



DEPARTMENT OF JUSTICE
Antitrust Division

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Randall S. Yavitz, Esquire
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2929 North Central Avenue
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Phoenix, AZ 85012-2742

Dear Mr. Yavitz:

This letter responds to your request, on behalf of Allied Colon and Rectal Specialists ("ACRS"), for the issuance of a business review letter pursuant to the Department of Justice Business Review Procedure, 28 C.F.R. § 50.6, regarding ACRS's proposal to form an independent practice association ("IPA") in Maricopa County, Arizona. For the reasons set forth below, the Department has no present intention of challenging ACRS's proposed activities under the antitrust laws.

Based on the information provided, we understand that ACRS will offer prepaid medical and surgical services on a capitated basis and on a fee-for-service basis (with substantial withhold) to third party payers and self-insured employers. These services will be offered primarily in Maricopa County (which includes the greater Phoenix metropolitan area), and also, throughout the state of Arizona. The association will be organized as an Arizona not-for-profit professional corporation.

ACRS proposes a membership consisting of seven of the ten physicians in Arizona whose practices are dedicated solely to colon and rectal surgical services. Four ACRS members now participate in two, two-person practices. The remaining members are not engaged in group practice. ACRS states that when other surgeons who are qualified and enjoy privileges to perform colon and rectal surgical procedures are taken into account, ACRS physicians will have a combined market share of 15% in Maricopa County and 9% statewide. (Percentages are based on a weighted average of the ten most commonly performed procedures.)

Surgeons participating in ACRS will do so on a non-exclusive basis. ACRS members will be free to contract individually with all other parties, including insurance companies, employers, and other physician network joint ventures. Each ACRS contract with health benefit plans will provide for physician services compensation either in the form of a capitated payment or under a discounted fee-for-service schedule for its member physicians, with a "risk pool" withhold of at least 20% of the fees due each physician. The withhold will be retained by ACRS or by the payers, and will be distributed to the participating physicians only if the panel of doctors as a group meets pre-established efficiency and quality parameters. ACRS plans to develop utilization review/quality assurance standards as well as practice parameters.

ACRS proposes several safeguards designed to address concerns about sharing of price information. Each ACRS participating physician will be expressly prohibited from disclosing to or receiving from any other ACRS physician any information regarding any individual physician's usual and customary or other individual charges, and the charges he or any other participant has agreed to accept under any managed care arrangement. Each ACRS participating physician will also be prohibited from disclosing to or receiving from any other ACRS physician other competitively sensitive information, including but not limited to, information regarding salary or fringe benefits for associates or employees. Furthermore, ACRS will utilize the services of a third party administrator or other consultant to negotiate with purchasers of its health care services, and the administrator or consultant will treat all price and otherwise competitively sensitive information received from the members as proprietary and confidential. Each ACRS member will agree that no member shall have access to any disaggregated information held by the third party administrator or by any accounting, actuarial or other firm providing services to the third party administrator.

Based on the information set forth above, it appears that ACRS will be a bona fide joint venture in which the participating physicians will assume significant financial risk by participating in either capitated contracts or in the fee withhold arrangements described above. See Statements of Antitrust Enforcement Policy and Analytical Principles Relating to Health Care and Antitrust, issued by the Department of Justice and the Federal Trade Commission, Sept. 27, 1994, ("Health Care Antitrust Statements") at p. 70. Thus, we have analyzed ACRS's proposed IPA pursuant to the rule of reason to determine if the proposed network is likely to be anticompetitive.

Rule of Reason Analysis

The rule of reason analysis focuses on whether the proposed network will create, enhance or facilitate the exercise of market power (i.e., the ability to impose supracompetitive prices or to prevent the formation of competing networks). ACRS's network is outside the safety zone of Statement 8 of the Health Care Antitrust Statements since, in Maricopa County (which, discussed below, can be reasonably treated as the appropriate geographic market), ACRS includes more than 30% of the providers in the colon and rectal surgeon physician specialty. However, based on the information available to us at this time, it appears that the proposed network is not likely to be anticompetitive.

As outlined in the Health Care Antitrust Statements, the first step in a rule of reason analysis is to identify the relevant service market and the relevant geographic market in which the IPA's members compete. Our investigation indicates that the appropriate service market appears to be colon and rectal surgical services. The ACRS network appears to be the only one in Arizona specializing in colon and rectal surgical services, and the inclusion of seven of nine dedicated specialists in Maricopa County (and seven of ten statewide) would appear on its face significantly to consolidate colon and rectal surgical services. However, ACRS contends that colon and rectal surgical services are provided by many surgeons other than colon and rectal specialists who limit their practice to these services. These other surgeons include allopathic and osteopathic general surgeons.

Our interviews with third party payers confirm ACRS's contention concerning the ready availability of colon and rectal surgical services through general surgeons and other types of surgeons in Maricopa County. Based on these interviews, it is evident that managed care plans and other payers in this market do not consider it necessary to include dedicated colon and rectal surgical specialists among their providers. Rather, they are able to utilize the services of general surgeons and others who have appropriate experience in performing colon and rectal surgical

procedures. Payers indicated that the experience level of a surgeon with a particular colon and rectal procedure is the crucial factor in the referral of a patient to that physician, rather than whether a physician limits his surgical practice to the colon and rectal specialty. Payers expressed confidence that after ACRS begins operating, they could successfully negotiate contracts and obtain necessary services at competitive rates from individual physicians, or other IPAs and networks. Thus, our investigation leads us to agree that, as ACRS contends, the appropriate service market for purposes of this analysis is broader than the colon and rectal sub-specialty and would include other qualified providers of similar surgical services.

Turning to the geographic market issue, for each relevant service market, the relevant geographic market will include all available physicians who are reasonably good substitutes for physicians participating in the joint venture. ACRS contends that the geographic market is the Maricopa County area, which our investigation confirms is reasonable. Payers told us that health benefit plan subscribers and other users in Maricopa County would generally be willing to travel anywhere within Maricopa County for colon and rectal surgical services. Except in unusual circumstances, they would be significantly less willing to travel outside of Maricopa County for these services. Thus, Maricopa County is a reasonable geographic market for analyzing the proposed IPA.

Competitive Effects

We next determine the share of the relevant market held by the members of the proposed IPA in order properly to evaluate the possible anticompetitive effects. In this case, market share is likely to be understated by calculating the number of individual physicians in the venture as a percentage of all physicians in Maricopa County who perform colon and rectal procedures since the calculation would include surgeons who devote only a portion of their professional practices to colon and rectal services. ACRS suggests that market share should be measured by calculating the number of colon and rectal procedures performed by ACRS physicians expressed as a percentage of all colon and rectal procedures performed by all qualified physicians in Maricopa County. We agree that this is a reasonable approximation of market share in the present case. Calculated on this basis, ACRS physicians will have a combined market share of 15% in Maricopa County. Such a share does not raise substantial antitrust concerns.

The ready availability of substitute providers for ACRS services indicates that ACRS is unlikely to be successful if it seeks to act anticompetitively. Payers have indicated that they would enter into contracts with ACRS only if they found it to be to their advantage in the form of lower costs or more efficient delivery of services. Furthermore, ACRS members will have complete freedom to affiliate with other networks or to contract individually with managed care payers. In addition, ACRS has established safeguards on information flow among ACRS members to protect against possible collusion among members for services provided outside ACRS.

Finally, it appears that the ACRS network may have procompetitive effects. ACRS states that its intent is to improve the efficiency of the marketing and delivery of its services by availing itself of the professional services and expertise of a third-party administrator. The third-party administrator will seek to control costs by tracking clinical outcomes, managing resource utilization, and helping to reduce unnecessary medical services.

Conclusion

For the reasons explained above, the Department has no present intention to challenge ACRS's planned IPA. In accordance with our normal practice, however, the Department remains

free to bring whatever action or proceeding it subsequently comes to believe is required by the public interest if the ACRS network proves to be anticompetitive in purpose or effect.

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 publicly available 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 in 30 days.

Sincerely,

Anne K. Bingaman