P854683

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

September 17, 1985

John K. Van de Kamp
Attorney General
State of California
Department of Justice
1515 K Street
Sacramento, California 95814

Dear Mr. Van de Kamp:

The Federal Trade Commission's Bureaus of Competition, Consumer Protection, and Economics 1/ are pleased to respond to your August 14, 1985 request for our views on California Assembly Bill 707 ("AB 707"). This bill is designed to grant special treatment under the antitrust laws to health care providers, insurers, and purchasers for joint activities relating to contracts for the provision of health services. As we discuss below, we believe it is unnecessary and unwise to adopt special antitrust rules for the health care sector. Consumers will best be served by reliance on the fundamental principles of existing antitrust law. If the proposed legislation has any impact, it will be to harm competition and consumers.

AB 707 provides in pertinent part:

> [T]he formation of groups and combinations of providers and purchasing groups for the purpose of creating efficient-sized contracting units [shall] be recognized as the creation of a new product within the health care marketplace, and [shall] be subject, therefore, only to those antitrust prohibitions applicable to the conduct of other presumptively legitimate enterprises.

From this and other language in the bill, it appears the bill is intended to reduce the risk of antitrust liability for a

---

1/ These comments represent the views of the Bureaus of Competition, Consumer Protection, and Economics of the Federal Trade Commission and do not necessarily represent the views of the Federal Trade Commission or any individual Commissioner. The Federal Trade Commission, however, has reviewed these comments and has voted to authorize their presentation.

variety of price-related agreements and combinations among competitors. Specifically, the bill cites the risk of per se antitrust liability as an obstacle to the development of such contracts.

The bill declares that a combination to form an "efficient-sized" contracting group should be recognized as creating a "new product." The purpose of this declaration apparently is to require that a "rule of reason" analysis always be used in evaluating the legality under the antitrust laws of concerted action by competitors who combine to form such groups. This is so because, under fundamental antitrust principles, the legality of joint ventures among competitors that create a new product through the achievement of otherwise unobtainable efficiencies is judged under the rule of reason, even though, as a necessary consequence of the joint arrangement, price competition among the participants may be restricted. See, e.g., National Collegiate Athletic Association v. Board of Regents of University of Oklahoma, 104 S. Ct. 2948 (1984); Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1 (1979).

We are troubled that California citizens may wrongfully be led to believe that the bill will protect them from federal antitrust standards. It would not. Under the Supremacy Clause of the United States Constitution, a state legislature cannot dictate the substantive rules, evidentiary burdens, standards for liability, or the facts that must be proved to establish liability in federal antitrust cases. Only Congress can take such action.

The states can, of course, impose regulation that displaces competition and, under the "state action doctrine," effectively immunize the private parties subject to such regulation from liability under the federal antitrust laws. See, e.g., Southern Motor Carriers, Inc. v. United States, 105 S. Ct. 1721 (1985); California Retail Liquor Dealers Association v. Midcal Aluminum, Inc., 445 U.S. 97 (1980); Parker v. Brown, 317 U.S. 341 (1943). However, the proposed legislation would not confer any state action immunity from the federal antitrust laws on affected parties, because it would not displace competition with a regulatory scheme subject to active state supervision. Nor does it appear that the bill's drafters were attempting to create antitrust immunity, since the bill apparently contemplates that all conduct by affected parties would still be subject to those laws. It appears, rather, that the bill seeks to alter the antitrust analysis to be used on the merits in federal court proceedings. The bill, however, cannot affect the operation of federal law in this fashion and would not therefore affect application of the per se rule, where otherwise appropriate, in federal antitrust cases. California may, of course, modify the

standards applicable in cases brought under its own state antitrust law, although we think that would be unwise in this particular instance.

From a policy perspective, we also find AB 707 very troubling. As a general principle, we believe it is unwise to create special antitrust rules for specific industries. Special antitrust status should only be granted when there is compelling evidence that competition is unworkable. Since Congress enacted the Sherman Act, various industries have, from time to time, claimed that unique circumstances required that they be granted special status. Congress wisely has been extremely reluctant to create industry-specific rules.

Thus, one should look skeptically at claims that promoting competition through traditional antitrust enforcement has undesirable results in the health care sector. Indeed, it is becoming increasingly clear that competition has an important role to play in health care. As health care costs have escalated, policymakers at all levels of government have shown an increasing tendency to adopt a competitive approach to help promote a more efficient, cost-effective health care system. This suggests that now is not the time to create special antitrust rules for competitors in health care markets.

Insofar as the bill would affect state antitrust adjudications, this particular proposal to grant special antitrust treatment is problematic because its meaning and scope are unclear. First, a key concept in the bill is an "efficient-sized contracting unit," yet there is no indication how that term is to be interpreted, how efficiency is to be measured, or who would bear the burden of proof regarding this issue. There is, moreover, no requirement that a combination of competitors seeking the bill's protection be no larger than reasonably necessary for efficiency. Thus, the bill might grant special antitrust treatment to combinations of competing physicians encompassing all or most of the doctors in a particular area, on the ground that participants in the venture deem it "efficient" to deal on this basis. A combination with such a large market share might achieve supracompetitive prices or effectively prevent the formation of competing entities.

Second, the bill would provide special antitrust protection to combinations formed for the "purpose" of creating an efficient-sized bargaining unit. The bill would appear, therefore, to make the participants' subjective intent a determinative factor in the legislation's applicability. Thus, protection could apparently be afforded whenever a group of providers, no matter what their share of the market, believed that the collective participation of so many providers would establish an "efficient-sized" contracting unit. No demonstration or measure of actual increased

efficiency via collective negotiations would apparently be required. We believe it likely that groups with anticompetitive purposes could easily shield their anticompetitive activities by superficial reference to efficiency purposes.

Third, it is unclear what actions by a contracting group would be shielded by the bill, which on its face deals only with the "formation" of a contracting group. The bill may be read to apply to such formation-related activity as an anticompetitive agreement among participants in a contracting group that they will not participate in any competing group or negotiate individually on their own behalf. In addition, the bill might be interpreted to cover a variety of collateral actions injurious to competition, that might flow from such a group's formation, such as boycotts, threats, and coercion of other parties to the contracting process. See Michigan State Medical Society, 101 F.T.C. 191 (1983).

Finally, aside from apparently displacing the per se rule, the bill might confine the courts to an inefficient and rigid mode of rule of reason analysis in some antitrust cases. Under current antitrust jurisprudence, the rule of reason need not always involve a "full blown," exhaustive analysis of markets and market power. When, for example, price competition among the participants in a joint undertaking is lessened and a sufficient procompetitive justification is absent, the rule of reason can in some situations be applied in the "twinkling of an eye." National Collegiate Athletic Association v. Board of Regents of University of Oklahoma, 104 S. Ct. 2948, 2965 n.39 (1984). The bill is apparently intended to afford otherwise inherently suspect price-related agreements the status of "presumptively legitimate enterprises." As such, the bill might in some cases inadvertently prevent proper rule of reason analysis by requiring a costly full blown rule of reason inquiry where such an approach is unwarranted.

Consequently, there is a very real risk that AB 707 could unintentionally shield from California antitrust law a variety of undesirable activities that would undermine the health care cost-containment that California is working hard to achieve. At best, its vague language will create confusion among providers, insurers, purchasers, lawyers and the judiciary.

We understand that proponents of AB 707 are concerned that uncertainty about potential antitrust liability may discourage valuable, innovative health care financing arrangements, including preferred provider organizations. There is, however, a well-developed body of federal antitrust principles that are applied to new forms of health care financing and delivery as they evolve. Federal antitrust law recognizes that agreements among competitors

can serve to increase efficiency, create new products, or make markets work more effectively. Traditional antitrust analysis is designed to protect valuable innovation while preventing those arrangements that harm competition. Thus, while naked price-fixing agreements are condemned by the antitrust laws, no matter how many competitors are involved, the Supreme Court has recognized that "a joint selling arrangement may be so efficient that it will increase sellers' aggregate output and thus be procompetitive," and that "a restraint in a limited aspect of a market may actually enhance marketwide competition." National Collegiate Athletic Association v. Board of Regents of University of Oklahoma, 104 S. Ct. 2948, 2961-62 (1984). In short, the federal antitrust laws afford appropriate flexibility for analysis of concerted activities in the health field, without need for the proposed legislation.

Moreover, the Federal Trade Commission and the Department of Justice, along with state attorneys general, can provide advice on the legality under the antitrust laws of new programs. The FTC and the Department of Justice, for example, have both issued advisory opinions on preferred provider organizations explaining how they can operate within traditional antitrust law. 2/

California has taken important steps to strengthen competitive forces in the health care sector. All evidence indicates that this new competition can produce much needed gains in efficiency and cost control. This is not the time for the state to retreat from these promising efforts by creating new rules for state antitrust enforcement in health care. We appreciate this opportunity to provide our views on AB 707.

Sincerely yours,

Timothy J. Muris
Director

2/ Advisory Opinion Letter from Emily H. Rock, Secretary, Federal Trade Commission to Irwin S. Smith, M.D., President, Health Care Management Associates (June 7, 1983), 101 F.T.C. 1014 (1983), 3 Trade Reg. Rep. (CCH) ¶ 22,036; Business Review Letter from William F. Baxter, Assistant Attorney General, Antitrust Division, Department of Justice to Dr. Irwin S. Smith, President, Health Care Management Associates (Sept. 21, 1983); Business Review Letter from William F. Baxter, Assistant Attorney General, Antitrust Division, Department of Justice to Donald W. Fish, Esq., Senior Vice President and General Counsel, Hospital Corporation of America (Sept. 21, 1983).