BUREAU OF COMPETITION

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

June 27, 1989

Robert P. Macina, Esq.
Greenberg, Traurig, Hoffman, Lipoff, Rosen & Quentel, P.A.
1221 Brickell Ave.
Miami, Florida 33131

Dear Mr. Macina:

This letter responds to your request on behalf of Pan American Management Associates, Ltd. for a staff advisory opinion concerning the legality under the laws enforced by the Federal Trade Commission of a proposal to establish a preferred provider organization.

According to the information contained in your letter, Pan American Management Associates, Ltd. ("PAMA") is a limited partnership organized under the laws of Florida. PAMA's general partner is Pan American Community Health Services, Inc. ("CHS"), a for-profit corporation wholly owned by Pan American Hospital Foundation, Inc. The Foundation is a not-for-profit Florida corporation whose primary function is to provide financial and other support for the operation of Pan American Hospital ("the Hospital"), a 146-bed nonprofit acute care hospital located in Dade County, Florida. PAMA has 61 limited partners who are physicians on the medical staff of the Hospital. The limited partners have each invested $ 10,000 in PAMA and together they have an 80% interest in the partnership. CHS, the general partner, owns the remaining 20% interest in the partnership.

PAMA and the Hospital are located in Dade County, Florida. There are approximately 31 acute care hospitals located in the county with a total of more that 9500 beds. The Hospital has approximately 1 1/2 per cent of the acute care beds in the county. In addition, there are a variety of specialized hospitals operating in the area, including psychiatric hospitals, rehabilitation hospitals, and substance abuse treatment centers. There are more than 6,800 licensed physicians in the county.

PAMA currently has a contract to provide management services to the Hospital. In addition, it proposes to establish and operate a "combined provider unit" ("CPU"), a business venture similar to a preferred provider organization ("PPO"). The CPU will be comprised of the Hospital and some of its physician staff members and will provide health care services to managed health care plans, including health

maintenance organizations, PPOs, insurance companies, and third-party administrators, with which PAMA contracts.

PAMA will solicit physicians who are members of the medical staff of the Hospital to contract with the CPU. The initial solicitation will be of the 61 limited partners. Other physicians will then be invited to contract with the CPU, with the expectation that between 100 and 200 physicians will enroll.

PAMA will then contract to provide health care services to employees and other individuals covered by managed health care plans. PAMA intends to negotiate contracts with individual health care plans that will specify, among other things, the price of the medical services to be provided by the CPU's participating physicians and the Hospital. Contracting health care plans will pay the providers the lesser of their customary charge or the negotiated rate. Some contracts may provide for payment on a capitated basis. PAMA will not have the authority to contract on behalf of providers; rather, it will present the negotiated agreements to the individual providers, who will decide independently whether or not to participate in each contract. PAMA will also provide administrative services, including utilization review and quality assurance services, to contracting plans.

Managed health care plans with which PAMA contracts will provide financial incentives for individuals covered by the plans to use the services of the CPU's participating providers. Covered individuals will be free to obtain services from non-contracting providers, but they may incur additional out-of-pocket expenses if they do so.

Participating physicians as a group will have no role in the negotiations between PAMA and the contracting plans. The Agreement of Limited Partnership states that the limited partners, the 61 physicians who have invested in PAMA, will not participate in or control the partnership's business. Management of PAMA is vested in the general partner, CHS, which is owned by the Hospital Foundation. Two of the four members of CHS's Board of Directors are physicians, of whom one is a limited partner in PAMA. Both of its officers are also physicians, and one of them is a limited partner in PAMA. The negotiation of contracts with managed care plans will be conducted by PAMA's Chief Operating Officer and its Chief Financial Officer, neither of whom is a physician.

Prices negotiated by PAMA will not affect what providers charge patients who are not members of contracting plans. Providers will be free to participate in other health

maintenance organizations, PPOs, or other managed care plans, except for plans that provide services to members of plans with which PAMA has a contract.

Based on the information you have provided, which is summarized above, it does not appear that the establishment and operation by PAMA of the proposed "combined provider unit" would violate any law enforced by the Commission. In general, preferred provider organizations have the potential to benefit consumers of health care services by organizing providers into identifiable groups that can compete with one another and with other providers on the basis of price, quality and service.[1] PPOs that are organized or controlled by health care providers raise several potential antitrust issues. The most important of these are whether operation of the PPO (1) involves suspect agreements among horizontal competitors or (2) establishes barriers to entry by other PPOs or similar entities. It does not appear that the proposed PPO would endanger competition in either of these ways.

First, as you have described the proposed operation of the PPO, it does not appear that it necessarily would involve any agreements among horizontal competitors concerning the prices to be charged for their services.

Management of the PPO, including negotiation of prices, is the prerogative of the general partner, CHS, which is closely affiliated with the Hospital. Even if the Hospital is able to exercise control over the PPO, this would not raise antitrust issues because the Hospital is the only provider of hospital services included in the PPO. Therefore, negotiation of prices will not involve price-related agreements among competing hospitals.

Operation of the PPO does not appear to involve agreements among competing physicians either. According to your letter, the physician limited partners as a group have no role in the management of PAMA, and will not be involved in price negotiations. The participating providers likewise

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[1] In an advisory opinion issued to Health Care Management Associates, the Commission analyzed a proposed preferred provider organization that was organized by an intermediary that was not a health care provider. It stated that the PPO's operation would not violate the antitrust laws and, on the contrary, was likely to be procompetitive. Letter from Emily H. Rock, Secretary, to Irwin S. Smith, M.D., 101 F.T.C. 1014 (1983).

are not involved either in managing the PPO or in price negotiations. The prices agreed upon between PAMA and purchasers of health care services will be submitted to the individual physicians, who will decide independently whether to participate in each contract. There is no agreement among the providers to accept particular prices, and there are no agreements concerning prices to be charged to patients not covered by PAMA contracts.

Antitrust issues would be raised by any agreements among the PPO's participating physicians as to the prices they would accept from third party payers contracting with the PPO or the prices they charge to other patients, or by an agreement to deal with third parties only through PAMA. Such agreements are not inherent in the operation of the PPO as its has been proposed. However, the physician participating providers and the management of the CPU should be aware that antitrust issues would arise if PAMA became a vehicle for collective negotiation between the participating physicians and third party payors.

According to your submission, four individuals who are physicians, two of whom are also limited partners in PAMA, are officers or directors of CHS, PAMA's general partner. While your letter states that these individuals will not directly participate in the negotiation of contracts between PAMA and managed care plans, it is possible that they could be able to direct or influence PAMA's activities, including contract negotiations. However, the presence of individual providers in the management structure of a PPO does not necessarily mean that the actions of the entity are considered to be the product of a horizontal agreement. As long as the physician managers are not responsible to, or otherwise acting on behalf of, a group of competing physicians, CHS would not be considered to be an organization controlled by competitors. Accordingly, PAMA's price negotiations would not appear necessarily to involve any agreements among competing physicians. However, horizontal price agreements could well be found to exist if the physicians acted as agents for the participating physicians and did influence the negotiations between PAMA and third parties.

For the reasons stated above, it appears that the proposed PPO can be operated in a way that would avoid horizontal agreements with respect to the prices of health care services, and that it is the PPO's intention to do so. Therefore, it is not necessary to consider whether any such price agreements could be considered legitimate ancillary aspects of the PPO's operation.

A second area of concern with respect to provider-sponsored PPOs relates to the effect of the PPO on possible market entry by other competing organizations of providers. A PPO could impede the development of other similar organizations if it included a large proportion of the providers in a market and those providers would not or could not participate in other plans. This could be the case if the PPO were organized in order to prevent the formation of competing plans and most local providers refused to participate in any other plan, or if the plan had a large proportion of local physicians and was able to require participating providers to affiliate only with it. In this case, the proposed PPO would have such a small share of the hospital and physician markets that there appears to be no possibility that its operation would impede entry by other PPOs.

For the reasons discussed above, it does not appear that the operation by PAMA of the proposed combined provider unit would violate any law enforced by the Federal Trade Commission. This office retains the right to reconsider the questions involved and, with notice to the requesting party, to rescind or revoke its opinion if implementation of the proposed program results in substantial anticompetitive effects, if the program is used for improper purposes, or if it would be in the public interest to do so. The above legal advice is that of staff of the Bureau of Competition only. Under the Commission's Rules of Practice § 1.3(c), the Commission is not bound by this advice and reserves the right to rescind it at a later time and take such action as the public interest may require.

Sincerely,

Michael D. McNeely
Acting Assistant Director