UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

BLUE CROSS AND BLUE SHIELD OF OHIO,	)	Civil No. 1:94CV 2297
Petitioner and Cross Respondent,	)	Judge Ann M. Aldrich
v.	)	
UNITED STATES OF AMERICA and ANNE K. BINGAMAN, Assistant Attorney General U.S. Department of Justice Antitrust Division,	)	
Respondents and Cross Petitioners.	)	

MEMORANDUM IN OPPOSITION TO PETITION TO SET ASIDE CIVIL INVESTIGATIVE DEMAND NUMBER 11466 AND IN SUPPORT OF PETITION FOR ENFORCEMENT

The United States and Anne K. Bingaman, Assistant Attorney General for the Antitrust Division of the United States Department of Justice ("Antitrust Division"), by their undersigned attorneys, are filing this Memorandum and the accompanying documents to support both their Petition for Enforcement and their opposition to the Petition to Set Aside Civil Investigative Demand Number 11466.

The Antitrust Division has information that the conduct of Blue Cross and Blue Shield Mutual of Ohio ("Blue Cross") when applying its most favored nation clause ("MFN") is anticompetitive. Because of Blue Cross's conduct, competitors may have been excluded from

entering the market, existing competitors may have been unreasonably restrained from competing effectively in the market, and insurers may have been discouraged from offering innovative and more efficient methods of delivering health care. Each of these potential effects of Blue Cross's conduct would directly affect the cost or premium for health care participants or the insurance coverage for a given cost or premium. As a result, the Antitrust Division is investigating Blue Cross's conduct in this market to determine whether Blue Cross's conduct violates the antitrust laws. Affidavit of John A. Weedon ¶ 2-3 ("Weedon Affidavit") (attached as Exhibit A).

As part of its investigation, the Antitrust Division issued Civil Investigative Demand No. 11466 ("CID No. 11466") on October 17, 1994 to Blue Cross. Weedon Affidavit ¶ 3. CID No. 11466 requests documents and information regarding, among other things, the corporate structure of Blue Cross, the health care industry in northern Ohio, the extent and purpose of the MFNs employed by Blue Cross, and efforts made by Blue Cross to enforce its MFNs. All of the documents and information requested are directly relevant to the pending investigation. Weedon Affidavit ¶ 3.

On November 4, 1994, counsel for Blue Cross met with counsel for the United States regarding CID No. 11466. At that meeting, counsel for the United States offered to accept by the production date a limited number of easily identifiable documents and to negotiate an extension of the production date for the remainder of the interrogatories and document requests. On November 7, 1994, Blue Cross rejected this offer and said that it would be filing a petition to set aside CID No. 11466.

Counsel for the United States and Anne K. Bingaman has filed a Petition for Enforcement along with the Answer to Petition to Set Aside Civil Investigative Demand No. 11466. The Court should grant the Petition for Enforcement and order Blue Cross to produce the documents and information sought within 14 days, so that the Antitrust Division can proceed with its investigation to determine whether Blue Cross's conduct is anticompetitive and violates the antitrust laws.

I

THE ANTITRUST CIVIL PROCESS ACT EXPRESSLY PERMITS THE DISCOVERY OF THE INFORMATION SOUGHT IN CID NO. 11466

The Antitrust Civil Process Act ("ACPA"), 15 U.S.C. §§ 1311-1314, authorizes the Assistant Attorney General for the Antitrust Division to issue a civil investigative demand to any person who "may be in possession, custody, or control of any documentary material, or may have any information, relevant to a civil antitrust investigation." 15 U.S.C. § 1312. Congress passed the ACPA to give the Antitrust Division pre-complaint discovery to determine if a person or corporation violated the antitrust laws. Petition of Gold Bond Stamp Co., 221 F. Supp. 391, 393 (D. Minn. 1963), aff'd, 325 F.2d 1018 (8th Cir. 1964). Courts have accorded a presumption of regularity to the issuance of civil investigative demands. Finnell v. United States Dep't of Justice, 535 F. Supp. 410, 412 (D. Kan. 1982); American Pharmaceutical Ass'n v. United States Dep't of Justice, 344 F. Supp. 9, 12 (E.D. Mich. 1971), aff'd, 467 F.2d 1290 (6th Cir. 1972).

A. The Petitioner Has Not Met Its Burden To Set Aside CID No. 11466

As Blue Cross recognizes in its Petition, this Court should apply the same standard of relevance to information sought by CID No. 11466 as it would apply to a grand jury subpoena.

15 U.S.C. § 1312(c)(1)(A); Blue Cross Pet. ¶ 6 The Supreme Court has recently observed that where a grand jury subpoena is challenged on relevancy grounds, such challenges "must be denied unless the district court determines that there is no reasonable possibility that the category of materials the Government seeks will produce information relevant to the general subject of the grand jury's investigation." United States v. R. Enter., Inc., 498 U.S. 292, 301 (1991). The "unenviable task" faced by a petitioner seeking to quash a subpoena is to "persuade the court that the subpoena that has been served on [it] could not possibly serve any investigative purpose that the grand jury could legitimately be pursuing." Id. at 300 (quoting 1 S. Beale & W. Bryson, GRAND JURY LAW AND PRACTICE § 6:28 (1986)).

Blue Cross has not met and cannot meet this high burden. The Antitrust Division has information indicating that Blue Cross's conduct may violate the antitrust laws and that the conduct warrants investigation. Weedon Affidavit ¶¶ 2-3.

B. The Appropriate Time for Blue Cross to Raise ItsArgument that Its Conduct Is Not Anticompetitive Is After The Antitrust Division Files a Complaint

Blue Cross claims that its conduct does not violate the antitrust laws and that therefore any investigation of its conduct fails to satisfy the relevance standard. This argument is premature and legally in error.

In Associated Container Transportation (Australia), Ltd. v. United States, the Court denied a petition to set aside a civil investigative demand in which the petitioners made similar arguments to those offered by Blue Cross in this action. 705 F.2d 53, 60, 62 (2d Cir. 1983). In that case, the petitioners made two arguments that would, if proven, have precluded antitrust liability. Id. at 58. The Second Circuit refused to pass on either argument. The Court recognized that it could not decide before the Antitrust Division had an opportunity to

investigate the alleged conduct. The Court held that the appropriate time to raise the defenses was after the Antitrust Division filed formal charges. Id. at 60, 62. Prior to that, neither the Court nor the Antitrust Division would have sufficient information to evaluate the merits of any possible defense. Similarly here, the appropriate time for Blue Cross to raise its present argument would be after the filing of a complaint.

II

AN MFN CAN ELIMINATE DISCOUNTING, EXCLUDE COMPETITION, AND REDUCE OR ELIMINATE COMPETITION

A. When A Dominant Insurer Like Blue Cross Enforces Its MFNs, It Can Coerce Participating Hospitals From Offering Discounts Or Favorable Contracts To Other Third-Party Payers

If an insurer has a dominant share of the non-governmental payer market, a hospital must contract with that insurer if the hospital wants to survive economically. If the dominant insurer then includes an MFN in its hospital contract, the cost to the hospital of granting a price concession to another third-party payer increases dramatically because the hospital must now give the dominant insurer that same price. Letter from Anne K. Bingaman to The Honorable Cynthia M. Maleski, Insurance Commissioner for the Commonwealth of Pennsylvania, at 2 (attached as Exhibit B);[1] Gail Kursh, Address to the National Health Lawyers Ass'n (Feb. 17,

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[1] The Pennsylvania Insurance Commissioner ("Commissioner") was deciding whether to allow Blue Cross of Western Pennsylvania to impose an MFN-like clause called a Fair Payment Rate Limitation ("FPRL") clause in its hospital contracts in Western Pennsylvania. The Antitrust Division believed that allowing Blue Cross of Western Pennsylvania to impose its clause could have anticompetitive effects in Western Pennsylvania and filed the attached letter to aid the Commissioner in her decision. The Commissioner ultimately decided to restrict Blue Cross of Western Pennsylvania's use of its FPRL.

For Blue Cross, here, to characterize what occurred in Western Pennsylvania as an

(continued...)

1994) (attached as Exhibit C). The hospital would therefore have an incentive not to discount below the price charged to the dominant insurer. In effect, the price charged the dominant insurer becomes the floor price at that hospital and whatever competition exists occurs above that floor price, not below it.[2]

When it is determined after investigation that MFNs are anticompetitive, the Antitrust Division has taken and will continue to take enforcement action. For example, in United States v. Delta Dental Plan of Arizona, Inc., the Antitrust Division filed a complaint that alleged that Delta Dental's enforcement of its MFNs prevented participating providers of dental care from offering discounts to competing insurers. United States v. Delta Dental Plan of Arizona, Inc., Civ. No. 1793 (D. Ariz. Aug. 30, 1994) (complaint attached as Exhibit D). The complaint sought to eliminate the MFNs from the dominant insurer's contracts with the participating dentists. Id. at ¶ 10. The parties entered into a consent decree which provides that the dominant insurer would eliminate the MFNs from its dentist contracts.

Before the insurer began enforcing its MFNs in Delta Dental, many dentists "chose to reduce their fees to participate in various competing managed-care and other discount plans." United States v. Delta Dental Plan of Arizona, Inc., Civ. No. 1793 (D. Ariz. Aug. 30, 1994)

(...continued)
abandonment of the investigation by the Antitrust Division is simply wrong. Blue Cross Pet. at 3.

[2] The Supreme Court in the context of labor contracts has likewise recognized that MFNs are a method of eliminating competition by eliminating discounting. Connell Construction Co. v. Plumbers & Steamfitters Local, 421 U.S. 616, 623-24 (1974). In Connell Construction, the Court stated that the MFN "guaranteed that the union would make no agreement that would give an unaffiliated contractor a competitive advantage." Id. at 623. The Court also noted, "The primary effect of the agreement seems to have been to inhibit the union from offering any other employer a more favorable contract." Id. at 623 n1.

(Competitive Impact Statement) (copy attached as Exhibit E). When the dominant insurer began enforcing its MFNs, the dentists quit offering discounts to competing insurers because an across-the-board reduction in fees would be too costly. Complaint ¶¶ 10-12.

Delta Dental is not unique. The Antitrust Division also filed a similar complaint and proposed final judgment in United States v. Vision Service Plan, Civ. No. 94-2693 (D.D.C. filed December 15, 1994) (attached as Exhibit F). In that case, the dominant insurer, Vision Service Plan, negotiated contracts with a large panel of optometrists and ophthalmologists in the areas that it serviced. Vision Service Plan included MFNS in its contracts that it referred to as "Fee Non-Discrimination Clause." When Vision Service Plan began to enforce the MFNs, many of the optometrists and ophthalmologists, like the dentists in Delta Dental, began to refuse to discount their fees to competing vision care insurers. Vision Service Plan, ¶ 9. Unable to negotiate fees at competitive levels, the MFNs "substantially restricted many competing plans' ability to attract and serve groups of patients on competitive terms." Id. at ¶ 11.

By refusing to offer competing insurers discounts below the discounts offered the dominant insurer, the dentists in Delta Dental and the optometrists and ophthalmologists in Vision Service Plan responded in a rational, economic manner. Prior to Delta Dental, various commentators had suggested just such a response. One commentator who analyzed the effects of MFNs in the health care industry concluded that MFNs "are the antithesis of competition." He explained his rationale as follows:

> [I]f a provider is not free to charge a lower price to the members of an HMO or PPO without also lowering prices to [Blue Cross and Blue Shield], the provider will be inhibited from lowering prices at all. The resulting price rigidity undermines the central role prices should play in a market and prevents movement toward a competitive equilibrium.

Arnold Celnicker, A Competitive Analysis of Most Favored Nations Clauses in Contracts Between Health Care Providers and Insurers, 69 N.C.L. Rev. 863, 885 (1990) (attached as Exhibit G).

B. MFNs Can Exclude Innovators From Entering The Market And Slow More Efficient Methods Of Delivering Health Care From Developing

Not only can MFNs prevent hospitals from offering discounts to competing insurers, MFNs can also prevent hospitals from agreeing to innovative health-care delivery methods. In Reazin v. Blue Cross and Blue Shield of Kansas, 899 F.2d 951, 970-71 (10th Cir. 1990), cert. denied, 497 U.S. 1005 (1990), the Tenth Circuit Court of Appeals based its decision in part on the testimony of experts that the MFNs as applied in Kansas had anticompetitive effects. The MFNs "hindered the development of alternative delivery systems" and could be used to "exclude or slow down the development of alternative delivery systems" and therefore could be used to "exclude competition." Id. at 970 (emphasis supplied).

The Reazin court recognized that MFNs may hinder the development of better alternatives to traditional indemnity insurance like health maintenance organizations and preferred provider organizations. By doing so, MFNs deter innovation and exclude competition.

C. MFNs Are Not Volume Discounts And Are Not Procompetitive

Blue Cross portrays its MFNs as volume discounts. Volume discounts promote lower unit costs. The more units of a product that a purchaser buys, the more willing the seller is to offer the purchaser a discount off the listed price. In industries in which competitors purchase identical products from the same seller, volume discounts often result in lower prices for the larger purchaser. Due to economies of scale, a seller's cost will normally decline as a purchaser

buys larger and larger quantities of the seller's product. The seller passes these lower unit costs on to the purchaser in volume discounts.

If MFNs were volume discounts, MFNs would promote and reflect lower unit costs for the hospitals. MFNs, however, only tie the pricing scheme of the dominant insurer to its competitors' pricing schemes, irrespective of whether the competitors may lower hospitals' unit costs.

Managed care plans, in particular, may offer hospitals lower unit costs, for example, by overseeing the patient's care, by prescreening patients, and by reducing hospital paperwork. These managed care plans lower hospitals' unit costs, not by purchasing more units, but by being more efficient.

When a managed care provider is more efficient and lowers a hospital's unit costs, an MFN, like Blue Cross's, should not force the hospital to offer a purchaser with higher unit costs the same pricing as the smaller purchaser with lower unit costs. If the MFN does force the hospital to offer the higher cost purchaser the same price as the lower cost purchaser, the hospital will charge a high price to both purchasers. By doing so, the hospital ensures that it will cover all of its unit costs -- both the higher unit costs of the larger purchaser and the lower unit costs of the smaller purchaser. This prevents the hospital from rewarding efficiency with lower pricing, the basis of a volume discount.

III

THE INVESTIGATION OF THE POTENTIAL ANTICOMPETITIVE EFFECTS OF BLUE CROSS'S CONDUCT WHEN APPLYING ITS MOST FAVORED NATION CLAUSE IS FACT SPECIFIC

Antitrust investigations are fact specific. Conduct in one factual situation may violate the antitrust laws, while similar conduct in another market may not. The Supreme Court recognizes this reality.

> [I]t should be remembered that this court has often announced that each case arising under the Sherman Act must be determined upon the particular facts disclosed by the record, and that the opinions in those cases must be read in the light of their facts and of a clear recognition of the essential differences in the facts of those cases, and in the facts of any new case to which the rule of earlier decisions is to be applied.

Maple Flooring Mfrs. Ass'n v. United States, 268 U.S. 563, 579 (1925) (emphasis supplied).

In Phoenix Board of Realtors v. United States Department of Justice, the petitioner sought to have a civil investigative demand set aside because the Antitrust Division had entered into consent decrees which had permitted similar conduct in other jurisdictions. 521 F. Supp. 828, 830-31 (D. Ariz. 1981). When the court denied the petition to set aside,, it pointed out that nothing in the record showed that the rules and regulations at issue in Phoenix Board of Realtors were the same as the rules and regulations at issue in the earlier cases; nor was there any showing that the rules and regulations had been implemented in the same manner. The Court held:

> [W]hether the Division has entered into consent decrees regarding similar activities is irrelevant to the issue of whether the Division may inquire into the instant conduct for the "purpose of ascertaining whether" there is or has been an antitrust violation.

Phoenix Board of Realtors, 521 F. Supp. at 830-31.

Likewise here, the Antitrust Division has already developed evidence suggesting that there are significant differences in the MFNs used in Ohio from those used elsewhere. Further, the manner in which Blue Cross uses and enforces its MFNs in Ohio may be quite different from the manner in which MFNs are used and enforced elsewhere. These differences may directly affect whether Blue Cross's conduct violates the antitrust laws. [3]

The instant investigation will determine, among other things, whether Blue Cross's conduct is excluding potential competitors from entering the market, unreasonably restraining existing competitors from competing in the market, or discouraging or preventing any competitors from offering innovative or more efficient forms of health care delivery. If these anticompetitive effects are established, then Blue Cross's conduct unnecessarily excludes competition and violates the antitrust laws.

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[3] Blue Cross's reliance on Ocean State Physicians Health Plan v. Blue Cross & Blue Shield of Rhode Island, 883 F.2d 1101 (1st Cir. 1989), cert. denied, 494 U.S. 1027 (1990), is misdirected. Even the Court in Ocean State recognized that in another set of facts, the clause in question could be anticompetitive and violate the antitrust laws:

> To decide whether the Prudent Buyer policy can reasonably be found to be exclusionary, we must ask whether Blue Cross's conduct "went beyond the needs of ordinary business dealings, beyond the ambit of ordinary business skill, and 'unnecessarily excluded competition'" from the health care insurance market.

Id. at 1110.

IV

CONCLUSION

The Petition For Enforcement of CID No. 11466 should be granted and the Petition to Set Aside should be denied.

Respectfully submitted,

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