FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

[redacted] OF COMPETITION

For Public Record — Advisory Opinion

APR 23 1982

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Steven E. Adams, J.D.
Director of Governmental Relations
Louisiana Health Care Association
7921 Picardy Avenue
Baton Rouge, LA 70809

Re: Request for Advisory Opinion

Dear Mr. Adams:

This is in response to your letter to Ben Sharp of August 18, 1981, requesting an advisory opinion on a proposed agreement between the Louisiana Health Care Association (the "Association") and Medi Co-op, Inc. (the "Co-op") to establish a group purchasing arrangement for the Association's members.

Pursuant to your telephone conversation with Judith A. Moreland of the Bureau of Competition, we are treating your request as one for a staff opinion letter under Section 1.1(b) of the Commission's Rules of Practice.

This letter sets out the views of the staff of the Bureau of Competition, as authorized by the Commission's rules. It has not been reviewed or approved by the Commission. The Bureau's advice is rendered without prejudice to the right of the Commission later to rescind it and, where appropriate, to commence an enforcement proceeding.

As we understand it, Medi Co-op proposes to administer a buying cooperative available to members of the Association, who are nursing home owners and operators throughout the State of Louisiana. The Co-op would maintain a staff and warehouse facilities in the state. Association officers would sit with the Co-op's General Manager on a review committee to oversee the Co-op's activities.

Food and medical equipment would be available through the Co-op, but members would be free to purchase these products from other sources. Food purchased through the Co-op would be delivered directly to members by existing wholesalers and suppliers. Members would be charged "prevailing prices" by Medi Co-op at the time of purchase. Quantity discounts received by the Co-op would be divided between the Co-op, the Association, and the members on a quarterly basis, with 20% retained by the

Co-op, 5% given to the Association for administrative services, and 75% distributed among the members, presumably in proportion to their purchases through the Co-op.

Commonly used medical supplies and equipment would be stocked in the Co-op's warehouse. Other products could be obtained through the Co-op from "regional supply points." Savings realized from quantity discounts and by "eliminating middle commissions" would be distributed among the parties in the proportions listed above.[1]

Group insurance policies would also be available through the Co-op. The Association would received 25% of commissions paid to the Co-op.

The laws administered by the Commission do not prohibit the formation of cooperative buying associations. Such organizations serve legitimate purposes, and in most cases can be expected to facilitate rather than to impair competition. However, in some circumstances these organizations may engage in conduct, or attain a degree of market power, that raises concerns under the antitrust laws.

The information you have provided us is not sufficient to allow us to give a definitive opinion on the legality of the Co-op's intended activities. Making that judgment would require knowledge of a number of factors, including the types of discounts received by the Co-op, the prices it charged its members, the distributive functions performed by the Co-op, the market power of its members, the availability of similar discounts to other nursing home operators, and the impact of the Co-op on competition in the market in which its members buy and sell. However, we can identify the major issues that are raised under the Robinson-Patman and Federal Trade Commission Acts by buying cooperatives like the Co-op.

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1 The Co-op suggests that Association members can save money by reporting as an "expense reduction" on Medicaid year-end reports only the percentage of the discounts distributed by the Co-op that is attributable to supplies purchased for Medicare patients, and by directly billing Medicare patients for catheter and ostomy supplies through an arrangement with a Co-op contractor. The staff of the Health Care Financing Administration has informally advised us that a nursing home that follows these suggestions may violate regulations governing Medicare and Medicaid reimbursement. The Association and its members may wish to inquire further before using the reporting and billing methods described above.

The Robinson-Patman Act

Section 2(f) of the Clayton Act, as amended by the Robinson-Patman Act, 15 U.S.C. § 13(f), prohibits knowing inducement or receipt of price discriminations that violate Section 2(a) of that Act. Section 2(a) makes unlawful direct or indirect discriminations in the price of commodities of like grade and quality, where the effect of the discrimination may be substantially to lessen competition or to tend to create a monopoly, or to injure competition with any person who grants or knowingly receives the benefit of the discrimination, or with their customers. 15 U.S.C. § 13(a). Members of buying cooperatives have been found to violate Section 2(f) when they indirectly received certain quantity and functional discounts granted to the cooperatives.

In three cases brought by the Commission, auto parts jobbers who established buying cooperatives in order to take advantage of manufacturers' quantity discounts were found to have violated Section 2(f). Alhambra Motor Parts v. FTC, 309 F.2d 213 (9th Cir. 1962); Mid-South Distributors v. FTC, 287 F.2d 512 (5th Cir.), cert. denied, 368 U.S. 838 (1961); American Motor Specialties Co. v. FTC, 278 F.2d 225 (2d Cir.), cert. denied, 364 U.S. 884 (1960). Quantity discounts were based on a customer's total annual purchases. The members of the cooperatives placed their orders in the name of the cooperative, but the goods were drop-shipped directly to each buyer by the supplier. The suppliers were paid by the cooperatives, which in turn billed the individual members. The discounts received by the cooperatives were based on all members' aggregate purchases, and were distributed to the members at the end of the year in proportion to their purchases through the cooperative.

In each case courts upheld the Commission's findings that individual members rather than the cooperatives were the real purchasers, that they received discounts not available to their competitors, and that the discounts caused competitive injury. Because the members received larger discounts on supplies purchased in the same manner and amounts as before they became members of the cooperatives, it was held that they knew or should have known that the discounts could not be legally justified.

Members of buying cooperatives were also found to have violated Section 2(f) when they received "functional" or wholesale discounts not available to their competitors, where the effect of the discrimination was to injure competition. Alhambra Motor Parts, 68 F.T.C. 1038 (1965); National Parts Warehouse, 63 F.T.C. 1692 (1963), aff'd sub. nom. General Auto Supplies, Inc. v. FTC, 346 F.2d 311 (7th Cir. 1965), cert. dimissed, 382 U.S. 923 (1965). In those cases, groups of automotive parts jobbers formed buying cooperatives to act as warehouse distributors. Goods were purchased by the cooperatives in their own name and stored in their warehouses, and then shipped to jobber members as orders were received. In some cases, goods were ordered through

the cooperatives but drop-shipped directly to the jobbers by manufacturers. The cooperatives received manufacturer's normal wholesale discounts, which were periodically distributed to the members in proportion to their purchasers from the cooperatives. The Commission found that the jobber members were the actual purchasers from the manufacturers, since the cooperatives were controlled by the members and acted as their agent. In making this finding, the Commission looked not to the members' management control over the cooperatives, but at their control over distribution of the cooperatives' "earnings" -- the functional discounts they received.

The jobber members were thus found to be the recipients of discriminatory prices that were not available to their competitors who were not members of the cooperatives. Since the members had formed the groups to obtain price concessions they could not get individually, the Commission also found that they knew or should have known that the price concessions they received were not legally justified, and were therefore "knowingly" induced or received.

The cases just discussed illustrate the ways in which Medi Co-op's activities could violate the Robinson-Patman Act. If the Co-op received and passed on quantity discounts on the aggregated individual purchases of its members or wholesale discounts on goods purchased for resale to its members, the members might be found to have induced or received a prohibited price discrimination.

Of course, for a violation of the law to occur, the other elements of price discrimination under the Robinson-Patman Act would have to be present as well. Only two will be noted here. First, if the discounts in question only made "due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities" in which the products were sold or delivered, no violation would occur. 15 U.S.C. § 13(a). Second, the likelihood of a substantial injury to competition flowing from the price discrimination would have to be present. A number of factors that would minimize the likelihood of competitive injury can be envisioned. For example, if the discounts received by the Co-op were relatively small, or if all nursing homes that compete in a significant way with Co-op members were also members, or eligible to become members, of the Co-op or of similar groups, there would probably be no substantial injury to competition from the Co-op's activities.[2] An assessment of competitive injury would also have to consider

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2 The Alhambra Motor Parts case was settled by a negotiated order that required the cooperative to make membership available to competing jobbers. Mezines, Group Buying - When Is It Permitted Under the Robinson-Patman Act?, 44 N.Y.U.L. Rev. 729, 748 n.78 (1969).

[redacted]at most products sold by the Co-op are not purchased for resale [redacted] the members, but are used in producing a service sold by the [redacted]rsing homes. In at least two cases it has been held that no injury to competition resulted from price differences on components sold to manufacturers for incorporation into another product, because the price of the component was only a small part of the cost of the finished product. Minneapolis-Honeywell Regulator Co. v. FTC, 191 F.2d 786 (7th Cir. 1951), cert. dismissed, 344 U.S. 206 (1952); Quaker Oats Co., 66 F.T.C. 1131 (1964). The impact of private and government reimbursement programs on price competition among the Co-op's members would also be relevant.

It should be noted that the Commission's orders relating to functional discounts granted to cooperatives have been the subject of substantial criticism, and the Commission may reconsider the legality of some types of functional discounts in pending administrative litigation. In an order accompanying issuance of the complaint in Boise Cascade Corp., FTC Docket No. 9133 (complaint issued April 23, 1980), the Commission stated that "evidence concerning services and functions performed by respondent [buyer] on goods it purchases for resale at the retail level" was to be admissible at trial, so that it could decide [redacted]hether discriminatory discounts could be justified by [redacted]stributional services performed by the favored buyer that are [redacted]ot performed by competing buyers. Compare Mueller Co., 60 ~~F.T.C. 120 (1962), aff'd, 323 F.2d~~ 44 (7th Cir. 1963), cert. denied, 377 U.S. 923 (1964), with Doubleday & Co., 52 F.T.C. 169 (1955). We cannot, however, predict the outcome of the litigation.

The Federal Trade Commission Act

Under most circumstances, cooperative buying associations perform a legitimate and procompetitive function. In limited unusual circumstances, however, the activities of such organizations may raise issues under Section 5 of the Federal Trade Commission Act. Three such circumstances will be noted.

First, cooperative associations normally are free to limit their membership. However, antitrust issues are raised when businessmen jointly exclude their competitors from membership in an organization which confers on its members a significant competitive advantage that is not reasonably obtainable elsewhere. See Silver v. New York Stock Exchange, 373 U.S. 341 (1963); Associated Press v. United States, 326 U.S. 1 (1945); United States v. Terminal Railroad Ass'n, 224 U.S. 383 (1912). [redacted]e would be concerned if the Co-op unreasonably excluded some [redacted]ompeting nursing homes, and if exclusion severely handicapped [redacted]those institutions' ability to compete. According to your letter, membership in the Co-op would be available only to

embers of the Association. It is not clear whether any nursing homes that compete in a significant way with Association members would in fact be excluded. Nor do we have enough information to determine whether membership in the Co-op would be of sufficient competitive benefit to any excluded nursing homes to raise antitrust issues. This determination would depend primarily on the magnitude of the discounts available to Co-op members, the proportion of nursing homes' costs accounted for by goods available through the Co-op, the significance of the cost savings to nursing homes' ability to compete effectively, and the availability of similar purchasing arrangements to any excluded competitors of Co-op members.

Second, a cooperative buying arrangement raises antitrust concerns if it represents a sufficient proportion of buyers in a market so that sellers are unreasonably deprived of competition among those buyers. See Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219 (1948). On the other hand, in circumstances where joint purchasing agencies are formed by buyers who do not possess any significant degree of market power, no antitrust concerns are likely to be present. While it seems unlikely that the Co-op would possess significant market power, we do not have enough information to make a definitive judgment on that question.

Finally, of course, serious antitrust issues would be raised if the Co-op were to become a forum for anticompetitive agreements among its members. However, we do not assume that the Co-op will be used for this purpose.

Conclusion

The antitrust laws do not prohibit the establishment of a cooperative buying association such as that proposed by Medi Co-op. However, as we have discussed in this letter, the Co-op's activities, or its exercise of significant market power, could in some circumstances violate laws administered by the Commission. We lack information sufficient to allow us fully to evaluate these issues. Nonetheless, we hope that this discussion will assist you in assessing Medi Co-op's proposal.

Sincerely,

Thomas J. Campbell
Director
Bureau of Competition