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Bureau of Competition
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

April 26, 1984

Larry D. Spencer
Executive Director
Peer Review Organizations of Ohio Foundation
1624 Tiffin Avenue, Suite One
Findlay, Ohio 45839

Advisory Opinion No. 84-0003

Dear Mr. Spencer:

This letter responds to the request of Robert P. Stone, Ph.D., former acting executive director of Peer Review Organizations of Ohio Foundation ("PROOF"), for an informal FTC staff advisory opinion concerning the legality under the antitrust laws of the formation of PROOF and its plans to bid for a contract with the U.S. Department of Health and Human Services ("HHS") to serve as the Peer Review Organization ("PRO") for Ohio under the Medicare program. I apologize for the delay in our response. Although we do not have enough information to provide a definitive response to PROOF's request, we can provide some general guidance on the applicable legal principles, which I hope you will find useful.

It is our understanding that PROOF is a non-profit corporation formed by Ohio's nine existing Professional Standards Review Organizations ("PSROs") in order to establish an organization eligible to serve as a PRO. PROOF's formation was prompted by Federal legislation establishing a new system for peer review under the Medicare program.[1] That legislation, among other things, replaces the prior system of PSROs, which generally performed Medicare peer review within local or regional areas, with PROs, which will generally be responsible for Medicare peer review for an entire state.[2] PROOF (as well as the state medical society, in all likelihood, and perhaps other organizations) intends to bid for the PRO contract for Ohio. HHS is expected to

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1 Peer Review Improvement Act of 1982, Pub. L. 97-248, sec. 141 et seq., 96 Stat. 324, 381 (1982) (to be codified at 42 U.S.C. §§ 1320c to 1320c-12 and other scattered sections of 42 U.S.C.). "Peer review" under the Medicare program is the review by physicians of the health care services provided by physicians, other health care practitioners, and institutions such as hospitals, to ensure that services for which Medicare provides complete or partial reimbursement are medically necessary, meet professional quality standards, and are provided in an efficient and economical manner. Such peer review sometimes results in the complete or partial denial of a claim for Medicare payments submitted by a practitioner or institution.

2 HHS has decided to contract with only one PRO for the entire state of Ohio. 49 Fed. Reg. 7209 (February 27, 1984).

award the PRO contract for Ohio by July 1, 1984, so that the contractor can begin operations as a PRO by October 1, 1984. PRO contracts will have a term of two years, and may be renewed at their expiration.

Should PROOF become the PRO for Ohio, it expects to subcontract (at least initially) with Ohio's nine existing PSROs for the performance of Medicare peer review in their respective regional service areas. PROOF will also arrange (through subcontract or otherwise) for Medicare peer review to be performed in areas not within the service area of any existing PSRO. PROOF will remain responsible for ensuring that Medicare peer review in Ohio, whether conducted by itself or by subcontractors, is conducted in accordance with Federal statutory and regulatory standards, and with standards established in PROOF's contract with HHS.

Should PROOF not be selected as the PRO for Ohio, the PSROs that formed PROOF will be free to perform peer review under subcontract for the organization awarded the PRO contract. Furthermore, PSROs or groups of PSROs participating in PROOF are not prohibited from submitting additional bids for the Ohio PRO contract in competition with PROOF.

To assess whether significant antitrust risks exist with regard to PROOF's planned activities, we first considered whether PROOF's formation and proposed conduct are impliedly exempt from the Federal antitrust laws.[3] Our analysis indicates that they probably are not. The United States Supreme Court stated in National Gerimedical Hospital & Gerontology Center v. Blue Cross of Kansas City, 452 U.S. 378, 388-89 (1981), that implied repeal of the antitrust laws "is not favored, and can be justified only by a convincing showing of clear repugnancy between the antitrust laws" and a subsequently enacted statutory scheme. Moreover, such implied repeal is to be recognized only "to the minimum extent necessary" to make the subsequently enacted statutory scheme work. We are unaware of any clear indication in the legislative history of the statutes providing for Medicare peer review that Congress intended to exempt from antitrust immunity ventures such as PROOF. Nor do we believe application of the antitrust laws to conduct like that proposed by PROOF would interfere with implementation of the statutory scheme for Medicare peer review as Congress intended.[4]

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3 The statutes governing Medicare peer review do not provide for an express antitrust exemption.

4 We also believe it is very likely that the interstate commerce jurisdictional requirements of the relevant Federal (Continued)

Applicability of the antitrust laws to PROOF's conduct does not mean, of course, that it is illegal under those laws. The courts recognize that "joint ventures," such as PROOF, often enhance competition by creating new products or services, or increasing the quantity or improving the quality of existing products or services. Accordingly, joint ventures are permitted by the antitrust laws in most circumstances. When such joint ventures appear to raise competitive concerns, the essential features of the venture are judged under the "rule of reason," under which the potential anticompetitive effects of a joint venture, or a particular aspect of it, place the joint venture in violation of the antitrust laws only if those effects are not justified by offsetting procompetitive benefits.[5] A joint venture ordinarily will be judged to have violated the antitrust laws only after a careful consideration of its effects on competition.

The antitrust question raised by PROOF's formation and proposed conduct is whether the PROOF joint venture may unreasonably restrain trade by preventing or avoiding competition that would otherwise have existed between or among the PSROs that founded PROOF, or small groups thereof, for designation as the PRO for Ohio, without providing offsetting procompetitive benefits. The statutory scheme for Medicare peer review contemplates that there should be competition for PRO designation where feasible, and that such competition would result in more effective Medicare peer review.

Recent merger and joint venture cases involving the "potential competition" doctrine, though not perfectly analogous, provide useful guidance on this question.[6] Those cases indicate

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antitrust statutes would be satisfied in this situation. We express no view as to whether, or how, Ohio's antitrust statutes would also apply to PROOF's formation and activities.

5 Some anticompetitive activities carried out in connection with joint ventures that are not reasonably related to their effective functioning (e.g., price fixing or division of markets as to non-venture sales or purchases) may be appropriately condemned as "per se" illegal (i.e., judged illegal without detailed analysis of their competitive effects), or at least are suspect and unlikely to survive scrutiny under the rule of reason.

6 See Tenneco, Inc., 98 F.T.C. 464, 577-624 (1981), vacated, 689 F.2d 346 (2d Cir. 1982); Heublein, Inc., 96 F.T.C. 385, 583-592 (1980); Brunswick Corp., 94 F.T.C. 1174, 1265-74 (1980), aff'd as modified sub nom. Yamaha Motor Co. v.

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that a plaintiff in an antitrust suit against PROOF, based on the possible loss of "potential competition" for PRO designation among Ohio's PSROs, would have to demonstrate that: 1) two or more Ohio PSROs, or groups of PSROs, each have the interest, incentive, and capability to compete effectively for PRO designation, so that at least two would likely compete independently for PRO designation in Ohio absent the PROOF joint venture; 2) the likely effect of the PROOF joint venture is to eliminate such independent efforts, or make them unlikely or less vigorous; and 3) this adverse effect on such potential independent efforts is competitively significant because few other organizations are capable of effectively competing for PRO designation in Ohio, so the competition for PRO designation would be less likely to produce bids as attractive to the Federal Government as those that would have been submitted absent the PROOF venture.

It is unclear to us whether or not some of Ohio's PSROs are capable of, or would be interested in, competing effectively on an independent basis for PRO designation. Some of Ohio's larger PSROs, by affiliating with smaller PSROs and/or by recruiting new physician members from outside their local areas, could conceivably increase their memberships to meet HHS requirements for designation as "physician-sponsored" organizations, which

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Federal Trade Comm'n, 657 F.2d 971 (8th Cir. 1981), cert. denied, 456 U.S. 915 (1982). The "potential competition" doctrine has been discussed (but not necessarily endorsed) by the Supreme Court in several merger cases brought under Section 7 of the Clayton Act, 15 U.S.C. § 18 (1976 & Supp. V 1981). See United States v. Marine Bancorporation, 418 U.S. 602, 623-41 (1974); United States v. Falstaff Brewing Corp., 410 U.S. 526, 531-37 (1973); United States v. Penn-Olin Chem. Co., 378 U.S. 158, 168-177 (1964). We believe the standards established in these cases are relevant even if only Sections 1 and 2 of the Sherman Act, and not Section 7 of the Clayton Act, were applicable to PROOF's proposed conduct.

7. A "physician-sponsored" PRO must be "composed of a substantial number of licensed doctors . . . engaged in the practice of medicine or surgery in the area" served by the PRO, and that those doctors be "representative of the practicing physicians in the area." 42 U.S.C.A. § 1320c-1(1)(A) (West 1983); 49 Fed. Reg. 7202, 7207 (Feb. 27, 1984). HHS regulations define "substantial number" as at least 10 percent of the area's physicians, and would not require organizations with memberships of at least 20 percent of the area's physicians to prove that they are "representative." 49 Fed. Reg. 7202, 7207 (Feb. 27, 1984). Ohio's two largest

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enjoy first priority for selection as a PRO.[8] They might well also be able to meet HHS requirements for "physician-access" organizations, the other class of organizations eligible for PRO designation.[9] However, it is possible that those PSROs would have difficulty administering a statewide peer review program, or would not be interested in doing so even if they could.[10]

We also cannot determine definitively whether the PROOF joint venture would likely eliminate whatever potential there may be for independent competitive efforts by Ohio's PSROs to seek PRO designation. While there is no formal prohibition on such efforts, foreclosure of such independent efforts may occur in other ways, such as by dulling the incentives of individual PSROs to initiate such efforts, or by a tacit understanding among them that PROOF will be the sole mechanism through which they collectively or individually will seek PRO designation.

Should any such foreclosure occur, it could have a significant effect on competition for the PRO contract for Ohio. Although it appears that a large number of organizations theoretically may be eligible to become the PRO for Ohio, the governing statutes give "physician-sponsored" organizations, such as PROOF and the state medical society, priority over others, and place "payor organizations" such as Blue Cross, Blue Shield, and commercial insurance companies at a significant disadvantage compared to non-payor organizations.[11] The statutory priority system may effectively insulate PROOF from competition from non-"physician-sponsored" organizations, leaving it with few effective competitors. But even if PROOF's formation and operation results in a reduction in the number of organizations seeking PRO designation, this would not necessarily result in

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PSROs each have only about 7 percent of Ohio's physicians as members.

8 The importance of this priority is discussed infra p. 5.

9 See 42 U.S.C.A. § 1320c-1(1)(B) (West 1983); 49 Fed. Reg. 7202, 7207 (Feb. 27, 1984).

10 You have informed us that prior to PROOF's formation, none of Ohio's PSROs showed interest in seeking PRO designation, and that they felt they were not capable of assuming PRO functions on their own.

11 See 42 U.S.C.A. §§ 1320c-1(1)(A), 1320c-2(b) (West 1983). HHS intends to evaluate proposals submitted by organizations competing for PRO designation on a 1500-point scale, with proposals of "physician-sponsored" organizations awarded 100 bonus points.

antitrust liability. Although a substantial lessening of competition might be inferred from a substantial reduction in the number of competitors (such as from three or four to two), PROOF could seek to show that the vigor and effectiveness of the competitive process would not be adversely affected.

In summary, whether or not PROOF's formation and proposed conduct will unreasonably restrain competition for the PRO contract for Ohio involves several factual questions for which the answers are not apparent, given the information currently available to us. As we have indicated, any challenge to PROOF's operation would require substantial evidence on each of a number of critical elements. Only if all were present would a violation be found.

The discussion above is limited to PROOF's formation and proposed conduct as to Medicare peer review. Any determination of the legality of PROOF's formation and proposed conduct as to Medicare peer review would not necessarily apply to any activities related to non-Medicare peer review that PROOF may wish to engage in.[12]

We have set forth above what we consider to be the potential antitrust risks involved in PROOF's plan to seek designation as the PRO for Ohio. The significance of those risks depends on factual questions that we could fully resolve, if at all, only after extended inquiry. The information we now have does not give us strong reason to believe that PROOF's formation, or its plan to seek designation as the PRO for Ohio, would be illegal under the Federal antitrust laws. We hope that the preceding discussion will help PROOF determine whether and how it can implement its plans to seek PRO designation, and operate as the PRO for Ohio if selected, in compliance with the antitrust laws.

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12 In particular, PROOF should take precautions to avoid promotion of, or involvement in, agreements among the PSROs that founded PROOF that unreasonably restrain whatever competition there may be, or may develop in the future, among those PSROs to perform non-Medicare peer review.

This letter reflects informal staff guidance. The staff reserves the right to reconsider this opinion and, with notice to the requesting party, to rescind this opinion if the public interest so requires. In addition, under Section 1.3(c) of the Commission's Rules of Practice, the Commission is neither bound by this advice nor foreclosed from taking action regarding the conduct in question.

Sincerely yours,

Arthur N. Lerner

Arthur N. Lerner
Assistant Director