DEPARTMENT OF JUSTICE
Antitrust Division

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David Marx, Jr., Esquire
McDermott, Will & Emery
227 West Monroe Street
Chicago IL 60605-5096

Dear Mr. Marx:

This letter responds to your request on behalf of Santa Fe, New Mexico Managed Care Organization ("SFMCO"), as contained in submissions of April 12, July 3, July 11, August 14, September 4, September 30, and December 2, 1996, and January 14, and January 23, 1997, seeking the issuance of a business review letter under the Department of Justice's Business Review Procedure, 28 C.F.R. § 50.6. SFMCO will be a provider-controlled network organization that will offer hospital and physician services to health insurance plans and other third-party payers using capitation and global fee contracts as well as other types of contract arrangements. Based on the information you have provided and our interviews with a number of payers and providers knowledgeable about the market, the Department has no present intention to challenge under the antitrust laws the formation of SFMCO's proposed network.

SFMCO will be organized as a nonprofit corporation and will operate in Santa Fe County, New Mexico, which contains a relatively concentrated population of roughly 100,000 people in an otherwise sparsely populated area. The expected members of SFMCO, similar to owners in for-profit corporations, are (1) St. Vincent's Hospital ("St. Vincent's"), a nonprofit 268-bed acute care inpatient facility in the City of Santa Fe, which is the only acute care hospital open to the general public within approximately 60 miles, and (2) approximately 70-75 physician members. Both St Vincent's and the physician members will share substantial financial risk for SFMCO's operations.

SFMCO will also invite La Familia Health Center, a publicly-funded health care clinic in Santa Fe that provides a substantial portion of the care for the uninsured and those covered by Medicaid in the community, to send a representative to SFMCO board meetings in an advisory or "ex officio" capacity. The La Familia representative will have no right to vote on any matter coming before the board for its consideration or action and will not be present or participate in any discussion or decision relating to physician compensation by SFMCO or to the terms of any contract between a payer and SFMCO. Precautions will be taken so that there will be no communication of information concerning these matters between SFMCO and the La Familia representative.

SFMCO will also subcontract individually with non-member physicians to provide services as part of SFMCO's physician panel. The non-member participating physicians will not share financial risk with SFMCO's members. Any Santa Fe physician who is not a SFMCO member will be eligible to subcontract as a non-member participating physician.

Both SFMCO's members and its non-member participating physicians will participate in the network on a non-exclusive basis. There will be no restriction on their ability to compete with the SFMCO venture, and they will not be discouraged from joining other networks or contracting directly with health benefit plans. You state that SFMCO is intended to be a de jure and de facto non-exclusive network.

SFMCO's primary interest is in negotiating risk contracts with payers. SFMCO's By-Laws define "risk contracts" as agreements between SFMCO and third-party payers that include a 20 percent or greater payment withhold or capitated or percentage of premium payment arrangements or other risk payment methodology. In further describing these provisions, you cite and quote language from the Statements of Antitrust Enforcement Policy in Health Care, issued by the Department and the Federal Trade Commission in August 1996 (the "Policy Statements"). From this description, we understand, and assume for purposes of this business review, that in all SFMCO's risk contracts SFMCO's member physicians will share "substantial financial risk" as that term is described in the Policy Statements.

For contracts that do not involve substantial financial risk sharing, SFMCO will act as a "messenger" to facilitate contracting between third-party payers and SFMCO's individual member and non-member participating physicians. We understand from your letters and your telephone conversations with staff, and we assume for purposes of this letter, that all such messenger arrangements will carefully avoid agreements among competing network providers on prices and price-related terms, will not facilitate collective decision-making by network providers, and will satisfy the description of such messenger arrangements found in Statement 9 of the Policy Statements.

With three exceptions, SFMCO's member physicians together with any physician employees of St. Vincent's will not exceed 30 percent of the physicians with offices in the City of Santa Fe in any physician specialty. The exceptions, which are discussed below, are for (1) physician specialties in which all the SFMCO member physicians in the specialty are in a preexisting integrated practice group that has not been formed or expanded to avoid the 30 percent limitation, (2) family practitioners and internists who, you have told us, are good substitutes for each other in the Santa Fe area, and (3) pediatricians.

The non-member participating physicians will subcontract individually with SFMCO to provide physician services as part of SFMCO's provider panel. The subcontract will establish a capitated payment as compensation for non-member participating primary care physicians and a discounted fee-for-service schedule for all other non-member participating physicians. Unlike

SFMCO's member physicians (whose compensation will be linked to SFMCO's overall financial performance through a formula that will make them liable for a share of SFMCO's deficits and eligible for a share of SFMCO's surplus), the non-member participating physicians' compensation will not depend on the overall economic performance of SFMCO.

SFMCO will bear, and not pass through to payers, the risk that its non-member participating physicians might deliver services inefficiently. No increases in fee schedules or capitation payments for non-member participating physicians will be automatically passed on to any payer; SFMCO, through its members, will absorb any such increases. In addition, no contract between SFMCO and a payer will be structured so that changes in SFMCO's payments to non-member participating physicians will automatically affect payments to SFMCO from the payer. Similarly, payments to non-member participating physicians will not depend on, or automatically vary in response to, the provisions of SFMCO's contracts with payers. You represent that SFMCO will be structured so that it will have the incentive to bargain down the compensation to be paid to non-member participating physicians.

No third-party payer will directly compensate a non-member participating physician for that physician's services pursuant to a contract with SFMCO. However, on behalf of SFMCO, a payer may administer payments to all physicians on SFMCO's provider panel, including non-member participating physicians. In all cases, the ultimate payment risk will remain with SFMCO.

We understand that non-member participating physicians will not participate in any discussion, negotiation, decision or agreement concerning fees or fee-related contract provisions for member physicians or each other. Non-member participating physicians will not vote for, or sit on, SFMCO's Board of Directors or serve on any SFMCO committee relating to contracting or compensation. Moreover, neither the St. Vincent's nor the La Familia Health Center representatives on the Board of Directors will participate in discussions or decisions concerning physician compensation since St. Vincent's and the Health Center employ a number of physicians who will be eligible to become non-member participating physicians.

Antitrust Analysis

As proposed, SFMCO appears to be an economically integrated joint venture designed with the stated purpose of producing significant efficiencies that should benefit third-party payers and their subscribers. To the extent that competitors will be participating in price or price-related agreements, they will share substantial financial risk in a manner that will create incentives to achieve efficiencies. In all situations not involving substantial financial risk sharing, SFMCO will utilize "messenger" arrangements that should avoid agreements on price and price-related terms if implemented carefully. Consequently, we have analyzed SFMCO's proposal under the rule of reason.

We have not attempted to define precisely the scope of the services or the geographic boundaries of the relevant markets for each different type of SFMCO member involved in this business review. Under the circumstances presented here, we have determined that our conclusions would not differ significantly under any reasonable market assumptions.

SFMCO will, with three exceptions, limit the sum of its members and the physician employees of St. Vincent's in any physician specialty to 30 percent of the physicians in that specialty with offices in the City of Santa Fe. Virtually every physician practicing in Santa Fe County maintains an office in the City of Santa Fe.

The first exception to the 30 percent limitation is for a preexisting integrated physician group not formed or expanded to avoid the 30 percent limitation. Where all SFMCO members in a specialty belong to such a preexisting group, the group's inclusion in SFMCO would not increase market concentration or power in that physician specialty.

The second exception is for family practitioners and internists. (We have assumed for purposes of this business review that you are correct in asserting that these physicians are good substitutes for each other in the Santa Fe area.) We understand that of the 50 internists and family practitioners in the Santa Fe area, 14 are expected to become SFMCO members and an additional four are employed by St. Vincent's. Thus, 36 percent of the internists and family practitioners will be SFMCO members or employees of the hospital. Nevertheless, we have concluded that the percentage is not so large that it is likely to cause anticompetitive effects under the circumstances and assumptions described in this letter.

The third exception to the 30 percent limitation is for pediatricians. There are a total of only 11 pediatricians in the area. Of these, two will become SFMCO members and an additional six are employed by St. Vincent's (some on a part-time basis). The two pediatricians that will become SFMCO members constitute a fully integrated group practice. The senior pediatrician in the group has been instrumental in the development of SFMCO and because of his leadership role is considered vital to the implementation of SFMCO.

The two member pediatricians plus the six pediatrician employees of St. Vincent's are more than 70 percent of the pediatricians in the area. Although SFMCO points out that the six hospital-employed pediatricians (as well as the hospital-employed internists and family practitioners) will not be SFMCO members, the hospital will be a member and its interest in SFMCO could affect how and the extent to which it will make those physicians available either to payers contracting outside SFMCO or as SFMCO non-member participating physicians. However, you have pointed out that the SFMCO member pediatricians will be a small minority among the primary care physicians whose compensation will be paid out of a single fixed revenue pool. Since paying the pediatricians supra competitive amounts would reduce the revenues available to compensate the other physicians participating in the pool, those other physicians will have strong incentives to keep the pediatricians' compensation at competitive levels. This is more likely to be the case here since neither the six St. Vincent's pediatricians nor

St. Vincent's itself will be involved in any of SFMCO's physician pricing discussions or decisions.

Nevertheless, we are concerned that managed care plans desiring to enter the market in Santa Fe could have difficulty obtaining sufficient pediatric care for their enrollees without SFMCO. Despite the presence in the market of family practitioners who do provide care to children, the availability of pediatrician services is important to the marketability of managed care plans. Thus, it is particularly important that both the member and non-member participating pediatricians in SFMCO will in fact participate non-exclusively as you have represented. The conclusion reached in this letter is based in significant part on this representation, and we caution that particular care must be taken to ensure that competition is not injured because of the concentration of pediatricians in SFMCO's provider panel.

Another matter of considerable concern is SFMCO's proposal to supplement its panel of physician members by subcontracting with additional physicians to offer payers a panel that could include virtually all of the physicians in Santa Fe. The Department has entered into final judgments that permitted such subcontracting arrangements where there appeared to be a demand for multi-specialty physician panels with high percentages of the physicians in the market, where the subcontract arrangements created divergence of economic interest between the subcontracting physicians and the member physicians so that the members had an incentive to control the network's costs from the physician subcontracts, and where market conditions otherwise indicated that the subcontract arrangements creating divergence of interest were sufficient to make exclusive behavior unlikely.[1/]

SFMCO asserts that payers in the Santa Fe area desire physician panels that are as broad as possible and certainly more inclusive than 30 percent of the physicians in each physician specialty. SFMCO believes that managed care plans in the Santa Fe area need to offer as large a physician panel as possible in order to be attractive to payers. The information we have obtained from payers in the Santa Fe area is generally consistent with these representations, and we have assumed these representations to be correct for purposes of this business review letter.

SFMCO's proposed subcontracting arrangements also appear to be structured in a manner to create a divergence of economic interest between SFMCO's members and the subcontracting participating physicians that will reduce the likelihood of anticompetitive conduct. SFMCO will bear the ultimate responsibility for payment of compensation to the non-member participating physicians. Unlike the subcontracting physicians whose compensation will not depend on the overall economic performance of SFMCO, the compensation of SFMCO's members will be

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[1] See, e.g., Competitive Impact Statements in United States v. Health Choice of Northwest Missouri, Inc., Case No. 95-6171-CV-SJ-6 (W.D. Mo.; filed Sept. 13, 1995), 60 Fed. Reg. 51808, 51815 (October 3, 1995); United States and State of Connecticut v. Health Care Partners, Inc., Case No. 395-CV-01946-RNC (D. Conn.; filed Sept. 13, 1995), 60 Fed. Reg. 52018, 52020 (Oct. 4, 1995).

directly and substantially linked to how well SFMCO performs financially. Member physicians will be both liable for a share of SFMCO's deficits and eligible for a share of the venture's surplus. SFMCO members will have the incentive to bargain down the compensation to be paid to non-member participating physicians.

We have spoken to payers, employers, physicians, and others, and reviewed documents and other information provided by SFMCO. While our investigation indicates the existence of significant actual and potential competition to SFMCO, clearly SFMCO's proposal creates the potential for anticompetitive conduct with harmful effects on consumers. In some physician specialities, more than 30 percent of the physicians in the area will be joining SFMCO as members who will set fees and decide other competitively sensitive matters for the venture. In addition, the members will be subcontracting with most, if not all, of the remaining physicians in the area. If the members and non-member physicians in fact view their interests as congruent, they could easily assert market power with serious anticompetitive consequences.

However, SFMCO's provider-controlled network also has the potential for creating significant efficiencies by offering payers capitation and global fee arrangements that are not now generally available in the Santa Fe area. These benefits must be weighed against the potential for competitive harm. Taking this into account and under all the circumstances here, we are unable to say that SFMCO's plan will likely cause anticompetitive harm if it is implemented carefully as proposed.

We have also considered the possible effects of including St. Vincent's in the network, since it is the only acute care inpatient hospital in the area.[2/] The inclusion of St. Vincent's will not reduce competition among hospitals, and we have found no reason to conclude that its inclusion in the network is likely to cause anticompetitive vertical effects. Similarly, we have found nothing objectionable about the inclusion of La Familia Health Center in the network as a non-voting, ex officio member that will not participate in consideration or determination of physician compensation issues.

For these reasons, and based on the facts you have represented, the Department of Justice has no present intention of challenging the formation of SFMCO's proposed network. However, we strongly emphasize that if in practice its formation and operation causes anticompetitive harm, the Department remains free to bring whatever action or proceeding it subsequently comes to believe is required by the public interest.

This statement is made in accordance with the Department of Justice Business Review Procedure, 28 C.F.R. §50.6, a copy of which is enclosed. Pursuant to its terms, your business review request and this letter will be made available to the public immediately. In addition, any supporting data that you do not timely identify as confidential business information under

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[2]See Statement 9 of the Policy Statements at footnote 59.

Paragraph 10(c) of the Business Review Procedure will also be made publicly available in 30 days.

Sincerely,

Joel I. Klein