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

BUREAU OF COMPETITION

November 5, 1986

David A. Gates
Commissioner of Insurance
201 South Fall Street
Carson City, Nevada 89701

Dear Commissioner Gates:

The Federal Trade Commission's Bureaus of Competition, Consumer Protection, and Economics are pleased to present their views on the use of exclusive contracts by health maintenance organizations.[1] We are advised that your office is considering whether to prohibit health maintenance organizations (HMOs) from entering into contracts with participating physicians that prevent the physicians from affiliating with other HMOs or, in some cases, with preferred provider organizations. Our experience in the antitrust and health care fields has enabled us to develop an understanding of exclusive arrangements between HMOs and their participating physicians. Our conclusion is that such exclusive arrangements are likely to benefit consumers by stimulating competition among medical prepayment plans and physicians. Although in some circumstances exclusive arrangements have the potential to endanger competition, those circumstances are rare and do not appear to exist in the market in which Nevada HMOs operate. Therefore, a blanket prohibition on exclusive arrangements can be expected to hamper procompetitive and beneficial activities of HMOs, and deny consumers the improved services that such competition would stimulate.

The federal antitrust laws are designed to improve consumer welfare by protecting the ability of the marketplace to supply the full range of goods and services that consumers want, at prices that reflect the lowest possible cost. Certain kinds of arrangements, such as agreements among competitors to fix prices, are virtually certain to hurt consumers, and are therefore subject to a blanket prohibition. Arrangements that can have either procompetitive or anticompetitive effects, however, are evaluated under the "rule of reason." The purpose of the analysis is to assess whether, in a given situation, the practice in question has a negative impact on competition, and if so, whether it produces countervailing competitive benefits that outweigh its harmful effects. Antitrust analysis focuses on the

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1 These comments represent the views of the Commission's Bureaus of Competition, Consumer Protection, and Economics, and do not necessarily represent the views of the Commission or any individual Commissioner. The Commission, however, has authorized the submission of these comments.

effects of a practice on consumer choice and welfare. Harm to individual competitors is an inevitable result of vigorous competition, and does not by itself constitute harm to marketplace competition. The Supreme Court has emphasized that it is undesirable to impose blanket prohibitions on business activities that do not ordinarily harm competition. Such prohibitions keep firms from operating more efficiently or offering new services or products, and thereby hurt consumers. See Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S 36 (1977).

Exclusive arrangements between firms and their suppliers or customers are common in many sectors of the economy. Such arrangements typically permit both parties to operate more efficiently and do not usually pose an unreasonable danger to competition. Therefore, they are not condemned summarily under the antitrust laws, but are evaluated on a case-by-case basis.

Exclusive provider agreements have the potential to help HMOs provide the services that consumers find desirable and thereby compete more effectively for enrollees against other HMOs and traditional insurance plans. While some HMOs enter into participation agreements with a large number of physicians, others choose to compete by having exclusive relationships with a limited panel of carefully selected physicians. Such a strategy can provide a number of advantages. First, it can foster a closer cooperative relationship between the HMO and its physicians, for the success of each is closely tied to that of the other. An HMO seeking to obtain exclusive provider agreements must satisfy its physicians that it is likely to succeed in attracting enrollees and that it will meet the needs of the physicians. A physician seeking a contract with an HMO having a limited provider panel must satisfy the HMO that he or she will help attract and retain enrollees by providing high quality and cost effective services, and will cooperate with the HMO's objectives. The mutual dependence between the HMO and its physicians should promote physician adherence to HMO's quality, service and utilization standards. This should help it deliver consistently high quality services at a lower cost.

Second, an HMO with a limited panel of physicians exclusively affiliated with it may be able to attract consumers and create a favorable market reputation based on its careful selection of physicians who meet high quality and cost control standards. If physicians are affiliated with many HMOs, the distinctions among the plans may be blunted, because the HMOs will have similar

physician panels and as a result may have similar health care service utilization patterns. Physicians' affiliation with only one rather than several HMOs sharpens the distinctions among the HMOs and thus clarifies the choices consumers need to make in selecting an HMO. As a result, competition based on price or quality will be more vigorous. To the extent that exclusivity clauses facilitate these and other benefits,[2] they are procompetitive and helpful to consumers.

Exclusivity will, of course, restrict the range of physicians available to patients enrolled in a particular HMO. However, this in itself is not anticompetitive. Consumers know that their choice of HMO determines the physicians to whom they will have access and HMOs accordingly compete with one another and against other medical prepayment plans by providing a highly qualified and accessible panel of participating physicians.

While in most cases exclusive physician arrangements are likely to lead to heightened competition, they may hinder competition if they permit an HMO to prevent other HMOs from entering the market (or drive them out of it) by depriving them of access to the physicians they need to operate effectively.[3] For example, if one HMO were able to obtain and keep exclusive contracts with a large percentage of physicians in a particular type of practice in a geographic market, other plans could be left without access to suitable physicians. Ordinarily, however, an HMO would not be able to obtain enough exclusive contracts of sufficient duration to exclude competitors in this way. Some physicians will wish to preserve their freedom to affiliate with other plans, and will decline exclusivity unless the HMO in question has some power over them (such as a very high share of subscribers in a particular area). Even physicians who sign exclusive contracts will be able to switch from one HMO to another, unless they have entered into long-term contracts or the HMO imposes substantial costs on doctors who leave the plan. Physicians who are particularly necessary to the operation of several HMOs, either because they practice a specialty in which there are few other physicians or because they are uniquely attractive for other reasons, would appear to be the least likely

2 An HMO dealing with fewer physicians will probably also have lower administrative costs.

3 The amount of consumer harm that would result if HMOs were hindered in entering the market would depend on the extent to which consumers regard other types of insurance plans as satisfactory substitutes for HMOs.

to agree to sign long-term exclusive contracts, because other plans would also bid for their services.[4]

A serious threat to competition among HMOs could arise if an HMO controlled by participating physicians employed exclusive provider agreements. If a large percentage of physicians affiliated exclusively [illegible] purpose might be to suppress price and service competition among the physician members. Exclusive arrangements used to achieve this purpose would likely violate the antitrust laws.

The experience of HMOs in Nevada, as we understand it, suggests that the current use of exclusive provider contracts has not harmed competition and is not likely to do so in the future. It appears that the largest HMO in Nevada currently has exclusive provider arrangements with only about 5 percent of Clark County physicians who are in private practice, and that even these agreements are for a term of only one year. Exclusivity is apparently a point of negotiation between physicians and the HMO. Some physicians have accepted it, some have obtained exceptions to the exclusivity policy, and others have refused to accept it and have still become participating physicians. Several other HMOs currently active in Nevada apparently have been able to obtain the physician services they need.

To summarize, exclusivity clauses have the potential to help HMOs provide at lower cost services that consumers want, and blanket prohibition of their use is likely to injure Nevada consumers. If it appears in the future that use of exclusivity hinders the effective operation of HMOs or otherwise harms consumers, the Nevada Insurance Division could take corrective action designed to address particular problems as they arise. Antitrust remedies would also be available if the agreements

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4 The first plan entering a particular area may be able to sign up those physicans who are most desirable or most likely to affiliate with an HMO. However, this is not necessarily an anticompetitive result, because other plans should normally be able to enter by developing relationships with other physicians or by getting the first HMO's physicians to switch. In addition, HMOs might be able to enter some areas by bringing in physicians from outside.

seriously restrain competition. We therefore recommend against prohibition of exclusive provider contracts.

We hope these comments are of assistance.

Sincerely yours,

Jeffrey I. Zuckerman
Director