Bank, the outside-the-area banks offered only partial competition to the inside-the-area banks. In the case of California's chiropractors, medical doctors who practice general medicine and who practice some specialties offer competition to the chiropractors in the same area, and the physical therapists offer partial competition. Moreover, in sheer numbers, the medical doctors and physical therapists overwhelm the chiropractors. Hence, a Philadelphia National Bank shave of 16.67 percent is exceedingly conservative.

Many of the communities in California identified in Exhibit A to the attached Memorandum of the CCA, e.g., Arleta, Canoga Park, Encino, Gardena, Los Angeles, and Pacific Palisades, among others in the Los Angeles metropolitan area, would most likely be considered part of a single relevant geographic market rather than separate markets. Therefore, the data of these communities will not, standing alone, support conclusions as to the CCA members' share of any particular relevant geographic market. Nonetheless, the data in Exhibit A suggest that the statewide ratio of members to non-members, i.e., approximately one out of three, holds steady for what are probably relevant geographic markets. For example, taking at random thirteen

communities in the Los Angeles metropolitan area, the member/non-member ratios are: Anaheim, 22/58; Arcadia, 3/15; Beverly Hills, 7/37; Canoga Park, 8/33; Culver City, 7/15; Gardena, 3/11; Glendale, 25/56; Hollywood, 3/9; La Canada, 1/6; Los Angeles, 97/321; Pacific Palisades, 4/4; Thousand Oaks, 13/34; Woodland Hills, 15/18. The members/non-members ratio for the total is 35.5 percent. Without Los Angeles, the ratio is 37.2 percent, a congruence that tends to confirm the notion that a statewide ratio of about 33.33 percent reasonably reflects the local market ratios.

Shaving by at least the 16.67 percent of Philadelphia National Bank would reduce the CCA's share from 33.33 percent to 23.12 percent. Thus, if a court were to find that chiropractors' services were a separate market for antitrust purposes, it is reasonable to expect a Philadelphia National Bank shave of the market shares, with a resulting share of no more than 23.12 percent in any market which would otherwise have a share of 33.33 percent. It would take a market in which CCA's unadjusted share is 40 percent for the market as shaved to reach 33.33 percent.

Exhibit A does not appear to show any substantial market in California in which the CCA's membership reaches 40 percent of the chiropractors.

Even without employing the shaving methodology of Philadelphia National Bank, several courts have indicated that in defining a market, account must be taken of competition between different kinds of health-care providers. In United States v. Carillion Health System, 707 F.Supp. 840, aff'd, 892 F.2d 1042 (4th Cir. 1989) (decision without published per curiam), the court, upon finding that outpatient services competed with acute inpatient hospital services, included them in the same market. In United States v. Rockford Memorial Corp., 717 F.Supp. 1251, aff'd, 898 F.2d 1278 (7th Cir.), cert denied, _____ U.S. _____, 111 S.Ct. 295 (1990), the court concluded that inpatient services offered by acute-care hospitals did not compete with other services offered by non-hospital providers. Therefore, the court held it improper to place the two types of providers in the same market. Thus, the case is different from the chiropractor-medical doctor-physical therapist situation since all three provide the same service (aside from other services). On the other hand, the court suggested that if the pricing of the services of the two types of service were "linked", then it would be proper to place them in the same market. In the case of chiropractors, medical doctors, and physical therapists, the pricing is linked, in that the pricing level for the same service

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by any one of the groups is constrained by the pricing level of the other groups for the same service. Hence, Carillion and the dictum in Rockford independently offer support for discounting the shares in a chiropractors-only market.

Even if chiropractors were considered a separate product (service) market, the CCA-MCO will not have power to raise prices above competitive levels in that market. It will have to compete with thousands of chiropractors who will continue to compete independently, and through participation in hundreds of other MCOs. Also, it will have to compete with thousands of medical doctors and thousands of physical therapists. Defining a market does not eliminate the need to determine market power if a practice is to be judged by the rule of reason. For example, in Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 725 (1988), the Court reiterated the observation of Continental TV v. GTE Sylvania, Inc., 433 U.S. 36, 52 n. 19 (1977), that exploitation of "power" in an "intra-brand market" is irrelevant so long as interbrand competition existed.

Accordingly, the proposed MCO will have neither a mechanism for nor the power to enhance prices in the marketplace for the services of chiropractors, or to restrain anyone, including PPO Members, from competing with the MCO in seeking reimbursement arrangements with third-party payors. Therefore, the CCA-MCO will not violate the rule of reason.

The CCA would be pleased to furnish any additional information it may have. We look forward to hearing from you at your earliest convenience.

Sincerely yours,


George Miron

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Enclosure

**CALIFORNIA CHIROPRACTIC ASSOCIATION --
MANAGED CARE ORGANIZATION**

The California Chiropractic Association (the "CCA") proposes to create and operate a Managed Care Organization (an "MCO"), as described below.

I. Structure and Operation of the MCO

(i) The CCA will create a single MCO to operate throughout the State of California. The MCO may be organized as a Preferred Provider Organization (a "PPO") or a Health Maintenance Organization (an "HMO").

(ii) The MCO will be a corporation, all the stock of which will be owned by the CCA. The corporate charter will provide that a majority of the directors must be persons who are not health-care providers. The non-provider directors will be persons of stature in their communities with no financial interest in providers. The compensation of such directors will not be made to depend on the level of profit, if any, earned by the MCO.

(iii) Every member of the CCA in good standing will be eligible to participate. A fee for membership will be charged.

(iv) A chiropractor other than a member of the CCA will be eligible to participate. The fee for a non-member will be greater for a non-member, but not prohibitively greater.

(v) The MCO's professional staff will negotiate with individual third-party payors to obtain agreements as to maximum fee levels and maximum reimbursement levels. The staff of the PPO will conduct the negotiations. A separate confidential negotiation will be conducted by the staff with each payor. The geographic area or areas covered by a contract with a payor will be determined in the course of the negotiation between the staff and that payor. With respect to any payor negotiation, the maxima for any one geographic area will not necessarily be the same as for any other area. The formulation of the maxima for any payor will be negotiated separately with that payor. For example, in one payor contract, the reimbursement maximum might be a stated percentage of each provider's usual, customary and reasonable charges, whereas another payor's contract might state a designated reimbursement of a designated amount for a designated service.

(vi) The MCO participants will agree to be subjected to utilization review by the third-party payors and by the staff of the PPO.

(vii) Participation in the MCO will not include an obligation of the participants to share the risk of non-payment of claims for services they render to patients.

(viii) The CCA will not control or own, in whole or in part, any health insurer or other direct or indirect payor of health care claims, except to the extent that the CCA contributes to the cost of the health insurance of its own employees.

(ix) Participants will not be required to deal exclusively with the MCO. Each will be free to provide service through other MCOs or otherwise and, in the course of providing that service, to make their own arrangements with third-party payors for reimbursements.

II. The Markets in California in Which Chiropractors Compete

(i) In California, a chiropractor's license authorizes the licensee to practice primary health care, i.e., to diagnose and treat all conditions and diseases except those conditions and diseases set forth in section 10(b) of the Chiropractic Act. The license issued to a medical doctor carries all the authority to practice primary health care that a chiropractor's license carries, and medical doctors compete with chiropractors in the diagnosis and treatment of the conditions and diseases covered by their licenses. There are approximately 9,000 licensed chiropractors and 100,000 licensed medical doctors in California. Of the 9,000 licensed chiropractors, approximately 8,000 are actually practicing. The CCA has no reason to believe that in any economically significant geographic market in California, the ratio of chiropractors to medical doctors is likely to exceed by any significant amount the ratio for California as a whole.

(ii) California licenses physical therapists. The license authorizes the licensee to diagnose and treat some of the conditions and diseases that chiropractors and medical doctors are authorized to diagnose and treat. Physical therapists compete with chiropractors and medical doctors in providing those health care services as to which the scopes of their licenses overlap. There are approximately 40,000 licensed physical therapists in California. The CCA has no reason to believe that, in any economically significant geographic market in California, the ratio of chiropractors to physical therapists is likely to exceed by any significant amount the ratio for California as a whole.

(iii) Competition among chiropractors, medical doctors and physical therapists constrains the prices that any of them may charge for the services as to which they compete.

(iv) Approximately 3,000 chiropractors in California are members of the CCA. For this memorandum, it is assumed that nearly all of them are actively practicing. The proportion of CCA-member chiropractors to non-member chiropractors varies from community to community in California, as shown in Exhibit A hereto.