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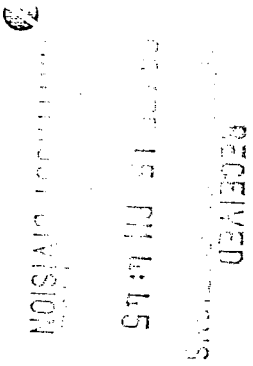

BY FEDERAL EXPRESS

Honorable Anne K. Bingaman
Assistant Attorney General
Antitrust Division
United States Department of Justice
10th and Constitution Avenues, N.W.
Washington, D.C. 20530

Re: Business Review Request for Santa Fe, New Mexico Managed Care Organization

Dear Assistant Attorney General Bingaman:

On behalf of the Santa Fe Managed Care Organization ("SFMCO"), located in Santa Fe, New Mexico, we request a business review pursuant to the Department of Justice's Business Review Procedure, 28 C.F.R. § 50.6 (1995). This request is made on the basis of the best information known to date and on reasonable estimates of future activity. We verify that we have undertaken a good faith search for the documents and information referenced in this request and, where applicable, have provided all responsive material.[1/]

INTRODUCTION

As explained further below, SFMCO proposes to create a provider-controlled organization to, among other things, offer a new capitated joint hospital/physician services product that would be marketed to payers and would benefit Santa Fe, New Mexico area healthcare consumers. Although Santa Fe healthcare providers currently participate in contracts with managed care payers, such as health maintenance organizations and preferred provider organizations, they do not offer a product through which the

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1/ A business review request on behalf of SFMCO was previously submitted on January 5, 1996. That request was withdrawn by letter, dated March 25, 1996.

hospital and physicians share the financial risk of performance with each other.

Most physicians in the community contract individually with health maintenance organizations that reimburse on a discounted fee-for-service basis. Santa Fe's only acute-care inpatient hospital facility that is open to the general public, St. Vincent Hospital (the "Hospital"), is typically paid on a per diem or DRG basis. Managed care representatives have indicated that the overall cost of healthcare delivery in Santa Fe is higher than in Albuquerque and believe that financial risk-sharing among the providers will be the most effective way to lower costs in Santa Fe. Providers in Santa Fe have proposed forming and operating SFMCO to respond to this concern.

Through SFMCO, the Hospital, a local healthcare center, and physicians would enter into contracts through which they would collectively share and bear the financial risk of providing healthcare services to health maintenance organizations and large self-insured employers. No more than 45% of the physicians in a specialty would take part in SFMCO as owners/risk-sharers ("Members"), except for specialties in which a pre-existing integrated practice group already has more than 45% of the practitioners in the specialty. In that case, the pre-existing practice group would be the specialty's only SFMCO Member. We believe that SFMCO's proposed structure is consistent with the guidelines the Antitrust Division has set forth in its Statements of Enforcement Policy and Analytical Principles Relating to Health Care and Antitrust, and with negotiated consent decrees that describe the requirements for a qualified managed care plan. United States v. Healthcare Partners, Inc., 7 Trade Reg. Rep. (CCH) ¶ 50,787 (D. Conn.) (1996); United States v. Health Choice of Northwest Missouri, Inc., 7 Trade Reg. Rep. ¶ 50,786 (E.D. Mo., filed Sept. 13, 1995).

To provide necessary coverage and to offer payers a full-range of physician choice, SFMCO also intends to seek contracts with all Non-Member M.D. and D.O. Hospital staff members, and other physicians in the community, who satisfy the organization's credentialing criteria. (The Non-Member and Member physicians are referred to collectively as "Participating Physicians.") Participation in the organization would be nonexclusive, so that, as they do currently, providers could participate in other networks or offer their services independently. The organization would function with primary care physicians acting as gatekeepers, so that SFMCO can achieve its cost containment and utilization goals. The formation and operation of SFMCO should enhance the quality of healthcare delivered in the area, help lower health

care costs, and lead to more efficient utilization of Santa Fe's healthcare delivery resources.

INFORMATION AND DOCUMENTS SUBMITTED

1. Name, Address, Legal and Ownership Structure.

The name of the proposed entity is the Santa Fe Managed Care Organization and its principal office will be located in Santa Fe, New Mexico. SFMCO will be a nonprofit corporation organized under the New Mexico Nonprofit Corporation Act, N.M. Stat. Ann. §§ 53-8-1 et seq. (the "Act"). Although SFMCO will have no shareholders, there will be members, as permitted by the Act.

As set forth in SFMCO's Bylaws, which are attached to this letter as Exhibit A, SFMCO will have three classes of Members (Exhibit A, Bylaws, Art. III, § 1):

a. The Physician Class consists of Physician Members, who will bear substantial financial risk for the payments to, and utilization practices of, SFMCO. The Physician Members would be subdivided into two "Physician Councils," the Specialty Physician Council (consisting of Members who are specialist physicians) and the Primary Care Physician Council (consisting of Members who are primary care physicians). (Exhibit A, Bylaws, Art. 3, § 3.1.1) Only Physician Members will be eligible to vote and to serve as Directors. (Exhibit A, Bylaws Art. VI, § 1) Non-Member Participating Physicians would not bear risk for the performance of the organization, and would participate in SFMCO's activities by entering into contracts with SFMCO to provide physician services; put differently, Non-Member Participating Physicians will serve as contract providers to SFMCO.

b. The Hospital Class will consist of the Hospital, a nonprofit 268-bed acute care inpatient facility, located at 455 St. Michael's Drive, Santa Fe, New Mexico 87505. (Exhibit A, Bylaws, Art. III, § 2.2)

c. The Health Center Class will consist of La Familia Health Center, a publicly-funded health care clinic, located at 1035 Alto Street, Santa Fe, New Mexico, 87502, which primarily treats the uninsured and those covered by Medicare and Medicaid. (Exhibit A, Bylaws, Art. III, § 2.3)

SFMCO will be supervised, controlled, directed and managed by a six-member Board of Directors. (Exhibit A, Bylaws, Art. VI, § 1) One Director would be appointed by the Hospital Class; one

Director would be appointed by the Health Center Class; one Director would be elected by the Specialty Physician Council of the Member Physician Class; and three Directors would be elected by the Primary Care Physician Council of the Member Physician Class. (Id.) The Hospital and Health Center Directors would be precluded from participating in decisions regarding the compensation of Non-Member Participating Physicians, because these Directors would be representing institutions which, in addition to providing other services, employ physicians who may participate as Non-Member Participating Physicians.

2. Persons Expected to Participate, Nature of Their Participation and Nature of their Contribution.

As set forth above, SFMCO Participating Providers will consist of Member and Non-Member Participating Physicians, the Hospital and the Health Center. SFMCO will provide professional and hospital inpatient and outpatient services, as well as other medical services, to payers through "Risk Contracts." "Risk Contracts" are defined in SFMCO's Bylaws as agreements between SFMCO and third-party payers that include a 20% or greater payment withhold and/or capitated or percentage of premium payment arrangements. (Exhibit A, Bylaws, Art. II, § 32) The specific nature of each type of provider's participation in SFMCO is described below.

a. Physicians

Both Member and Non-Member Participating Physicians will provide health care professional services to payer enrollees. One of SFMCO's guiding principles is that reducing the cost of health care delivery requires primary care physicians to assume a significant patient case management role and coordinate patient referrals. Therefore, primary care physicians will be responsible for authorizing all care provided to subscribers of organizations that contract with SFMCO.

Prior to SFMCO's incorporation, each physician applying to join SFMCO as a Member will be required to pay an initial assessment. (Exhibit A, Bylaws, Art. XIV, § 1.1) Any physician admitted as a Member after the time of SFMCO's incorporation would also be assessed a fee to join the organization. (Id.) Physicians applying to join SFMCO as Non-Member Participating Physicians would not be assessed a fee.

Except for the compensation provisions, the Participating Physician Agreement for Members and Non-Members will be similar. All Participating Physicians will be required to comply with various SFMCO and payer policies and procedures, such as

credentialing and utilization management. However, the two types of Participating Physicians will be compensated differently. Non-Member Primary Care Physicians will be compensated on a capitated basis and Non-Member Specialty Physicians will be paid on a fee-for-service basis. These payment mechanisms will not depend on SFMCO's overall financial performance. Member Physicians, on the other hand, will bear financial risk for SFMCO's overall economic performance through a formula which will make them liable for a share of SFMCO's deficits, as well as eligible for a share of SFMCO's surplus.

b. Hospital

The Hospital will provide general acute inpatient and out-patient hospital care to the public. The Hospital furnishes comprehensive acute medical, surgical, psychiatric, rehabilitative and intensive care services, radiation oncology services (as part of the Cancer Treatment Center), a Sleep Disorder Clinic and skilled nursing services. The Hospital's outpatient services include community outreach programs, emergency services, an urgent care clinic, rehabilitation services, psychiatric and chemical dependency programs, home care services, laboratory services, radiology and diagnostic imaging, including CT and MRI, and the Santa Fe Ambulatory Surgery Services.

The Hospital will be required to pay an initial assessment that equals the total amount paid by all Member Physicians. (Exhibit A, Bylaws, Art. XIV, § 1.1) The payment methodology for the Hospital will require the Hospital, like the Member Physicians, to share in SFMCO deficits and surpluses.

c. Health Center

The Health Center will provide professional healthcare services to payers' enrollees. The Health Center provides a comprehensive range of family medical and dental services, including emergency care, to low income citizenry and the medically undeserved.

The Health Center will be required to pay an initial assessment for each Health Center physician admitted to SFMCO as a Member Physician. (Exhibit A, Bylaws, Art. XIV, § 1.1) The Health Center's Participating Provider Agreement with SFMCO relating to its physician employees, will provide for compensation

as Non-Member Participating Physicians, for those physicians who participate in SFMCO on that basis.[2/]

d. Other Providers

SFMCO may contract with one or more Albuquerque hospitals for tertiary and quaternary care, such as neonatal intensive care, cardiac surgery and transplants, that the Hospital does not provide. In addition, SFMCO is contemplating contracting for services to complete the continuum of care, such as skilled nursing facilities, home health and home IV infusion, urgent care, ambulance service, durable medical equipment supply, and pharmacy service.

3. SFMCO's Purposes and Objectives, With Any Limitation on the Nature or Scope of Its Activities or Operations.

a. Purposes and Objectives

SFMCO's primary purposes and objectives are:

- To develop and implement a new globally-priced joint hospital/physician product that can be marketed to payers that includes a complete provider network (although only a subset of the network - the Members - bear risk). This should result in lower prices to payers and their subscribers, as well as a reduction in procedures performed and inpatient hospital days, without a decrease in the quality of care;

- To organize and operate a quality-driven and cost-effective integrated healthcare delivery system to service third-party payers;

- To develop a primary care-driven organization, recognizing that successful managed care organizations emphasize the role of primary care physicians in both care delivery and governance;

- To have primary care physician leadership in the areas of risk-sharing strategies, medical management and credentialing plans;

2/ The Participating Provider Agreements are being revised and will reflect the terms discussed in this letter.

- To focus on preventive care and health maintenance in the Santa Fe community and to represent the medically underserved on the Board of Directors, through the inclusion of the Health Center;

- To provide a vehicle to continuously educate participating providers to promote cost-effective quality of care; and

- To strive to reduce administrative burdens of Participating Providers through centralized credentialing and consistency in the utilization management process.

b. Criteria for Physician Participation

As defined in Art. II, § 27 of SFMCO's Bylaws, primary care physicians, whether Members or Non-Members, are those Participating Physicians who may be designated by SFMCO in certain agreements as physicians responsible for providing primary care professional services and authorizing all care provided to a payer's enrollee. If a physician practices in a medical subspecialty, at least 50% of his or her practice must be in general primary internal medicine, pediatrics, family practice or obstetrics/ gynecology for that physician to be considered a primary care physician. (Exhibit A, Bylaws, Art. II, § 27) Further, primary care physicians must be Board-certified or Board-eligible in family practice, internal medicine, pediatrics or obstetrics/gynecology for SFMCO's Board to deem the physician a primary care Member or Non-Member Participating Physician. (Id.)

For the first 60 days following SFMCO's establishment, to be a Participating Physician (Member or Non-Member) and remain qualified as such, a physician must, inter alia, (i) be a member in good standing of the Hospital's active medical staff, unless otherwise approved by SFMCO's Board of Directors, or be eligible to become a primary care physician practicing in Santa Fe County, New Mexico and (ii) be board certified or board eligible and actively pursuing his or her boards. (Exhibit A, Bylaws, Art. V, § 1) On or after the 61st day following SFMCO's establishment, unless otherwise approved by SFMCO's Board of Directors, SFMCO will accept applications to become a Participating Physician only from physicians who are newly eligible to apply, provided that any such newly eligible physician applies within the time limits, established from time to time, by SFMCO's Board.

c. **Limitations on Physician Participation**

To best effectuate SFMCO's purposes and objectives, and to provide necessary coverage and a full-range of choice, SFMCO will establish two categories of physician participation, as set forth above. One category will consist of Members[3/] of the MCO; the other category will be comprised of physicians who participate solely through a contract with SFMCO and who do not have any membership rights.

The Member category physicians will not exceed 45% of the physicians in any specialty in the community, except when the Member Physicians in a specialty are in a preexisting integrated practice group whose size exceeds 45% of the total number of community physicians in the specialty. SFMCO will permit up to 45% of the physicians in a specialty to participate as Members so that it is ensured enough risk-sharing physicians to support risk-sharing contracts, and enough capitalization to field a financially sound organization. SFMCO Members will be compensated on either a capitated or discounted fee-for-service basis, against a capitated pool, and will bear financial risk for the economic performance of SFMCO as a whole. Members will have the right to vote for, and serve on, SFMCO's Board of Directors, and will be eligible to serve on committees.

In contrast, Primary Care Non-Member Participating Physicians will be compensated on a capitated basis and Specialty Non-Member Participating Physicians will be paid on a fee-for-service basis. They will not take part in any incentive mechanisms that are linked to SFMCO's overall economic performance. (Such contracting providers might have incentives tied to their own performance, however.)

SFMCO will bear, and not pass through to payers, the risk that its Non-Member Participating Provider panel would deliver services inefficiently. No increases in fee schedules for Non-Member Participating Physicians would be passed on to any payer; rather, SFMCO (through its Members) would absorb any such increases. No payer contracts would be structured so that changes in payments by SFMCO to its physicians directly affected payments from the payer to SFMCO. Nor would contracts between SFMCO and the Non-Member Participating Physicians provide that payments to the physicians depended on, or varied in response to, the terms and conditions of SFMCO's contracts with payers. No payer would

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3/ Members of a nonprofit corporation such as SFMCO are like owners in terms of governance issues, since the Members elect the Board.

directly compensate a Non-Member Participating Physician for that physician's services pursuant to a contract with SFMCO.[4/] By compensating the contracting physicians in this manner, SFMCO's Members will bear significant financial risk for the overall economic performance of the MCO as well as maintain significant financial risk for payments to, and the utilization practices of, the contracting Non-Member Participating Physicians.

No Non-Member Participating Physician will have the right to vote for, or sit on, SFMCO's Board of Directors, or serve on any SFMCO committees that relate to contracting or compensation. Moreover, neither the Hospital nor Health Center member of the Board of Directors would have the right to participate in decisions concerning Non-Member Participating Physician compensation. As set forth more fully below, these Directors represent institutions that employ physicians who may be Non-Member Participating Physicians. Because the Board of Directors' incentive would be to bargain down the fees of such physicians, Directors who might be viewed as representing them would be precluded in taking part in such decisions.

The percentage of Member physician participation may exceed the antitrust safety zone of 30% or fewer of physicians in each specialty who practice in the relevant market and share substantial financial risk that Statement 8 of the Antitrust Guidelines establishes for nonexclusive physician networks. Similarly, Member participation may be greater than the 30% benchmark set forth in the Danbury and St. Joseph consent decrees for qualified managed care plans. However, the Policy Statements, and business review letters issued since the Policy Statements were published, make it clear that those limits are only guidelines and that the formation and operation of an organization with physician participation that exceeds those guidelines will be reviewed under the rule of reason if the network's Members share substantial financial risk or the venture enables them to offer a new product producing substantial efficiencies. Indeed, as the Division has noted, on several occasions, it has approved physician networks that are comprised of more than 30% of the physicians in the relevant market. (See, e.g., California Chiropractic Association (December 8, 1993) (50%); Collaborative Provider Organization (July 6, 1994) (six specialties in which the percentage of physicians exceeded 30%); International Chiropractor's Association of California (October 27, 1994) (50%);

4/ However, in some cases a payer could administer payments to all Participating Physicians, including Non-Member Participating Physicians, on behalf of SFMCO. Of course, ultimate payment risk would remain with SFMCO.

Physician Care, Inc. (October 28, 1994) (percentage in certain specialties "significantly higher" than 30%); Mid-South Physician Alliance, Inc. (March 30, 1994) (42%) (statistics quoted in Children's Healthcare, P.A. (March 1, 1996))). Here, given the size of the market and the number of physicians necessary to comprise a viable risk-sharing network, SFMCO believes that the 45% cap is reasonable, and will preserve competition in the market.

d. Inclusion of Physicians as Members or Participating Physicians

There are 183 physicians (M.D.s or D.O.s) with active privileges, not on leave of absence, who practice in a variety of specialties on the Hospital's staff. (See Exhibit B attached.)[5/] Of these physicians, 100 practice in one of the 24 group practices; 83 are sole practitioners. SFMCO's organizers have analyzed the practice patterns of the physicians, and identified 66 of these physicians as primary care physicians and 117 as specialty physicians. (See Exhibit C attached.)

In accordance with the principles outlined above, SFMCO would include physicians in the categories of Member and Non-Member Participating Physician as follows:

(1) Internal Medicine and Family Practice

After analyzing the practice patterns of the internists and family practitioners with privileges at the Hospital, SFMCO's organizers determined that internists who provide primary care and family practitioners are substitutes for each other. Therefore, SFMCO considers these physicians a single specialty market. SFMCO's organizers have identified 46 such physicians. Fifteen of these physicians are internists and 31 are family practitioners. No more than 21, or 45%, of these physicians would be invited to join SFMCO as Members. The remaining 25 physicians, as well as any of those invited who elect not to become Members, will be eligible to participate as Non-Member Participating Physicians.

SFMCO anticipates that three groups (comprising 17 physicians) would initially be assigned Participating Physician status, if they choose to participate at all: Hospital employees;

5/ Exhibit B sets forth 184 physicians in its physician listing. This number includes one physician, who is in group practice with physicians on the Hospital's active staff, but does not have Hospital admitting privileges.

Health Center employees; and Lovelace employees. That would leave 29 internists/family practitioners as potentially eligible to join SFMCO as Members or Non-Member Participating Physicians. If eight physicians from this group elect to participate as Non-Member Participating Physicians (or decline to participate at all), then 25 remaining physicians would be invited to join as Members. (Twenty of the 29 physicians in these specialties have indicated to SFMCO's organizers that they would potentially prefer to participate in SFMCO as Non-Member Participating Physicians.) If fewer than eight physicians seek to join as Non-Member Participating Physicians, SFMCO's Managed Care Steering Committee would recommend that the Committee adopt a set of membership criteria to be applied to all eligible internists and family practitioners to determine the 21 members.

(2) Pediatrics

SFMCO plans to offer Membership to two of the 10 pediatricians, or 20%, with Hospital privileges. The other pediatricians may, if they apply and are accepted, participate initially as Non-Member Participating Physicians.

(3) Obstetrics/Gynecology

As set forth on Exhibit B, the obstetricians-gynecologists practice in a variety of group and individual practices. It is unclear how many of these physicians are interested in joining SFMCO as Members. SFMCO's organizers initially would invite all of these physicians to be Members subject to a stipulation that if more than 45% wish to become Members, SFMCO would offer all obstetricians-gynecologists Non-Member Participating Physician status.

(4) Hospital-Based Specialties

Physicians in the hospital-based specialties of pathology, radiology, anesthesiology and emergency medicine are in single integrated group practices, with the sole exception of two solo emergency medicine practitioners and two solo anesthesiologists. The Hospital is currently in the process of negotiating an exclusive contract with the anesthesia group. The physicians in the practice groups would be offered Member status in SFMCO.

(5) Surgical Subspecialties

All the surgical subspecialists practice in solo or small group practices. It is unclear how many of such physicians are interested in becoming Members of SFMCO. Initially, all such physicians would be invited to join SFMCO as Members. However, if

more than 45% of any specialty seek Membership status, then all such physicians would be invited to join as Non-Member Participating Physicians.

(6) Medical Subspecialties

The medical subspecialists in the disciplines of cardiology, oncology and nephrology are all in group practices, with the exception of two solo cardiologists. The physicians in the group practices will be invited to join SFMCO as Members. Only one physician practices in each of the medical subspecialties of infectious disease, rheumatology and critical care. Each would be invited to join SFMCO as a Member. Physicians in the remaining medical subspecialties practice in either individual or small group practices. In these disciplines, SFMCO would initially invite all practitioners to join as Members. However, if more than 45% of any specialty want to join the organization as Members, then all such physicians would be offered Non-Member Participating Physician status.

e. Nonexclusivity

Membership in SFMCO will be nonexclusive. As described more fully in SFMCO's response to Question 7 below, SFMCO Participating Providers will be able to participate in any other provider networks and provide medical services independent of and apart from the services to be provided to SFMCO subscribers. The only limitation on participation in other networks and programs is that a physician cannot simultaneously serve as an officer or director of such other organization and SFMCO, and a Participating Provider's participation in other networks or programs cannot preclude the provider from complying with the terms of his, her or its agreement with SFMCO. (Exhibit A, Bylaws, Art. V, § 6) Moreover, the Participating Provider Agreements will set forth that SFMCO may contract with any health care provider to become a Participating Provider without the prior consultation or approval of any Participating Provider.

4. Services SFMCO Will Develop, Produce, Market or Distribute.

SFMCO will assist health care providers in furnishing high-quality, cost-effective and competitive health services by providing a vehicle for them to enter into "Risk Contracts" with payers. SFMCO's Bylaws define "Risk Contracts" to mean agreements between SFMCO and third-party payers that include a 20% or greater payment withhold and/or capitated or percentage of premium payment arrangements. (Exhibit A, Bylaws, Art. II, § 32) As part of its risk contracting, SFMCO would develop and offer payers a new capitated joint hospital/physician services product through which

SFMCO Members collectively would assume the financial risk of the organization's performance.

SFMCO will negotiate Risk Contracts through a Negotiation/ Finance Committee, which will be appointed by and report to SFMCO's Board of Directors. (Exhibit A, Bylaws Art. X § 1.1) The Participating Provider Agreements will indicate that SFMCO's Board will review, evaluate and approve or reject risk contracts with payers. The Participating Provider Agreements will state that Participating Providers will appoint SFMCO as their agent and attorney-in-fact to contract for services rendered by SFMCO and to bind them to agreements that SFMCO's Board concludes are acceptable, in accordance with contracting guidelines SFMCO adopts. As noted above, only Member Participating Physicians, and not Non-Member Participating Physicians, will bear risk for the economic performance of the organization under such agreements.

5. Extent to Which SFMCO Members Currently Market Services That Will be Offered by SFMCO.

Prospective members of SFMCO presently independently negotiate and contract with HMOs, PPOs, insurance companies, employers and other organizations. Most Santa Fe physicians have individual contracts with HMOs that reimburse on a discounted fee-for-service basis; there is limited risk sharing among competing or complementary physicians. The Hospital is typically paid on a per diem or DRG basis, but does not share risk with its medical staff. The Health Center engages in a minimal amount of fee-for-service contracting with HMOs.

SFMCO will offer providers enhanced opportunities to engage in risk-sharing managed care contracting. Since SFMCO will be nonexclusive, participants will retain their ability to contract with payers individually or to join other healthcare networks.

6. The Identity and Competitive Significance of Persons and Firms That Participate in the Relevant Product and Geographic Markets.

a. Product Market

SFMCO will compete in several relevant product markets, including: general acute-care inpatient hospital services; the provision of services by Members and Non-Member Participating Physicians practicing in their medical and surgical specialties; and the health care financing market. Besides the Hospital, there are no other acute-care, inpatient hospital facilities located in Santa Fe that are open to the general public. (There is an acute care facility in Santa Fe, operated by the Indian Health Service,

but it is only available to the Native American population.) There are acute-care inpatient hospitals in Taos (about 70 miles away), Espanola (about 25 miles away), Los Alamos (about 35 miles away), and Las Vegas, New Mexico (about 65 miles away) from which the Hospital and some of its physician specialists draw patients; however, these facilities do not compete in a significant way with the Hospital. We understand that these hospitals are, however, forming integrated delivery systems with their medical staffs to facilitate their joint participation in managed care contracting on a local and regional basis.

SFMCO proposes to invite qualified physicians to join, on a nonexclusive basis, as Members or Non-Member Participating Physicians. Prospective Members' and Non-Member Participating Physicians' specialties comprise the full array of specialties represented on the Hospital's staff. A delineation of each specialty is set forth in Exhibit B.

Lovelace Medical Group is a closed-staff-model HMO located in Santa Fe and affiliated with CIGNA Insurance. Lovelace consists of four family practice physicians, one pediatrician and three internists. (See Exhibit B.) The Lovelace physicians have privileges at the Hospital. Physicians who join SFMCO would not be precluded from contracting with Lovelace to provide services to Lovelace subscribers. Lovelace physicians could join SFMCO as Non-Member Participating Physicians, as long as they meet credentialing criteria and Lovelace's closed-staff model did not preclude their serving SFMCO's subscribers. (Exhibit A, Bylaws Art. V, § 1) (Given Lovelace's closed-staff model, however, it is not likely that these physicians would join SFMCO.)

The Santa Fe Physician's Independent Practice Associates (the "IPA") consists of 116 physicians. Approximately 47% of its members are specialists; the rest are primary care physicians. Approximately 52% of the Hospital's staff belong to the IPA, which engages in discounted fee-for-service contracting and risk contracting, on a minimal basis. (See Exhibit B.) IPA physicians will be free to join SFMCO if they meet credentialing criteria. Similarly, physicians who join SFMCO could participate in the IPA.

b. Geographic Market

The geographic market for SFMCO's primary care services is anticipated to be Santa Fe County. The county has a population of approximately 110,550 people. (A map of the geographic market is attached as Exhibit D.) The largest city in the area is Santa Fe, with a population of roughly 65,000. The Hospital and its physician specialists also draw patients from an area that includes Espanola (population of roughly 9,000), Taos (population

of about 4250), Los Alamos (population of about 11,455) and Las Vegas (population of roughly 15,000).

New Mexico is a sparsely populated state and it appears that, for some specialties, SFMCO's market would extend to Albuquerque, which is approximately 60 miles away. There are three systems which operate six acute care hospitals in Albuquerque. Payers have shifted patients from Santa Fe to Albuquerque for some procedures, including cancer treatment, radiation, rehabilitation and orthopedics cases. One study of Presbyterian Health Plan PHP members (formerly HealthPlus) indicated that 30% of the plan's subscribers were being referred to Albuquerque hospitals for non-tertiary elective care. SFMCO has indications that CCN is forming a PPO network to cover both Santa Fe and Albuquerque. Additionally, some Santa Fe ophthalmologists, anesthesiologists and cardiologists have joined with physicians in Albuquerque and provide coverage in Santa Fe and Albuquerque.

7. Any Restrictions on the Ability of Participants in the Venture to Compete With the Venture.

SFMCO will be nonexclusive. (Exhibit A, Bylaws, Art. V, § 6) The Participating Provider Agreements will state that SFMCO may contract with any hospital, physician or other health care provider to become a Non-Member Participating Provider, upon such terms and conditions as it deems appropriate, without prior consultation or approval of other Participating Providers. The agreements will also state that Participating Providers may participate in any other provider network, and provide medical services independent of, and apart from, the services to be provided to subscribers of organizations contracting with SFMCO, as long as such participation does not preclude the Participating Provider from complying with the terms of its agreement with SFMCO. The agreements will also forbid Members from diverting or usurping opportunities or from participating in, directly or indirectly, activities that the Member knows, should know or should reasonably anticipate that SFMCO will be pursuing.

The Participating Provider Agreements for SFMCO Members will also provide that SFMCO Members, but not Non-Member Participating Providers, must grant SFMCO the first opportunity to negotiate and execute risk agreements on the Members' behalf. If a Member is contacted by a payer to enter into or renew a risk agreement with the payer, or if the Provider Member desires to enter into or renew a risk agreement with a payer, the Member must promptly, wherever practicable and in good faith, notify SFMCO's Board in writing of SFMCO's possible opportunity to be the contracting party, which information shall be retained by the Board in confidence.

This provision will also require SFMCO to make a good faith effort to actively commence all payer negotiations within 30 days of learning of a payer's interest or within 30 days of SFMCO's Board's decision to pursue a payer. If negotiations timely commence and proceed in good faith, SFMCO has 90 days from the receipt of such notice to negotiate or decide to execute a risk agreement with the payer. The Participating Provider Agreements will also state that nothing in the Agreement is intended to prohibit the Participating Provider from negotiating and entering into or renewing agreements directly with payers who do not have an agreement with SFMCO regarding similar services.

8. Restrictions on the Flow of Information From SFMCO to its Owners.

No SFMCO Participating Provider will have access to another Participating Provider's patient fee or pricing information or other financial or cost data.

9. Ten Largest Customers (Projected) for Services To Be Offered by SFMCO.

SFMCO has signed no contracts with payers. Since SFMCO has not executed any contracts, it is difficult to project the organization's top ten customers or their anticipated volume. However, SFMCO's organizers have identified seven payers with which SFMCO would pursue contracts, once the organization is formed. These payers were identified based on the payers' current membership, anticipated membership growth and expressed desire to work with SFMCO. The payers are: Blue Cross; Prudential; QualMed; FHP; Presbyterian Health Plan PHP (formerly HealthPlus); St. Vincent Hospital Employees Health Plan; and Medicaid. SFMCO also contemplates approaching payers and health delivery systems in the surrounding cities of Espanola, Taos, Los Alamos and Las Vegas to propose bundled pricing or capitation arrangements for tertiary services that could be performed in Santa Fe.

10. Requirements for Entry Into The Relevant Product or Geographic Market And the Identity of Other Persons or Firms Believed to Be Positioned to Enter Within One or Two Years.

Other managed care payers or provider-controlled networks competing in or seeking to enter the market would require a supply of physicians, particularly primary care physicians, and a hospital. Because SFMCO will be nonexclusive, physicians who join SFMCO (and those who do not) will be able to participate in existing networks, or form new physician networks in addition to SFMCO. There is not another Santa Fe hospital, open to the general public, with which physicians could form a network.

However, there are indications that the Hospital and some of its physician specialists are competing presently with providers in Albuquerque.

11. Business Synergies, Efficiencies or Other Benefits Likely to Flow from SFMCO.

SFMCO's preliminary Business Plan (attached as Exhibit G) provides background and demographic information relevant to the formation and operation of SFMCO. SFMCO requests that the document be treated as confidential. Disclosure of SFMCO's plans and strategies would have a detrimental impact on SFMCO's relationships with potential customers and would impair SFMCO's competitive position.

The preliminary Business Plan describes the principles that would guide the organization's activities and operations, including its plans to contract on a capitated or global-fee basis with payers, and the methodology SFMCO would use to reimburse Members from a variety of "risk pools" through which the Members would share the financial risk associated with the organization's performance. It further describes SFMCO's proposals to compensate Non-Member Participating Physicians so that they have incentives to reduce their own individual costs, but assume no risk for the overall performance of SFMCO.

It is expected that the formation and operation of SFMCO will result in several synergies, efficiencies and other procompetitive benefits. These include:

- Reduction of healthcare costs for payers and subscribers, through the introduction of joint hospital/physician risk-sharing contractual arrangements;

- Establishment of a primary-care driven vehicle, which will more efficiently manage referrals to physician specialists, eliminate unnecessary services and reduce hospital days, thereby decreasing healthcare costs;

- Performance of more efficient contract negotiation and administrative services than would be possible by SFMCO members individually, most of whom do not have the experience, expertise or time necessary to negotiate with various providers, particularly with respect to risk-sharing contracting; and

- Promotion of high-quality healthcare, through SFMCO's review of Participating Providers' credentials, development and administration of a utilization review program, and tracking of clinical outcomes.

12. All Documents Reflecting or Effectuating Formation of SFMCO.

Attached as Exhibit A is SFMCO's proposed Bylaws. The Bylaws have not been adopted. SFMCO's Participating Provider Agreements are being revised, and will reflect the terms discussed in this letter. SFMCO does not anticipate adopting Bylaws or executing Participating Provider Agreements until completion of the Business Review process.

13. All Documents Discussing, Reflecting or Representing the Business Plans or Strategies for SFMCO.

Attached as Exhibit E is SFMCO's preliminary Business Plan.

14. All Documents Prepared Within Two Years Reflecting the Business Plans or Strategies of any SFMCO Participant With Respect to any Service That Will be Offered by SFMCO.

Attached as Exhibit F is the section of the Hospital's Business Plan that pertains to managed care products. The Hospital requests that this document be treated as confidential. Disclosure would have a detrimental impact on the Hospital's relationships with potential customers and would impair its competitive position.

15. All Documents Discussing or Relating to SFMCO's Legality or Illegality Under the Antitrust Laws or its Impact on Competition or the Price of Any Product or Service.

The preliminary Business Plan (Exhibit E) discusses the impact of the venture on competition.

* * * *

Thank you for your consideration of this matter. We believe that the formation and operation of SFMCO will lead to reduced health care costs, while maintaining or enhancing the provision of high quality medical services. Please contact me at 312/984-7668 if you have any questions or need any additional information.

Sincerely,

David Marx, Jr.

Enclosures
cc: Ronald C. Winger (by Federal Express)
Thomas W. Olson, Esq. (by Federal Express)