

Department of Justice Takes the Position That HMOs are a Relevant Market

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In a pending settlement with The Prudential Insurance Company of America ("Prudential") and Aetna, Inc. ("Aetna"), the Antitrust Division of the U.S. Department of Justice has taken the position that HMOs are a relevant product market separate from PPOs and other fee-for-service plans. This could have a significant impact on health care antitrust and appears to place the Division at odds with at least one U.S. Court of Appeals.

In December of 1998, Aetna and Prudential entered into an agreement pursuant to which Aetna would acquire substantially all of Prudential's assets relating to group medical, dental indemnity, and managed care plans for \$1 billion. Through its wholly-owned subsidiary, Aetna U.S. Healthcare, Aetna offers an array of health insurance products, including traditional indemnity ("fee-for-service"), preferred provider organization ("PPO"), health maintenance organization ("HMO"), and point-of-service ("POS") plans. In 1998, Aetna U.S. Healthcare was the largest health insurance company in the nation, providing benefits to approximately 15.8 million people and generating revenues of over \$14 billion.

Prudential, through Prudential Healthcare, also offers indemnity, PPO, HMO and POS plans. In 1998, it was the ninth largest health insurance company in the United States, with approximately 4.9 million covered lives and about \$7.5 billion in revenues.

In view of the positions of Aetna and Prudential in the health insurance field, close scrutiny of the proposed transaction by one of the federal antitrust enforcement agencies (*i.e.* the Antitrust Division of the U.S. Department of Justice or the Federal Trade Commission) was inevitable. The result of that scrutiny was a proposed consent judgment among Aetna, Prudential, the Antitrust Division and the Attorney General of Texas. The proposed consent judgment would permit Aetna to acquire Prudential's health insurance business, but would require Aetna to divest its HMO and HMO-based POS ("HMO-POS") businesses in Houston and Dallas, Texas. Specifically, the proposed consent judgment requires Aetna to divest the Houston-area commercial HMO and HMO-POS businesses of NYLCAre Health Plans of the Gulf Coast, Inc. ("Gulf Coast"), a wholly-owned subsidiary serving Houston and other areas of south and central Texas, and the commercial HMO and HMO-POS businesses of NYLCAre Health Plans of the Southwest, Inc. ("Southwest"), another wholly-owned Aetna

subsidiary servicing the Dallas area.

As part of the settlement, Aetna agreed to a hold separate order requiring it to ensure that Gulf Coast and Southwest "are maintained and operated as independent, ongoing, economically viable, and active competitors until completion of the divestitures." (Revised Hold Separate Stipulation and Order ¶ III.C.) Until the government determines that Gulf Coast and Southwest can function as effective competitors, Aetna may not take any action to consummate the proposed acquisition of Prudential. (Revised Final Judgment ¶ IV.I.)

In its complaint, the government alleged that Aetna's proposed acquisition of Prudential's health insurance business would have anticompetitive effects in two related relevant markets¹. First, the government charged that the acquisition would unreasonably restrain competition in the sale of HMO and HMO-POS plans in Houston and Dallas. Second, the acquisition would consolidate Aetna's purchasing power over physician's services in Houston and Dallas, enabling it to unduly reduce the rates paid for those services.

The Sale of HMO and HMO-POS Plans

In support of its position that HMO and HMO-POS plans are a separate product market, the government asserted that such plans differ from PPO or indemnity plans in terms of structure, price, licensing requirements and benefit configurations. (Complaint ¶ 15.) For example, HMOs provide superior preventive care benefits, but place limits on treatment options and generally require use of a primary care physician "gatekeeper". (*Id.*)

The government alleged that neither employers nor employees view HMOs and PPOs as reasonable substitutes for one another, and enrollees who leave an HMO disproportionately select another HMO, rather than a PPO, for their next plan. (*Id.* ¶ 17.) This is confirmed by brokers, consultants and health plans themselves, which note the differences in networks, benefits, regulatory requirements, administrative systems, medical management requirements, and cost between HMOs and PPOs. (Revised Competitive Impact Statement n.2.)

As to the geographic market, the government alleged that both patients and employers required

treatment close to where patients work or live, and that managed care plans competed on the basis of their local provider networks. (Complaint ¶ 19.) Therefore, the relevant geographic markets were the Metropolitan Statistical Areas in and around Houston and Dallas. (*Id.* ¶ 20.)

With the relevant market thus defined, according to the government, after the acquisition, Aetna would have a 63% share of the HMO market in Houston and a 42% share in Dallas. (*Id.* ¶ 22.) Because of the costs in time and money of setting up an HMO plan and because of advantages Aetna and Prudential hold over existing competitors, neither new entry nor existing competitors would be able to restrain anticompetitive conduct by Aetna (e.g., a price increase). (*Id.* ¶¶ 23-24.)

Physician Services

The complaint alleged that physician services also were a relevant product market with the same local geographic market as for HMO and HMO-POS plans (i.e., Houston and Dallas). (*Id.* ¶¶ 27-28.) As a result of the proposed acquisition, Aetna will account for a large share of all payments to physicians in the Houston and Dallas areas. Because of this market concentration, a significant number of physicians will be unable to reject Aetna's demands for lower rates than it could demand if Aetna and Prudential remained competitors². Thus, according to the government's complaint, the acquisition would give Aetna the ability to depress physicians' rates, likely leading to a reduction in quantity or quality of physicians' services. (*Id.* ¶ 33.)

The "HMO Market"

As previously mentioned, the Antitrust Division's position that HMOs are a relevant product market separate from PPOs and other fee-for-service plans could have a significant impact on health care antitrust and appears to place the Division at odds with the U.S. Court of Appeals for the Seventh Circuit.

In Blue Cross & Blue Shield v. Marshfield Clinic, 65 F.3d 1406 (7th Cir. 1995), the Court rejected the plaintiffs' claim that HMOs constituted a relevant product market. Writing for the Court, Chief Judge Posner, a recognized authority on antitrust law, noted that an HMO is not a distinctive organizational form or assemblage of skills but "is basically a method of pricing medical services." (*Id.* at 1409.)

Contrary to the Antitrust Division's position in Aetna, the Seventh Circuit in Marshfield found "that individuals, and their employers, and medical insurers (the real "buyers" of medical services, according to the plaintiffs) regard HMOs as competitive not only with each other but also with the various types of fee-for-service

providers, including "preferred provider" plans...." (*Id.* at 1410.) The Court also found that PPOs "are particularly close substitutes for HMOs, since they use the insurer's clout with physicians to drive down price." (*Id.*)

In addition, the Court found no significant barrier to the formation of HMOs:

All that is needed is an array of physicians who among them provide a broad range of medical services, and the same thing is needed for a preferred-provider plan. [*Id.*]

Thus, the Seventh Circuit concluded that HMOs are not a separate product market:

The services offered by HMOs and by various fee-for-service plans are both provided by the same physicians, who can easily shift from one type of service to another if a change in relative prices makes one type more lucrative than others. [*Id.*]

See, Ball Memorial Hospital, Inc. v. Mutual Hospital Ins., Inc., 784 F. 2d 1325 (7th Cir. 1986).

Although the Antitrust Division recognizes that its position differs from that of the Seventh Circuit, based on informal discussions with senior officials in the Division's Health Care Task Force it appears that the Division will persist in its position that HMOs are a separate product market. This could have a significant impact on health care antitrust.

Except for per se illegal violations of Section 1 of the Sherman Act³, the definition of a relevant market is a key part of any antitrust analysis. Under the "rule of reason,"⁴ which is the standard method used for analyzing possible restraints of trade, the competitive effects of an alleged restraint can only be evaluated in the context of a properly defined relevant market.

For example, the single most important factor in evaluating an exclusive dealing arrangement under Section 1 of the Sherman Act is the percentage of commerce foreclosed by the arrangement in a properly defined relevant market. Similarly, a key consideration in evaluating an attempt to monopolize under Section 2 of the Sherman Act is the market share of the company concerned. Moreover, a key and often determinative issue in evaluating a proposed acquisition under Section 7 of the Clayton Act is the market share of the company involved.

The potential problem caused by the Antitrust Division's advocacy of an HMO product market is that it is a narrower market than that most health care antitrust

attorneys believed was appropriate based on Marshfield Clinic. In general, a narrower market increases the market shares of the participants, and may make potential acquisitions and other agreement more susceptible to attack as violative of the antitrust laws.

It remains to be seen as to whether the Antitrust Division will be successful in convincing the courts to adopt its position that HMOs are a relevant product market. Nevertheless, the Antitrust Division's position has to be considered by competitors in the health care field in evaluating their proposed conduct in the managed care arena.

¹In antitrust analysis, a "relevant market" consists of both a product market and a geographic market. A product market consists of those products (or services) which consumers consider to be reasonable substitutes for one another. A geographic market consists of the area in which consumers, as a practical matter, can turn to other providers for substitute products.

²According to the complaint, this inability is exacerbated by Aetna's "all products clause", which requires a physician to participate in all of Aetna's health plans if he or she participates in any Aetna plan. (Complaint 32.)

³A per se illegal violation is one that is presumed illegal without inquiry into its actual competitive effects and which cannot be justified by its alleged procompetitive benefits. Per se illegal offenses include price fixing, horizontal market division, tying arrangements, and certain types of group boycotts.

⁴Simply stated, the rule of reason provides for an assessment of the anticompetitive effects of an alleged restraint against its potential procompetitive benefits in order to determine whether it amounts to an "unreasonable" restraint of trade.

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