



DEPARTMENT OF JUSTICE

Antitrust Division

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Christopher H. Casey, Esquire
116 North Washington Avenue
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Dear Mr. Casey:

This letter responds to your November 7, 1997, request to the Federal Trade Commission for an advisory opinion regarding the proposed merger of The Heritage Alliance ("THA") and Lackawanna Physicians Organization ("LPO"), two independent practice organizations in northeastern Pennsylvania. As you know, by agreement, the FTC forwarded your request to the Department of Justice for consideration under the Department's Business Review Procedure, 28 C.F.R. § 50.6. Based on the information in your November 7, 1997, request and your December 30, 1997, March 27, 1998, and June 3, 1998, letters to the Department, as well as further information supplied by facsimile transmission in July and August 1998, together with information from our interviews of payers knowledgeable about the market, the Department has no present intention to take enforcement action if THA and LPO combine and operate as proposed.

Background

THA was formed in 1996 and currently has 90 primary care physicians ("PCPs"), which THA defines as physicians practicing in the areas of family practice, general practice, internal medicine and pediatrics. Eighty-one of the THA physicians are based in Lackawanna and Luzerne Counties (42¹ and 39² physicians respectively), and the remaining nine have practices in Wayne, Wyoming, Susquehanna, and Monroe Counties. LPO was formed in December 1995

¹ Seven of these are pediatricians; of the remaining 35, nine are employed by Mercy Health System, owner of Mercy Hospital, one of the three major hospitals in Scranton.

² Three of these are pediatricians; of the remaining 36, 22 are employed by Mercy Health System.

and currently has approximately 167 specialty care physicians (“SCPs”) and 23 PCPs,³ all with practices based in Lackawanna County. In November 1997 THA and LPO entered into an agreement to merge and form a new multi-specialty physician network (“the Network”) and a management services organization (“MSO”). The Network will enter into risk contracts with payers to provide physician services; the MSO will negotiate and manage those payer contracts and associated risk pools and will provide utilization and quality management services. After the merger, the Network, in addition to providing physician services, would recruit and credential new physician members and provide continuing education for its physician members. The two groups plan to merge by September 30, 1998.

Through the MSO, the Network will negotiate risk-sharing contracts with payers, providing services with compensation in the form of capitated payments or payments using fee schedules from which at least 15% of the fees would be withheld pending successful accomplishment of efficiency goals. The MSO will also market the Network’s services on behalf of its members and provide medical management services and practice management support. The MSO will have an interim board of seven physicians -- five PCPs and two SCPs. A Contract Committee composed of four physicians will receive contract offers, including proposed fee schedules, from payers and convey those offers to the MSO’s Board of Directors. If the Board accepts an offer, physician members would have ten days to opt out of the contract. If the Board rejects the offer, the Contract Committee would go back to the payer seeking new terms. Eventually the MSO may employ an actuarial firm to develop a fee schedule for various payers based on demographic and market conditions, but in no case would prices charged by individual physicians be solicited or communicated to other physicians, or used to set fees for the network.

The Network will be nonexclusive. The physician members of both THA and LPO will remain free to compete with each other for payer contracts outside of the network.⁴

The Network has agreed that it will limit its membership of pediatricians to no more than 30 percent of the non-employed pediatricians with active admitting privileges in any relevant geographic market, and where percentages of other SCPs are currently less than 30 percent, to limit non-pediatrician SCPs to 30 percent as well. For those specialties in which the group

³ Six of these are pediatricians.

⁴ We understand that you have deleted a provision (section 3.10) in the physician participation agreement submitted with your request that would have required physician members to wait 90 days before negotiating with a payer after opting out of that payer’s contract with the MSO or after that payer stopped negotiating with the MSO. With such contracting restrictions, the Network would be less than non-exclusive, which under the circumstances here might raise serious competitive concerns.

already has more than 30 percent of non-employed physicians with active admitting privileges, the Network will add no additional SCs.

The Network will seek to create significant efficiencies through, among other things, a coordinated management information system, operations management and oversight of clinical performance, outcome and utilization for each payer contract, joint marketing and contracting, and joint purchasing of medical malpractice insurance, office supplies and other necessities. All members of the Network will follow the same clinical guidelines and will utilize the same case management structure, including the same educational programs. A utilization management committee will meet at least monthly to ensure that the network meets cost-containment goals. The Network expects these joint efforts to produce significant cost savings and allow physicians more time and energy to devote to their patients. A Credentialing Committee will also be formed to screen and select only physicians likely to further the efficiency goals of the network for future membership. A \$5 million capitalization plan is envisioned to create the infrastructure needed to accomplish the Network's efficiency goals.

Antitrust Analysis

Where two fully integrated entities propose to merge into a single entity, the Department applies the antitrust analysis set forth in the Horizontal Merger Guidelines issued by the Department and the Federal Trade Commission. However, according to the proposal here, two independent practice organizations composed of independent physician practices are proposing to merge in order to form a new, partially integrated physician network joint venture. In this situation, the antitrust analysis applied to physician network joint ventures is most appropriate. See Statement 8 of the Statements of Antitrust Enforcement Policy in Health Care ("Statements") issued by the Department and the Federal Trade Commission.

As Statement 8 makes clear, physician network joint ventures will be analyzed under the Rule of Reason, and will not be viewed as *per se* illegal, if the physicians' integration through the network is likely to produce significant efficiencies that benefit consumers, and any price agreements by network physicians are reasonably necessary to realize those efficiencies. In this case, the members of the Network propose to share substantial financial risk in providing Network services, and it appears that the establishment of common prices for use in negotiating contracts with managed care plans or other third-party payers is reasonably necessary to achieve the efficiencies anticipated through the proposed network. Thus, we have analyzed the effects of the Network under the rule of reason.

The first step in our rule of reason analysis is to establish relevant product and geographic markets. The Department has found that in general all services provided by each physician specialty can be considered to be a separate relevant product (service) market. However, in this case, as in many markets, it appears that family practitioners, general practitioners, and internists are considered to be good substitutes and can be viewed as participants in a single service

market. For purposes of this business review, we have treated services provided by pediatricians and all other physician specialties as separate service markets.

Next, we determine the relevant geographic market or markets in which to analyze the proposed venture. For each relevant service market, the relevant geographic market will include all physicians who are good substitutes for the physician participants in the joint venture. For purposes of this business review, we have treated Lackawanna County as the relevant geographic market in which to assess the effects of the Network.⁵

In Lackawanna County, it appears that there are currently 98 physicians who practice in the areas of family practice, general practice, and internal medicine, and who are not employed by hospitals or payers. The Network would account for 38⁶ non-employed physicians in these practice areas, or approximately 39 percent of the total available in the county. In the area of pediatrics, the Network would account for eight⁷ of 29 Lackawanna County practitioners, or approximately 28 percent. These percentages are not likely to cause substantial adverse competitive effects in this market. However, if the Network's percentage of PCPs in Lackawanna County were to increase, our assessment of possible anticompetitive effects might change.

All of the other members of the Network in Lackawanna County are specialists who have been participating in the market as members of LPO. Thus, the formation of the Network will not result in any increase in the concentration levels for specialists beyond what they have been in LPO.

Nevertheless, we note that in eight of the 27 medical specialties represented in the Network, Network members will account for more than 50 percent of the physicians in Lackawanna County with admitting privileges in those specialties. Although these high concentrations of specialists raise concerns that the Network might be able to exercise market power causing competitive harm, it appears this has not occurred with these same physician concentrations in LPO. In general, the payers we interviewed supported formation of the

⁵ The Network's proposed operations in other counties do not raise substantial antitrust concerns, and we have not found it necessary to discuss our competitive assessment of the Network in those areas. Since members of LPO practice only in Lackawanna County, the joint venture physicians practicing in surrounding counties will be the same physicians who already are members of THA.

⁶ Excluding pediatricians, there are 26 independent THA PCPs and 17 LPO PCPs in Lackawanna County. Of these 43, five are members of both groups, resulting in a total of 38.

⁷ There are a total of 13 names on the pediatric rosters of THA and LPO; however, five of these are members of both groups.

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Network and did not believe anticompetitive effects were likely. Some payers believe the Network will provide significant competition to another physician network joint venture that is already operating in Lackawanna and surrounding counties.

Under the circumstances here, the Department has no present intention to challenge the formation of the Network if it operates nonexclusively and as proposed. The Network's operations may lead, as the Network members expect, to more efficient provision of health care services to the benefit of consumers in the area.

In accord with our normal practice, the Department remains free to bring whatever action or proceeding it subsequently concludes is required by the public interest if the actual operation of the Network proves anticompetitive in purpose or effect.

This statement of the Department's enforcement intentions is made in accordance with the Department'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 made available to the public immediately. Your supporting documents will be publicly available within 30 days of the date of this letter, unless you request that any part of the material be withheld in accordance with Paragraph 10(c) of the Business Review Procedure.

Sincerely,

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Joel I. Klein