

December 5, 1995

Melissa J. Fields, Esquire
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201 South Biscayne Boulevard
Miami, FL 33131

Dear Ms. Fields:

This letter responds to your request on behalf of Dermnet, Inc. for a statement, pursuant to the Department of Justice Business Review Procedure, 28 C.F.R. § 50.6, of the Department's present enforcement intentions regarding Dermnet's proposal to form a provider-controlled network of board-certified or board-eligible dermatologists, plastic surgeons, and dermatopathologists to contract with third party payers in Dade, Broward, and Palm Beach counties, Florida. For the reasons set forth below, the Department has no present intention to challenge Dermnet's proposed activities under the antitrust laws.

I. Proposed Operation of the Network

Based on information provided in your original submission, as supplemented by your letters of March 6, 1995, June 12, 1995, July 7, 1995, August 21, 1995, August 28, 1995, September 11, 1995, and September 27, 1995, we understand that Dermnet is organized as a non-profit Florida corporation, and that its members will form a pool of providers whose services will be offered to third party payers in Dade, Broward, and Palm Beach counties. Dermnet's members will be free to participate in other physician networks and to contract individually with managed care organizations. In forming their own provider panels, third party payers contracting with Dermnet will be able to select all or any part of Dermnet's membership pool. At present that pool consists of 130 providers broken down as follows: 100 dermatologists, 19 plastic surgeons, and 11 dermatopathologists.

Dermnet's proposed course of operation involves two separate phases. In the first phase, Dermnet will contract with payers for a short period (anticipated to be the first three to six months of service) only long enough to establish usage trends and develop sufficient numbers of patients to enter the second phase of operation. In this first phase, Dermnet will be compensated using capitated rates,

but with a certain percentage of standard Medicare reimbursement levels guaranteed.¹ In the second phase, Dermnet will contract with payers by accepting fully capitated rates; that is, Dermnet will receive a flat fee per enrollee, per month from each payer, in return for performing all necessary dermatologic procedures for that payer's enrolled members.

You have indicated that Dermnet will establish quality assurance, utilization review and credentialing rules and standards ("QAUR") in order to present a high quality and efficient network to potential payers. The QAUR package will be presented to potential payers as a basis for discussion regarding the types of services to be offered by Dermnet and reasonable capitation rates for such services.

II. Antitrust Analysis

The Department's analysis of physician network joint ventures ("PNJVs") in which the member physicians collectively agree on prices or other significant terms of competition and jointly market their services is discussed in Statement 8 of the Statements of Enforcement Policy and Analytical Principles Relating to Health Care and Antitrust, issued by the Department and the Federal Trade Commission ("the Agencies") on September 27, 1994. That Statement sets forth antitrust safety zones for 1) exclusive PNJVs that comprise 20% or fewer of the physicians in each specialty who practice in the relevant geographic market and share substantial financial risk; or 2) non-exclusive PNJVs that comprise 30% or fewer of the physicians in each specialty who practice in the relevant geographic market and share substantial financial risk.

The Statements recognize that PNJVs falling outside these safety zones are not necessarily anticompetitive. If the physicians in the venture share substantial financial risk or the venture creates a new product producing substantial efficiencies the joint venture will not be deemed *per se* illegal; rather a rule of reason analysis will be utilized to determine the legality of the PNJV. Dermnet qualifies for rule of reason analysis because its members will share substantial financial risk through the venture's capitation payment policy. Although Dermnet would be guaranteed a minimum payment during its initial three to six months of experience with any given payer, the minimum amount guaranteed would be significantly less than usual and customary charges. The risk of receiving only the minimum guaranteed payment would still create substantial incentives among Dermnet's members to control costs and provide services in the most cost effective manner possible. Under a rule of reason

¹ For this initial phase, Dermnet and each payer will agree on a capitation rate. Operations under this rate will be reviewed after 90 days; if, given the number of patients and types of services provided by Dermnet during that period, Dermnet would have earned more revenue had it been paid a percentage (expected to be set in the range of 60% - 80%) of the Medicare fee schedule, the payer will make up the difference between the two payments. A similar assessment will be made for the second 90-day period.

analysis, the likely competitive effects of Dermnet's proposal must be ascertained in the relevant economic markets.

A. Service Market

Dermnet proposes to offer physician services in three separate service markets: dermatologic services, plastic surgery services, and dermatopathologic services. With regard to dermatologic services, health care payers in southern Florida have informed us that they cannot reasonably use other types of doctors to perform those procedures typically provided by board-certified dermatologists. While general and family practitioners typically and routinely treat a number of minor skin ailments, board-certified dermatologists are generally required for more serious problems, such as skin cancer. Payers have told us that their enrollees would not be willing to visit a general surgeon or family practitioner for ailments such as skin cancer, and that therefore their panels must include dermatologists in order to be marketable in southern Florida.

The same is true with regard to plastic surgery services. Payers have told us that the services provided by plastic surgeons are not interchangeable with those provided by other types of doctors, and that patients would not accept a plan that did not offer board-certified plastic surgeons as part of its panel of specialists.

Although some dermatologists and pathologists who are not board-certified in dermatopathology² can reasonably be used to read many skin culture slides, there remains a small but important percentage of cases where payers and providers recognize the need for the services of dermatopathologists, thus leading us to conclude that there is a separate dermatopathology service market. Payers are unanimous, however, in their opinion that dermatopathologists are infrequently required and that one or two can easily service a payer's needs for the entire tri-county area.

B. Geographic Market

While Dermnet contends that the relevant geographic market for all of its proposed operations covers the entire tri-county area, our investigation suggests that relevant geographic markets for both dermatologic and plastic surgery services are no greater than a single county³ and probably somewhat

Dermatopathologists are either dermatologists or pathologists who have been specially trained in the reading and analysis of skin biopsies. Dermatopathology certification is obtained through a one-year training course recognized by the American Board of Dermatology and the American Board of Pathology. Members in the American Society of Dermatopathology are evenly divided between dermatologists and pathologists.

For example, Dermnet's own members rarely admit patients to hospitals outside the county in which they maintain their offices. Thus, of 47 Dermnet providers in Dade County, only 1 has privileges in a

smaller. Health plan officials in southern Florida told us that their plans would not be marketable if their enrollees had to travel substantial distances (in fact, their many elderly enrollees cannot travel very far at all) to see a dermatologist or a plastic surgeon.⁴ They also told us that they must have providers in all three counties in order to reasonably market a plan to area employers.

Geographic markets for the services of dermatopathologists, however, appear to be larger than the tri-county area and, indeed, may be limited only by the delivery capabilities of air express or courier services. The work of dermatopathologists is essentially to read specimen slides, and such slides can be easily transported to distant lab locations. These reference labs can be located at great distances from the office of the physician who has collected the sample. One southern Florida payer, for example, told us that the company often sends slide samples for analysis to the Armed Forces Institute of Pathology in Washington, D.C.. Thus, if local dermatopathologists attempted to raise prices or restrict output, we are told that payers could easily turn to more distant substitutes.

C. Competitive Effects

In the market for dermatology services, Dermnet's panel of physicians comprises 43.5% of all board-certified dermatologists in the tri-county area, and that share does not significantly change if calculated separately for each of the three counties or other reasonably drawn sub-divisions of the tri-county area. While these figures exceed the safety zone of 30% for non-exclusive PNJVs, and thus can not be presumed to be competitively benign, Dermnet's proposed operations are unlikely to result in anticompetitive effects in the tri-county area, for a number of reasons.

First, Dermnet's members already participate in a significant number of health care provider entities that will compete with Dermnet. Currently 27% of Dermnet's enrolled members are also members of a dermatology network managed by a company that organizes specialty networks to contract with managed care organizations. One-third of all Dermnet members also serve on a PPO panel of 154 dermatologists who were signed up individually by one area payer, and overall Dermnet's members serve on at least 13 different HMO panels and at least 18 different PPO panels. Based on the information provided to us, we expect that this pattern of non-exclusive contracting by Dermnet's members will continue after Dermnet becomes operational. This degree of nonexclusive contracting by Dermnet's members, and the existence of numerous provider entities greatly reduces any potential anticompetitive effects that might result from the operation of Dermnet.

hospital outside of Dade County; of 30 in Palm Beach County, only 1 has privileges elsewhere; and of 51 providers in Broward, which is the middle county, only 9, or 18%, have privileges in Dade or Palm Beach Counties.

When asked what travel time was reasonable, one payer mentioned what it believed to be a HCFA standard of no more than 30 minutes or 30 miles; others said that a travel time of 20 minutes was preferable.

Further, our investigation revealed no qualms among area payers about Dermnet's proposed operations. Payers in the area told us that they are accustomed to working with specialty networks, like the convenience of dealing with one network representative, appreciate the cost savings (usually through capitation) and quality control provided by networks, and believe that their ability to contract with dermatologists will not be adversely affected by the creation of Dermnet.⁵

The situation with respect to plastic surgery services does not raise competitive concerns. Among plastic surgeons, Dermnet represents 12.5% of the board-certified physicians in the tri-county area, and in no reasonably drawn market within that area does its membership exceeds 30% of all plastic surgeons. Thus, Dermnet's panel of plastic surgeons, if presented as a free-standing network, would fall within the Statement 8 Safety Zone for non-exclusive PNJVs.

Finally, the proposed dermatopathologist pool does not raise competitive concerns. While eleven of the fifteen dermatopathologists in the tri-county area will be members of Dermnet's eligibility pool, payers can and do use the services of dermatopathologists located significantly beyond the tri-county area. Consequently, payers were not concerned about the number of dermatopathologists from the tri-county area that will participate in Dermnet.

In light of the foregoing, the Department of Justice has no present intention of challenging the proposed operations of Dermnet. The network as outlined will provide payers with an additional choice of dermatologic services, and will allow payers the flexibility of acquiring a tailor-made panel of providers of their choice without the necessity of dealing individually with each physician. In addition, the members of Dermnet will share significant financial risk through capitation contracts, that create incentives to achieve quality control and reduced costs.

We would be concerned, however, if the operation of Dermnet should result in anticompetitive effects in the tri-county area, such as restrictions on the supply of dermatologic services that resulted in higher prices for such services. This might occur, for example, if a significant number of Dermnet's members either unilaterally or collectively refused to deal with payers except through Dermnet. Thus, in accordance with our normal practice, the Department remains free to bring whatever action or proceeding it subsequently comes to believe is required by the public interest, if the proposed network proves to be anticompetitive in purpose or effect.

Payers were pleased that they will be able to contract with Dermnet for less than Dermnet's entire physician panel. Some payers have told us that they currently service the tri-county area with panels of dermatologists that are significantly smaller than the panel offered by Dermnet, and that they would not want to contract with every member of a large network. They plan to conduct their own credentialing of physicians in Dermnet's pool, using only those that they designate. Dermnet's proposal specifically acknowledges this fact, and offers a pool of providers from which payers "may pick and choose." Dermnet's non-exclusivity will allow any of its members who are not signed on by any particular payer to contract elsewhere, either individually or as members of other networks.

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 to the public immediately. 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,

/S/

Anne K. Bingaman
Assistant Attorney General