



DEPARTMENT OF JUSTICE
Antitrust Division

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Janet L. McDavid, Esquire
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Washington, D.C. 20004-1109

Dear Ms. McDavid:

This letter responds to your request, pursuant to the Department of Justice's Business Review Procedure, 28 C.F.R. § 50.6, for a statement of the Department's enforcement intentions regarding a joint venture proposed by First Priority Health ("FPH") and NEPPO Ltd. ("NEPPO"). FPH, which is the HMO subsidiary of Blue Cross of Northeastern Pennsylvania, and NEPPO, a limited partnership of 166 physicians, propose to form First Priority Health System ("FPHS"), a risk-bearing service delivery organization to provide and manage medical services to FPH enrollees in a five-county area of northeastern Pennsylvania. Based on the information you have provided and our own investigation, the Department has no present intention to challenge under the antitrust laws the proposed joint venture. However, as explained below, there are novel aspects to the proposed joint venture, and some entities, including both purchasers and rival provider plans, have raised questions that could be of serious concern if there were material alteration of the presumptions underlying our analysis. Consequently, we caution you that this Business Review Letter is strictly limited by its stated assumptions and the facts as we understand them at this time.

Background

As described in the material you have provided, FPHS is a joint venture between FPH and NEPPO to provide medical services to FPH enrollees in Lackawanna, Monroe, Pike, Susquehanna, and Wayne counties. NEPPO, which was formed in December 1994, is composed of 166 primary

care physicians ("PCPs")¹ and specialists who practice primarily in the five-county area. The vast majority of NEPPO's participating physicians (40 of 50 PCPs and 102 of 116 specialists) are located in Lackawanna County. Scranton, Pennsylvania is located in Lackawanna County and is the only major city in the five-county area.

The joint venture is designed to align the economic incentives of providers (in this case, physicians) and a managed care insurer (*i.e.*, a payer) that uses those providers' services. By supplying a mechanism to involve physicians in utilization management, FPHS expects to create incentives for those physicians to produce both better clinical outcomes for FPH enrollees and lower cost health care services. FPHS expects to achieve significant efficiencies through the implementation of clinical protocols, medical management plans, on-line utilization management, development of quality assurance, clinical practice and credentialing standards, elimination of duplicative or unnecessary services, and reduced administrative costs.

With certain limited exceptions, FPH has agreed that FPHS will be the exclusive provider of medical services to its enrollees. NEPPO has agreed that FPHS will be the only managed care plan with which its PCPs will contract to provide "gatekeeper" services.² The PCPs will be free to contract with any other health plan that is not a gatekeeper-type plan.³ NEPPO specialists will be free to contract with all other managed care plans, including gatekeeper-type plans. In order to provide adequate coverage for the enrollees of FPH, NEPPO may contract with additional PCPs and specialists in the five-county area. These supplemental physicians will not be subject to any exclusivity provisions. FPH and NEPPO have agreed that neither will separately acquire any provider in the five-county area unless that opportunity has first been offered to FPHS.

Each of the 166 physicians who are members of NEPPO has been required to contribute \$10,000 towards capitalization of the partnership. NEPPO shareholders have raised over \$1.5 million through these initial capital contributions and annual dues, and an additional \$830,000 through demand notes. In addition, each NEPPO physician is committed to provide sufficient

additional capital to operate FPHS. Any gains or losses from NEPPO will be shared equally by the 166 NEPPO physicians.

¹ PCPs are defined as general practitioners, family practitioners and internists for the purposes of this business review.

² A "gatekeeper" plan is one in which enrollees must obtain a referral from a PCP (the "gatekeeper") to see a specialist. This "gatekeeper" mechanism helps in controlling the utilization of specialist services. You informed the Department on October 7, 1997, that 12 PCPs in remote locations within the five-county area, including two in Lackawanna County, would be exempt from the exclusivity requirement. These included all NEPPO PCPs in Susquehanna and Monroe counties, and two of three NEPPO PCPs in Wayne County.

³ We note that most health care insurers in the five-county area contract with physicians using so-called "all products" contracts; that is, payers expect physicians to treat patients under each type of coverage the payer offers. Thus, most payers would have to change current practices to contract on a limited basis with a physician who refuses to treat patients covered by the payer's gatekeeper-type HMO plan.

FPH will pay FPHS an agreed annual fee for each enrollee pursuant to a premium allocation formula. Thus, FPHS will be a "capitated" venture. FPHS's board of directors will appoint a special Reimbursement Committee, made up solely of non-NEPPO board members appointed by FPH, to develop a physician fee schedule. Therefore, only payer representatives will determine the fees to be paid to providers by FPHS. The Committee will employ an outside agent to collect and analyze fee data needed to develop these rates. The agent and the Committee will maintain strict confidentiality of all pricing information collected for this purpose.

NEPPO PCPs will be paid through capitated rates developed by the Reimbursement Committee. To create additional incentives for PCPs to monitor utilization of services, NEPPO will also establish compensation pools to reward PCPs for improvements in utilization efficiency. In addition, NEPPO PCPs are expected, at least initially, to receive an additional per-member-per-month payment in connection with their limited exclusivity to FPHS.

NEPPO specialists will be paid on a discounted fee-for-service basis. However, NEPPO specialists will share substantial risk because of their ownership interest in NEPPO and because FPHS will operate under a capitated arrangement with FPH so that the total amount available for payments to both specialists and PCPs is fixed. Through ownership in NEPPO, NEPPO members will share in any gains realized by FPHS as a result of efficient management and operation or losses from over-utilization or other causes.⁴ In the future, NEPPO specialists as well as NEPPO PCPs may also share risk through the implementation of a global capitated system, which FPHS expects to develop and administer after it has gained sufficient experience with medical management and reimbursement.

In order to provide an adequate physician network for the enrollees of FPH, FPHS will contract with supplemental PCPs and specialist physicians who are not members of NEPPO. No supplemental physician will be restricted in any way from contracting with other managed care plans. As with NEPPO physicians, the fee schedules for the supplemental physicians will be developed by the FPHS Reimbursement Committee, consisting of only payer representatives from the FPHS Board of Directors. Supplemental PCPs will be paid capitated rates and will be eligible for incentive payments for efficient utilization patterns. Supplemental specialists will be paid on a discounted fee-for-service basis, using the same rates developed for NEPPO members. Since supplemental physicians will not be members of NEPPO, however, they will not share in the profits or losses of NEPPO or FPHS.

Although there is no hospital participant in the FPHS joint venture, since 1993, FPH has had a provider contract with Community Medical Center ("CMC")⁵ under which CMC has agreed that it will not contract to provide hospital services to patients covered by any gatekeeper-type HMO payer other than FPH. In return, FPH has agreed that it will direct its Lackawanna County HMO patients to CMC unless medical necessity demands otherwise, and that CMC will be the tertiary

⁴ If the capitated payment from FPH is insufficient to provide all covered services to FPH enrollees, the NEPPO physicians are contractually bound to provide those services, and through their ownership in NEPPO, to contribute additional capital to fund any FPHS losses.

⁵ CMC is viewed by many payers and consumers as the premier hospital in Scranton.

referral center for all FPH patients in the five-county area. This contract will be transferred to FPHS when it becomes operational.⁶

Antitrust Analysis

The FPHS proposal does not fall under any of the fact patterns analyzed in the joint Department of Justice/Federal Trade Commission *Statements of Antitrust Enforcement Policy in Health Care* (August 1996)(*hereinafter* "Policy Statements"). However, Statement 9 of the Policy Statements, which concerns multiprovider networks, provides a useful general framework for analyzing the proposed joint venture.

Many of the NEPPO physicians as well as the FPHS supplementary physicians are competitors, and we begin our analysis by considering whether the proposed activity should be viewed under the *per se* rule or under the Rule of Reason. Where competitors form network joint ventures, such ventures will be analyzed under the Rule of Reason if the physicians' integration through the network is likely to produce significant efficiencies that benefit consumers and any price agreements (or other agreements that would otherwise be *per se* illegal) by the network physicians are reasonably necessary to realize those efficiencies. As proposed, FPHS is a *bona fide* joint venture in which all its participating owners, including all of the NEPPO physicians, will share substantial financial risk as described in the Policy Statements at pp. 108-110. FPHS will be a capitated venture since payment to it from FPH will be an agreed annual fee for each enrollee pursuant to a premium allocation formula. In addition, as we understand the proposal, all NEPPO physicians, including specialists, will share substantial financial risk as joint venture owners who will share in the profits and losses of the joint venture. Thus, we have analyzed the activities of FPHS under the Rule of Reason.

As we would do with any multiprovider network, we have evaluated the possible competitive effects of FPHS in each of the relevant markets in which it will operate or have substantial impact. In this case we have considered the effect FPHS may have on primary care and specialized physician services and on managed health care plans.

You have identified both Lackawanna County and the five-county area described above as potential relevant geographic markets within which to assess the effects of the proposed joint venture. Based on our experience in other markets and the information available to us about this area, it is likely that the markets for at least some types of physician services are substantially

⁶ The second largest Lackawanna County managed care insurer has an "exclusive" arrangement with the physician hospital organization ("PHO") of Moses Taylor Hospital, also in Scranton. However, Moses Taylor Hospital as a separate entity is free to contract with anyone it chooses, and the physicians belonging to the Moses Taylor PHO are free as individuals to contract with any plan. A third Scranton hospital, Mercy Health System, has no restrictive relationships with any payer, and currently contracts as a provider hospital for the third and fourth largest HMO plans.

We note here that, since FPH's agreement with CMC has been in effect since 1993, we have not analyzed the effect of this agreement on the market for inpatient hospital services. However, we have considered the agreement in our analysis of the joint venture's likely effect on the ability of other managed care plans to develop an adequate panel of gatekeeper PCPs in the Lackawanna County area.

smaller than the five-county area and perhaps smaller than an entire county. However, for purposes of this business review, it is not necessary to reach a determination of the precise geographic market boundary for each type of physician service. From our investigation, we are satisfied that in this case the results of our analysis would be the same under any reasonable geographic market definition.

While for most categories of specialists NEPPO physicians in Lackawanna County (or in the five-county area) constitute no more than 30% of the total, for a few categories of specialists NEPPO significantly exceeds the 30% level.⁷ However, nearly all of these instances involve specialties with few physicians in the area. For example, NEPPO has one of the two neonatal-perinatal specialists in both Lackawanna County and the five-county area, and one of only two pediatric neurologists in the five-county area (and the only one in Lackawanna County). In other instances, pre-existing groups that were not formed for the purposes of this venture account for large percentages of a specialty. For example, NEPPO accounts for five of the six physiatrists in the five-county area and four of four in Lackawanna County, but the four in Lackawanna County are incorporated partners and thus function as a single economic entity.⁸

Our interviews of a substantial number of employers, health plans and providers in the Lackawanna County area revealed little or no concern that the concentration of specialists in NEPPO (or indeed in the current FPH panel made up of both NEPPO and non-NEPPO specialists) would cause anticompetitive effects. We agree that the proposed involvement of physician specialists in the venture is unlikely to create competitive harm if the NEPPO specialists in fact participate in the NEPPO network on a non-exclusive basis. The proposed FPHS specialist panel will be of the same size as the present FPH specialist panel, and we have received no complaints that the operations of NEPPO have caused anticompetitive effects.

In addition to NEPPO specialists, FPH also currently contracts with supplemental specialist (and PCP) physicians, and after its formation, FPHS will continue to do so in the manner you have described in some detail in your letters to us. There appears to be a need in the five-county area for a broader physician panel than could be provided by the NEPPO members alone, and the manner of contracting with the supplemental physicians appears to be designed to ensure a real divergence of economic interest between the supplemental specialist physicians and the NEPPO physician owners.

Of far greater concern is the potential that the exclusivity commitment of the NEPPO PCPs might foreclose gatekeeper-type HMOs from maintaining or forming adequate physician panels to

⁷ Statement 8 of the Policy Statements sets forth a safety zone for a non-exclusive physician network joint venture whose physician participants share substantial financial risk and constitute 30% or less of the physicians in each physician specialty with active hospital staff privileges who practice in the relevant geographic market.

⁸ In this instance, you also contend that physical therapists, PCPs and orthopedic surgeons provide services in competition with physiatrists, and thus that NEPPO's percentage of that specialty overstates its market share. We have made no independent assessment of this claim.

serve enrollees in the area.⁹ In Lackawanna County, the 38 NEPPO PCPs who will be tied exclusively to FPHS represent 30.6%¹⁰ of all available general practitioners, family practitioners and internists.¹¹ FPH currently is the largest gatekeeper plan in the area with about 60% of the lives covered by such plans in Lackawanna County. Three other insurers offer gatekeeper plans in the county and a fourth is actively preparing to enter. In general these insurers have expressed concern that their PCP panels will be too small to allow them to compete effectively without access to the 38 NEPPO PCPs who will be precluded from participating on their panels by the exclusivity provision.¹²

We have explored these concerns in considerable detail, and have encountered some concern among employers in the county that their employees will not be well served if there is a significant reduction in the physician panels of managed care plans that they currently offer or might offer in the future. Clearly, the FPHS exclusivity arrangement with the NEPPO PCPs will create a competitive challenge to these other plans in the market. We are unconvinced, however, that the uncommitted PCPs in the market will be insufficient to staff other plans' panels or that other plans (whether using gatekeepers or other managed care mechanisms) will be unable to respond competitively to the joint venture.¹³

⁹ FPHS will contract with supplemental PCPs on a non-exclusive basis to provide FPH with a sufficient PCP panel. As with supplemental specialists, it appears that the proposed manner of contracting is likely to insure a real divergence of economic interest between the supplemental PCPs and the NEPPO physician owners.

¹⁰ While the proposed venture is not simply a physician network joint venture, it is useful to note that this number exceeds the Policy Statements' Statement 8 safety zone of 20% for exclusive ventures involving physicians in any particular specialty with active hospital staff privileges who practice in the relevant geographic market and who share substantial financial risk. Networks falling outside the safety zones do not necessarily raise substantial antitrust concerns; rather, such networks may be lawful if they are not anticompetitive on balance.

¹¹ General practitioners, family practitioners and internists are often considered to be good substitutes, and that appears to be the situation here. For purposes of this business review, the three practice areas can be viewed as a single physician specialty -- essentially "gatekeeper" physicians as defined by FPH and NEPPO.

¹² All of the rival plans currently contract with some NEPPO PCPs who will withdraw from those panels when FPHS becomes operative.

¹³ It should be noted that our calculation that NEPPO physicians constitute 30.6% of the PCPs in Lackawanna County does not count as available the PCPs employed by health plans or other entities. The second largest managed care plan in the area, for example, currently employs 15 PCPs, who constitute approximately 20% of its PCP panel. We take these employed physicians into account in our analysis in the sense that they might mitigate foreclosure concerns with respect to that payer alone. But they cannot be considered true market participants otherwise because they are not available to other payers as substitutes for the exclusive FPHS PCPs that those payers will lose from their panels.

We understand that most area physicians have privileges, or could easily obtain privileges, at all three Scranton hospitals, and that all of the Scranton hospitals are located within a few blocks of each other. From our investigation, it also appears that employers in the area are willing to consider the merit of plans using any of the hospitals in Scranton and that non-NEPPO PCPs are willing to admit to each of those hospitals. In addition, some of FPH's competitors are considering possible contracts with more than one Scranton hospital, which may assist them in recruiting additional physicians for their panels and enhance their plans' marketability. All of this suggests that the non-exclusive PCPs remaining in the county, which constitute almost 70% of the total available today, will be largely available to contract with the other gatekeeper-model HMOs.¹⁴

In conclusion, on balance we are reluctant to discourage the innovative and potentially procompetitive venture that you have proposed. To the extent that FPHS's implementation may pose a risk of anticompetitive harm, we believe that risk is outweighed by the overall efficiencies that it is likely to achieve.¹⁵ However, the venture involves a novel arrangement between a prominent health plan and a substantial number of providers who have agreed to limit their availability to other payers, which has raised concerns by some area employers and rival plans. Under these circumstances, we emphasize that this Business Review Letter is strictly limited to its facts and is based on our assumption that the proposal will be implemented as described.

In your request letter, you also sought advice concerning the possible future expansion of the physician membership of NEPPO. You have not presented a specific proposal for the expansion, and we cannot predict the market conditions in which FPHS might be operating in the future. However, for the reasons explained in this letter, we caution you that, with the facts as we understand them at this time, expansion of the joint venture's panel of exclusive PCPs could well have anticompetitive foreclosure effects without countervailing efficiency benefits beyond what could be achieved with a smaller panel.

For the reasons explained above, the Department has no present intention of challenging the formation or operation of FPHS. However, should FPHS's activities prove to be anticompetitive in purpose or effect, 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's 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 placed in a file that will be available immediately to the public.

¹⁴ Our concern about competitive harm stemming from possible foreclosure of other gatekeeper-model HMOs in this area is further mitigated, first by the likely competition between gatekeeper-model HMOs and other types of managed care plans that will not be directly affected by the exclusivity provision; and second, by the fact that all of the rival gatekeeper plans in Lackawanna County have considerable experience and market presence in other parts of eastern Pennsylvania.

¹⁵ While overall there appear to be efficiency benefits from the implementation of FPHS, we have given little weight to the efficiency arguments you presented specifically to justify the limited exclusivity commitment of NEPPO PCPs to the venture.

In addition, any supporting data that you have not identified as confidential business information under paragraph 10(c) of the Business Review Procedure also will be made publicly available.

Sincerely,

Joel I. Klein