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December 2, 2004

By Hand Delivery

Donald S. Clark
Secretary
Federal Trade Commission
Office of the Secretary of the Commission
Room 159
600 Pennsylvania Ave., NW
Washington DC 20580

Re: *In the Matter of California Pacific Medical Group, Inc.*, FTC Docket No. 9306

Dear Mr. Clark:

In accordance with Paragraph IV(A) of the Consent Order in the above-referenced matter, I am writing to notify you that Brown & Toland intends to contact payers to negotiate contracts on behalf of network physicians with regard to Brown & Toland's PPO product. Enclosed are three detailed descriptions of Brown & Toland's PPO product: (1) the "PPO Submission," which was provided to FTC Staff on June 17, 2004; (2) the "Follow-Up Submission," which was provided to FTC Staff on October 7, 2004; and (3) the "Second Follow-Up Submission," which is being provided to FTC Staff contemporaneously with this notification letter.

Please note that Brown & Toland is designating this notification letter (including the exhibit to this letter) as well as the three descriptions of Brown & Toland's PPO product referenced above (including the exhibits to the documents) as confidential under Section 6(f) of the FTC Act. Brown & Toland may, at some point in the future, withdraw the confidentiality designation as to some or all of these documents. I will notify you of any such change to the confidentiality designation of the documents.

Set forth below is additional information concerning Brown & Toland required by Paragraph IV(B) of the Consent Order.

1. *For each physician participant, the name, address, telephone number, medical specialty, medical practice group, if applicable, and the name of each hospital where he or she has privileges.*

Exhibit 1 to this letter includes, for each physician participant in Brown & Toland's PPO network, the name, address, telephone number, medical specialty, medical

practice group (if applicable), and the name of each hospital where he or she has privileges.

2. *A description of the Arrangement and its purpose, function, and geographic area of operation.*

Brown & Toland's PPO product is designed to provide to consumers and payers in the San Francisco Bay area a clinically-integrated product that will reduce costs and improve quality. The PPO Submission, Follow-Up Submission, and Second Follow-Up Submission describe in detail the PPO product, including the product's clinical programs and the function of these programs.

3. *A description of the nature and extent of the integration and the efficiencies resulting from the Arrangement.*

The PPO Submission, Follow-Up Submission, and Second Follow-Up Submission describe in detail the nature and extent of Brown & Toland's PPO product integration and the efficiencies stemming from this integration.

4. *If the Arrangement in any way restricts the ability, or facilitates the refusal, of physicians who participate in it to deal with payers on an individual basis or through any other arrangement, an explanation of the relationship of that restriction or facilitation to the efficiencies resulting from the Arrangement.*

Physicians participating in Brown & Toland's PPO network remain free to contract with PPOs independent of Brown & Toland, with one limited exception: When Brown & Toland executes (on behalf of its network physicians) a contract with a payer, network physicians may be required to terminate individual contracts with the same payer in order to avoid the administratively unworkable circumstance whereby a physician is providing the same service for the same payer pursuant to two different contracts.

5. *An explanation of how any agreement on prices (or on contract terms related to price) furthers the integration and achieves the efficiencies of the Arrangement.*

For at least two reasons, joint negotiation of payer contracts on behalf of Brown & Toland's PPO network physicians is necessary to ensure the overall implementation and delivery of Brown & Toland's PPO product, including the product's integration and efficiencies.

First, Brown & Toland's joint negotiation of PPO contracts will ensure that enough physicians, across multiple specialties, participate in the network to offer a viable, clinically-integrated product to payers. Brown & Toland's PPO integration enables the group to offer payers benefits of integration – such as identifying and correcting outliers through utilization review – with its PPO business that typically arise

only in an HMO setting.[1] These benefits can be realized only by spending significant time and resources to develop, implement, and deliver the integrated PPO product. Ultimately, Brown & Toland's PPO network physicians are responsible for the time and resources this integrated PPO product requires.[2]

Like all rational actors, physicians expect to benefit from their time and resource investment in Brown & Toland's PPO product. The primary benefit of their participation in this product is delegating at least some PPO contracting to Brown & Toland. This saves the physicians the time and hassle of negotiating contracts with payers that choose to contract with Brown & Toland.[3] It also reflects, candidly, a recognition that contract terms are likely to be better when negotiated by an integrated group as opposed to being negotiated individually. Even if such negotiations result in higher prices for some physician services, it does not necessarily follow that the overall costs of care incurred by payers will increase. Rather, such a result reflects an understanding that payers are more likely to improve contract terms (including price) if they can otherwise reduce costs and enhance quality by (a) improving efficiency and quality through utilization review, credentialing, quality assurance, etc. and (b) saving transaction costs by negotiating and entering one contract for a physician network rather than hundreds of individual contracts.

Absent the ability to jointly negotiate contracts, the physicians will realize literally no benefits from participating in Brown & Toland's PPO network while at the same time incurring significant costs for this very participation. The physicians, then, will have every incentive *not* to participate in the network. This is especially true considering that PPO payers typically reimburse physicians on a fee-for-service basis and that Brown & Toland's clinical integration is designed, at least in part, to rationalize care. Against this backdrop, precluding joint negotiation of PPO contracts would be tantamount to precluding Brown & Toland from offering a PPO product altogether.

Second, because Brown & Toland will offer to payers a single, comprehensive, and integrated PPO physician network (arguably unlike any other in the market), the network deserves to be priced in the aggregate, not through individual contracts with

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[1] Pages 1-2 of the PPO Submission discuss some of the costs associated with Brown & Toland's PPO product.

[2] Physicians ultimately bear the cost of the integration and delivery of Brown & Toland's PPO product in one of two ways: (a) any investment made by Brown & Toland reduces funds allocated to its physicians; or (b) being charged a fee directly by Brown & Toland.

[3] Of course, if payers do not want to contract with Brown & Toland with regard to its PPO product, they can contract individually with physicians to participate in a PPO network.

physicians. Just like its HMO business, Brown & Toland is seeking to deliver a PPO product that is distinct from and superior to competing PPO products: no other physician group in Northern California can offer a product that achieves a level of integration anywhere close to Brown & Toland's. The procompetitive benefits of this product (high quality, low cost) will be achieved only through rigorous analysis by Brown & Toland employees of the network physicians' delivery of care. These employees will negotiate PPO contracts, as they will be the most familiar with the benefits stemming from Brown & Toland's integration. These benefits, of course, have value. And this value should be reflected, at least in part, in the terms of PPO contracts. Because Brown & Toland employees are in the best position to know the market value of the PPO product, they are in the best position to negotiate contract terms that reflect this value.

An argument can always be made that, if the PPO product is indeed superior to competing products, then payers will price the product at a competitive level irrespective of whether contracts are negotiated individually by physicians or in the aggregate by Brown & Toland. But this argument ignores the realities of contract negotiations. These negotiations involve a process of give and take: they involve an initial offer, counter offers, discussion of terms, justification of positions, etc. Each side seeks to advance its own position. Payers will obviously know the value they attribute to Brown & Toland's PPO product; Brown & Toland employees who are responsible for analyzing the network physicians' delivery of care will likewise be in the best position to place a value on the network's services from Brown & Toland's perspective.

Individual physicians, however, who have neither the time nor expertise to assess the aggregate value of a product in which they individually participate, are not in a position to negotiate competitive terms with payers. Payers would have an inherent advantage in any such negotiations, which – as rational actors themselves – they would certainly exploit. While it is always possible, in theory, that any one physician may spend the significant time necessary to assess the aggregate value of Brown & Toland's PPO product, it is a certainty that almost all of the network physicians would not, as they are already stretched and often find it difficult to find enough time to perform their clinical services and manage their medical practices in any event. As a consequence, requiring these physicians to negotiate contracts for the integrated PPO network would result, in all likelihood, in the PPO product being undervalued in the market. This, of course, would threaten the viability of the product altogether.

Moreover, in our view, it is precisely because of these market realities that the agencies and courts apply a "reasonably necessary" standard in assessing ancillarity, as opposed to requiring a much stricter standard such as "absolute necessity." When the sum of a network is greater than its parts, it makes no sense to require that the network be priced on a part-by-part basis. This would create disincentives for participation in the network and risk eliminating the procompetitive efficiencies attendant to the network's

product offering. Such a result would be contrary to a number of court decisions[4] as well as the Charlestown IPA example from Statement 8 of the Health Care Guidelines.

In addition, Brown & Toland's PPO product compares favorably to the integration described in the FTC's MedSouth Advisory Opinion.[6] In connection with its PPO product, for instance, Brown & Toland will conduct utilization review; MedSouth does not have this capability. Compared to MedSouth, this presumably enables Brown & Toland to more easily identify and discipline each physician whose delivery of care is inefficient. And considering that Brown & Toland and MedSouth share a fundamental rationale for joint negotiation – physician network participation – it seems that joint negotiation of contracts, if ancillary in MedSouth, should be ancillary here. Moreover, there can be no question that the starting point for Brown & Toland's integrated PPO network—a well-established, efficiently operated HMO network (in existence since 1993) —far exceeds the existing integrative efficiencies from which MedSouth launched its PPO network.

Finally, we note that the Initial Decision in North Texas Specialty Physicians ("NTSP"), FTC Docket No. 9312, November 15, 2004 found that NTSP was not clinically integrated for care provided under non-risk contracts because:

> NTSP does not: engage in case management; provide feedback to physicians concerning patient care; require adherence to its clinical guidelines and protocols; operate or refer patients to any disease management programs or patient registries; or engage in meaningful patient education. F. 365, 370, 372-3, 375. NTSP's medical director has no responsibility for controlling costs for patients under NTSP's non-risk contracts and NTSP's medical management committee does not evaluate the care of patients under NTSP's non-risk contracts. F. 366-67. NTSP's hospital utilization management program does not apply to patients under NTSP's non-risk contracts and NTSP's information systems do not include data for patients under NTSP's non-risk contracts. F. 368-69. Initial Decision at 83.

As demonstrated by the materials accompanying this notification, each of the indicia of clinical integration found to be absent in NTSP is present in Brown & Toland's PPO product.

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[4] See e.g., Rothery Storage & Van Co. v. Atlas Van Lines Inc., 792 F.2d 210, 224 (D.C. Cir. 1986); General Leaseways, Inc. v. National Trucking Leasing Assoc., 744 F.2d 588, 595 (7th Cir. 1984).

[5] Letter from J. Brennan to J. Miles of February 19, 2002.

[6] Letter from J. Brennan to J. Miles of February 19, 2002.

6. *A description of any procedures proposed to be implemented to limit possible anticompetitive effects resulting from the Arrangement or its activities.*

Possible anticompetitive effects resulting from Brown & Toland's PPO product will be limited in at least two ways. First, Brown & Toland's PPO network is not exclusive, and physicians are free to contract independently with payers who prefer not to contract with Brown & Toland for PPO services. Second, counsel will provide Brown & Toland and its PPO network physicians with antitrust guidance explaining that network physicians: (a) are free to contract with payers independent of Brown & Toland (including through other physician networks); and (b) in so doing, cannot agree with other Brown & Toland network physicians (outside of their own practice group) about the payers with which they will contract or about reimbursement rates that they will accept.

7. *All studies, analyses, and reports that were prepared for the purpose of evaluating or analyzing competition for physician or hospital services in any area, including, but not limited to, the market share of physician services in any area or the market share of hospital services in any area.*

Brown & Toland has no non-privileged responsive documents.

Sincerely,

Richard A. Feinstein

Richard A. Feinstein

cc: Anne R. Schenof, Esq. (By Hand Delivery)
John P. Wiegand, Esq. (By FedEx)

Enclosures