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Federal Courts and Enforcers Diagnose Physician Practice Associations with Risk of Conspiracy Liability: Degree of Integration is Crucial to Challenges to Medical Network Price Agreements

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I. INTRODUCTION

Thanks to a recent federal district court decision, physicians and medical staff have more reason to think twice about price and other arrangements adopted by the practice associations and clinics to which they belong. Last Spring, the United States District Court for the Eastern District of California held that a hospital and a physicians practice association, and a hospital and the physicians that provide services to it under contract, may be sufficiently distinct separate economic actors capable of conspiring with each other under Section 1 of the Sherman Act.² The court denied a motion to dismiss a complaint that alleged that a hospital and two independent physician practice associations conspired to restrain trade in violation of Section 1 of the Sherman Act by prohibiting neonatologists who did not agree to practice exclusively at the hospital or refer cases to doctors practicing exclusively neonatology at the hospital, from using the hospital's neonatal intensive care unit ("NICU").

There are few Ninth Circuit cases addressing these issues and other circuits have come to different conclusions. Federal antitrust enforcement agencies have taken the position that members of physician practice associations and networks can conspire with each other and with hospitals for antitrust purposes. In fact, the *Perinatal* decision is fairly consistent with the enforcers' approach to evaluating antitrust issues with clinical integration practices and arrangements.

II. BACKGROUND FACTS OF THE PERINATAL CASE

The plaintiffs are neonatologists who practice together in a medical corporation named Perinatal Medical Group, Inc. ("PMG"). PMG's physicians have provided services in and for various Fresno and Madera County hospitals since 1980. Defendant Children's Hospital Central California ("Children's") owns and operates a NICU that has a "regional" designation. Under California law, certain critically ill infants must be treated at a regional facility. Through February 2009, PMG had a contract with Children's to provide coverage at and administrative services for Children's NICU. The contract provided plaintiffs with staff privileges at Children's NICU as well.

In December 2008, members of PMG helped another hospital, Community Medical Center ("Community") open its own NICU. Community's NICU does not have a regional designation. Thus, certain critically ill infants must be transferred from Community's NICU to

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² *Perinatal Medical Group, Inc. et al. v. Children's Hospital Central California et al*, Case No. CV F 09-1273 LIO GSA (April 15, 2010).

Children's NICU for treatment. When this was happening, according to the complaint, Children's, and an independent physicians practice association, co-defendant Specialty Medical Group Central California, Inc. ("SMG"), complained to PMG about two PMG doctors who were referring cases to a doctor who had left SMG. SMG lost business when referrals were made to this former member. Children's asked one of the PMG doctors to restrict referrals to doctors affiliated with it. In addition, the complaint alleges that Children's was concerned that Community's NICU would compete with its NICU and, for this reason, conspired to foreclose neonatologists not affiliated with either SMG or co-defendant, Central California Neonatology Group ("CCNG"), from admitting or treating their patients at Children's NICU.

Soon after, Children's approached one of the members of PMG to tell him that if he did not agree to practice exclusively at Children's and, in particular, not at Community, then Children's would not renew PMG's contract. Children's also demanded that PMG sign an amendment to their contract to prohibit PMG physicians from admitting or treating patients at competing hospitals and from referring patients to any specialist who is not a member of SMG. PMG refused to sign the amendment and Children's terminated the contract. However, several of PMG's members agreed to the amendment and left PMG to form CCNG. PMG's remaining members were unable to admit and care for patients at Children's NICU. When they attempted to, they were told they could not admit patients unless they or another physician was present in Children's NICU 24 hours a day, seven days a week, during a patient's stay. This 24/7 rule was adopted in a regulation of Children's. PMG filed suit and, in its amended complaint, asserted violations of Sections 1 and 2 of the Sherman Act, violation of the Cartwright Act, unfair competition, and other business torts.

III. ARGUMENTS AND HOLDINGS IN THE PERINATAL CASE

In its motion to dismiss, CCNG argued that PMG's Section 1 claim fails because the defendants are not "separate entities pursuing different economic goals capable of conspiring for Sherman Act purposes." CCNG also argued that Children's has no duty under antitrust law to make its facilities available to PMG and antitrust law "is not concerned with the kind of injury that plaintiff PMG is claiming."

The court began its consideration of the issue with the principle that that it takes two separate economic entities to conspire under Section 1 of the Sherman Act.³ In *Copperweld*, the United States Supreme Court held that a parent corporation and its wholly owned subsidiary are incapable of conspiring for antitrust purposes because the two entities "are not separate economic actors pursuing separate economic interests." Next, applying a Ninth Circuit decision that interprets *Copperweld*, the court observed that in considering whether defendants are a "single entity" or capable of conspiring for Section 1 purposes, the "crucial question" is "whether the entities alleged to have conspired to maintain an 'economic unity,' and whether the entities were either actual or potential competitors."⁴

Applying other circuit decisions, the court found that physicians, including members of an independent practice association, are independent entities that can conspire with each other and others for antitrust purposes. Citing a Third Circuit decision, the court noted that each member practices medicine in his individual capacity and each is a separate economic unit

³ *Copperweld Co v. Independence Tube Co.*, 467 U.S. 752 (1984).

⁴ *See Jack Russell Terrier Network v. Am. Kennel Club, Inc.*, 407 F.3d 1027, 1035 (9th Cir. 2005).

potentially in competition with other physicians. The court thus found that CCNG can conspire legally within the group and with co-defendant SMG.

As to whether physicians can conspire with a hospital for antitrust purposes, the court observed this question is unresolved among circuit courts. With one Ninth Circuit precedent determining that this is a question of fact and with other circuits differing on the question, the court rejected CCNG's argument that CCNG is unable to conspire with Children's as a matter of law. The court determined this is a question of fact. In this instance, plaintiffs alleged that Children's and CCNG have different economic interests. Children's interest, plaintiffs alleged, is to protect the market share of its NICU, whereas CCNG's interest is to benefit from exclusive and restrictive neonatology referrals to its members. The court also observed, as an organization independent of Children's, CCNG contracts its services to Children's and its members are thus independent contractors to Children's, not employees or officers of the hospital. Without actually determining whether a hospital and physicians can conspire as a matter of law, the court held that it could not decide, as a matter of law, that a hospital and physicians are incapable for conspiring for Section 1 purposes. The court thus denied CCNG's motion to dismiss on these grounds.

The court's analysis appears consistent the Supreme Court's recent decision in *American Needle, Inc.*⁵ In *American Needle*, the Court applied *Copperweld* as well and held that the relevant inquiry in determining whether entities are sufficiently separate to be capable of conspiring for antitrust purposes, is whether the alleged combination is among "separate economic actors pursuing separate economic interests such that the agreement deprives the marketplace of independent centers of decision-making and therefore of diversity of entrepreneurial interests."⁶

The court also denied CCNG's motion to dismiss on the ground that the plaintiffs failed to allege antitrust injury. CCNG argued that Children's has no duty to share its facilities with PMG or its members. PMG argued that Children's was subject to such a duty under state law. The court rejected this, observing that a duty to deal arising from state law does not establish a duty to deal for antitrust purposes. However, the court also found that a key authority on which CCNG relied⁷ was distinguishable because, in that instance, the parties were direct competitors whereas, in this instance, Children's and PMG were not direct competitors. Exclusive agreements between a hospital and specialty groups of physicians may violate the Sherman Act, just as group boycotts of individual physicians do. PMG's complaint sufficiently and plausibly alleged both.

IV. ANTITRUST ANALYSIS OF PHYSICIAN AND MEDICAL STAFF NETWORKS AND THEIR RESTRAINTS

The *Perinatal* court's approach to analyzing physician associations and their restraints under the antitrust laws appears generally consistent with that used by most other federal courts and antitrust enforcement agencies. As to physician and medical staff associations and networks, so long as the association or network is likely to produce significant efficiencies that benefit consumers, and any price agreements by members are reasonably necessary to realize those efficiencies, the circuit courts as well as the Federal Trade Commission ("FTC") and Antitrust

⁵ *American Needle, Inc. v. National Football League, et al.*, 500 U.S. ____ (2010).

⁶ 500 U.S. ____, at *10.

⁷ *Four Corners Nephrology Assocs. v. Mercy Medical Center of Durango*, 582 F.3d 1216 (10th Cir. 2009).

Division of the Department of Justice (“DOJ”), will analyze the price agreements under the rule of reason.⁸

This implicitly means that for the agencies and as held in *Perinatal*, physicians and medical staff who belong to a physicians or medical staff association are capable under the antitrust laws of conspiring with one another and the association. Additionally, FTC consent orders indicate that the enforcers generally regard members of an independent practice as independent, separate entities that are capable of conspiring with each other and others for antitrust purposes. Like the court in *Perinatal*, however, the FTC has not in its consent orders determined whether, as a question of fact or law, a hospital and its physicians are capable of conspiring under the antitrust laws.

V. DEGREE OF INTEGRATION KEY TO ANALYSIS

The Supreme Court’s three most significant antitrust decisions concerning joint ventures and competitor collaborations, *Copperweld*, *Texaco*,⁹ and *American Needle*, demonstrate that the degree of economic integration in a joint venture or collaboration is a crucial consideration in determining the validity of a joint venture’s restraints. With physician and medical staff associations, substantial clinical integration is a key consideration of the agencies when evaluating the lawfulness of restraints under the antitrust laws. For example, when competing physicians establish a non-exclusive physicians network but do not share substantial financial risk, the agencies may evaluate the network and its price restraints under the rule of reason, rather than the *per se* rule, so long as the network involves substantial clinical integration. Substantial clinical integration can be found when: the network develops and invests in mechanisms to provide cost-effective quality care, including standards and protocols for treatment and services; develops and invests in information systems to measure and monitor individual physician and aggregate network performance; and utilizes procedures such as expulsion from the network to modify physician behavior and assure adherence to network standards and protocols.

Substantial clinical integration may be found in other circumstances as well. When a substantially integrated network negotiates fees and contracts with health care payers on behalf of the network’s participants but does not disseminate information about what participating physicians charge non-network patients, and the participants do not agree on the prices they will charge patients not covered by contracts with the network, the fee negotiations and contracts with health care payers will be analyzed under the rule of reason. For the agencies, the price agreement, under such circumstances, is subordinate and reasonably necessary to achieve significant efficiencies in reducing the costs of and increasing the quality of health services.

The agencies would also apply the rule of reason to determine whether to challenge the physicians’ agreement to establish and operate the network themselves. The agencies would consider whether the network is likely to limit competition in any relevant market by hampering the ability of health plans to contract individually with physicians in the network or with physicians in other networks, or by enabling physicians to raise prices above competitive levels. The agencies would also evaluate whether the network is over- or under-inclusive in selecting its participating physicians, whether the participants share competitively sensitive information which

⁸ Department of Justice and Federal Trade Commission Statements of Antitrust Enforcement Policy in Health Care, Statement 8: Enforcement Policy on Physician Network Joint Ventures (Revised August 1996), p. 4 (“Health Care Statement”).

⁹ *Texaco Inc. v. Dagher*, 547 U.S. 1 (2006).

could increase the likelihood of anticompetitive spillover effects outside the network where the physicians still compete, and whether the network has or avoids any anticompetitive collateral agreements.

The FTC has obtained consent orders in several cases featuring facts similar to those in *Perinatal*. In *Good Samaritan*,¹⁰ the FTC charged in its complaint that non-employee physicians with privileges at a regional hospital conspired with each other to prevent the hospital from opening a multi-specialty clinic that would have competed with them. The physicians threatened to stop admitting patients to the hospital if the hospital proceeded with plans to open the clinic. The FTC obtained a consent order in *Medical Staff of Holy Cross Hospital*¹¹ in a complaint that similarly alleged that physicians and other health practitioners with privileges at a hospital conspired to threaten to boycott the hospital in order to coerce the hospital not to enter a business relationship with a clinic or grant privileges to clinic physicians. Likewise, in *Physician Group*,¹² the FTC charged a group of physicians with conspiring with each other to prevent or delay the entry of a third party payer into two counties, and fixed price and other terms on which they would deal with third party payers.

VI. ANOTHER EXAMPLE OF ANTITRUST ANALYSIS OF PHYSICIAN NETWORKS AND THEIR PRICE RESTRAINTS

The FTC's *Staff Advisory Opinion Concerning Suburban Health Organization, Inc.* underscores how much the degree of integration matters in determining the lawfulness of an association's or network's price restraints. In that instance, the FTC outlined the integration features of a proposed physicians network that would be formed by eight competing or potentially competing hospitals. Similar to the forms of integration mentioned in the *Health Care Statement*, the proposed network would integrate medical management (such as monitoring patients to identify conditions), adopt and disseminate practice guidelines and protocols, and reward physicians for compliance. In addition, the proposed network would collectively negotiate payment fees for the physicians' services with health services payers. In its advisory opinion, the FTC found the proposal involved enough integration to hold some potential to improve quality and efficiency in the provision of physicians' services and to justify applying the rule of reason in analyzing the proposed network's price restraint.

The agency noted that the proposed joint contracting of uniform fees on behalf of the participating hospitals, regarding the services of their combined physician employees, would eliminate price competition among the hospitals. Without this restraint, payers could contract individually with the member hospitals for the services of the hospitals' physician employees, and competition for contracts with these payers could lead the hospitals to reduce prices or enhance the quality of those services.

Describing its analysis, the FTC noted first that the proposed arrangement lacked "a hallmark of integration," e.g., interdependence. The individual hospitals, not the joint venture, would each be responsible for motivating and disciplining physician participants. The joint venture would have no authority or mechanism to discipline or remove noncompliant physicians. Additionally, the physicians would not work collaboratively to attain the program's goals or work

¹⁰ *Good Samaritan Medical Staff of Good Samaritan Regional Medical Center*, 119 F.T.C. 106 (1995) (consent order).

¹¹ *Medical Staff of Holy Cross Hospital*, 114 F.T.C. 555 (1991) (consent order).

¹² *Physician Group, Inc.*, 120 F.T.C. 567 (1995) (consent order).

together in providing services to patients. There would be little contact or interaction, much less interdependence, between physicians at different participating hospitals. The absence of integration cast a dark shadow on the proposed venture's need for the price restraints.

The agency next examined whether joint contracting by the hospitals with payers for the physicians' services was reasonably necessary to achieve the potential efficiencies of the venture itself. The proposal's potential efficiencies, the FTC determined, would be limited in nature and scope and the proposal would not make available a "new" service that the hospitals could not individually offer, as in *Broadcast Music*.¹³ Patients would continue to seek individual physicians' services, not the services of some combined entity that involved the unification of physicians employed by the eight hospitals. Further, the hospitals, not a combined entity, would continue to individually bill and collect payment for their respective physicians' services. The nature of the services patients receive would not be fundamentally altered either. While the proposal could enhance the attractiveness of the physicians' services, this did not mean the physicians' services would deliver a new product.

In addition, the FTC observed, many physician networks adopt practice protocols and standards and monitor provider performance. They also frequently offer services to payers at separately established prices. These networks do so without jointly setting fees. The hospitals also failed to explain how joint fee setting would motivate physicians to comply with the proposed program's requirements. The physicians may not even be aware of what fees their employers are charging and collecting for their services and they can be expected to be responsive to their employers' quality practice-related requirements. Thus, a horizontal agreement among the hospitals on the fees to be charged for the services of their physician employees, and the elimination of the individual hospitals' freedom to compete with each other in the sale of those services, did not appear reasonably necessary or ancillary to achieving those efficiencies.

VII. CONCLUSION

Cases like *Perinatal*, the Supreme Court's leading joint venture decisions, and the agencies' consent orders and statements give ample reason for associations, joint ventures, and other collaborations between potential and actual competitors and their individual members to exercise caution before agreeing to or utilizing competitive restraints. What some might assume is a single entity or an entity with a substantial degree of integration, may not be treated as such by a court or enforcer. Consequently, members of a professional association, network or similar arrangement could unwittingly find themselves facing criminal charges of illegal conspiracy.

¹³ *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979).