



OFFICE OF
CONSUMER AND
COMPETITION ADVOCACY

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION

WASHINGTON, D.C. 20580

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COMMISSION AUTHORIZED

March 29, 1993

~~The Honorable W. Scott Garrett~~
Chairman, Assembly Insurance Committee
The State Assembly
61 Spring Street
Newton, NJ 07860

~~Dear Chairman Garrett:~~

~~The staff of the Federal Trade Commission¹ is pleased to submit this response to your request for views on the possible competitive effects of Assembly Bill No. 1221. This bill could limit the ability of several kinds of health benefit plans to arrange capitation-type services through contracts with providers, by requiring that services be available through any provider willing to meet the plan's terms. The bill would prevent limiting the panel of providers, and thus would discourage contracts with providers in which lower prices are offered in exchange for the assurance of higher volume. The bill~~
~~reduced transaction and auditing costs, made possible by the ability to contract selectively. Although the bill may be intended to assure consumers greater freedom to choose where they obtain pharmacy services, it appears likely to have the unintended effect of denying consumers the advantages of cost-reducing arrangements and limiting their choices in the provision of health care services.~~

I. Interest and experience of the Staff of the Federal Trade Commission.

The Federal Trade Commission is empowered to prevent unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.² Pursuant to this statutory mandate, the Commission encourages competition in the licensed professions, including the health care professions, to the maximum extent compatible with other state and federal goals.

¹ These comments are the views of the staff of the Federal Trade Commission, and do not necessarily represent the views of the Commission or any individual Commissioner.

² 15 U.S.C. § 41 et seq.

For several years, under the Commission and its staff have investigated the competitive effects of such arrangements.

The Commission has observed that competition among third-party payors and health care providers can enhance the range of services available to consumers in the market and can reduce the use by prepaid health care programs of limited panels of health care providers is an effective means of promoting competition among such providers.³ The Commission has taken law enforcement action against anti competitive efforts to suppress health care programs such as health maintenance organizations (HMO's), and limited panels of health care providers.⁴ The staff of the Commission has submitted, on request, comments to federal and state government bodies about the effects of various regulatory schemes on the competitive operation of such arrangements.

³ Federal Trade Commission, Statement of Enforcement Policy With Respect to Physician Agreements to Control Medical Prepayment Plans, 46 Fed. Reg. 48982, 48984 (October 5, 1981); Statement of George W. Douglas, Commissioner, On Behalf of the Federal Trade Commission, Before the Subcommittee on Health and the Environment of the Committee on Energy and Commerce, United States House of Representatives, on H.R. 2956: The Preferred Provider Health Care Act of 1983 at 2-3 (October 24, 1983); Health Care Management Associates, 101 F.T.C. 1014, 1016 (1983) (advisory opinion). See also Bureau of Economics, Federal Trade Commission, Staff Report on the Health Maintenance Organization and Its Effects on Competition (1977).

⁴ See, e.g., Medical Service Corp. of Spokane County, 88 F.T.C. 906 (1976); American Medical Association, 54 F.T.C. 201 (1979), aff'd as modified, 638 F.2d. 443 (2d Cir. 1980), aff'd by an equally divided court, 455 U.S. 676 (1982); Forbes Health System Medical Staff, 84 F.T.C. 1042 (1979); Medical Staff of Doctors' Hospital of Price George's County, 110 F.T.C. 476 (1977); Medical Staff of Holy Cross Hospital, No. C-3345 (consent order, Sept. 10, 1991); Medical Staff of Broward General Medical Center, No. C-3345 (consent order, Sept. 10, 1991); Medical Staff of Broward General Medical Center, No. C-3345 (consent order, Sept. 10, 1991); Sherman A. Hone, M.D., 98 F.T.C. 58 (1981).

⁵ The staff of the Commission has commented on a prohibition of exclusive provider contracts between HMO's and physicians, noting that the prohibition could be expected to hamper pro competitive and beneficial activities of HMO's and deny consumers (continued...)

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Several of these comments have addressed "any willing provider" requirements for pharmacy and other health care service contracts.

II. Description of A.B. 1221.

This bill would require HMO's, hospital and medical service plans, and health insurance plans that offer a prescription drug benefit to permit plan subscribers to obtain drugs from any pharmacy.⁷ In addition, it would require that any pharmacy be permitted to participate in a preferred or contract provider program if the pharmacy was willing to accept the program's terms.⁸ It would require that copayments, fees, or other conditions be the same for all participating pharmacies, including mail order pharmacies, and would forbid requiring the use of mail order pharmacies.⁹ The bill states explicitly that

⁵ (...continued)
the improved services that such competition would stimulate. See, e.g., Letter from Bureau of Competition to David A. Gates, Commissioner of Insurance, State of Nevada (November 5, 1986).

⁶ The staff submitted comments to the Massachusetts House of Representatives about legislation to require prepaid health care programs to contract with all pharmacy suppliers on the same terms as self-insured employers. See, e.g., letter from Bureau of Competition Representative John C. Bartley (May 30, 1989, commenting on S.B. 526). The staff has submitted similar comments on similar legislation in Pennsylvania (letter from Cleveland Regional Office to Senator H. Craig Lewis (June 29, 1990, commenting on S.B. 675)), New Hampshire (letter from Office of Consumer and Competition Advocacy to Paul J. Alfano (March 17, 1992, commenting on H.B. 470)), and California (letter from Office of Consumer and Competition Advocacy to Senator Patrick Johnston (June 26, 1992, commenting on S.B. 1996)). See also letter from Office of Consumer and Competition Advocacy to Montana Attorney General (June 26, 1992, commenting on S.B. 1996).
broad "any-willing-provider" requirement on PPO's.

⁷ Assembly, No. 1221 ("A-1221"), §§1(a)(1), 2(a)(1), 3(a)(1), 4(a)(1), 5(a)(1), 6(a)(1).

⁸ A-1221, §§1(a)(2), 2(a)(2), 3(a)(2), 4(a)(2), 5(a)(2), 6(a)(2).

⁹ A-1221, §§1(a)(3), 1(a)(4), 2(a)(3), 2(a)(4), 3(a)(3), 3(a)(4), 4(a)(3), 4(a)(4), 5(a)(3), 5(a)(4), 6(a)(3), 6(a)(4).

~~it is not intended to add to or increase the scope of benefits provided under group contracts or by HMO's.¹⁰~~

This comment will focus on the "any willing provider" aspects of the bill, that is, its requirement that all providers be permitted to participate in contracts to provide services, and on its effective prohibition of exclusive contracting for pharmacy services.¹¹ Our concern here is principally with the ultimate effects on the consumer that result from competition, or lack of it, among providers of health care services, including pharmacies. This comment addresses the effects on consumers of the bill's regulation of contracts in which insurance companies and health care plans such as HMO's act as purchasers of health care services.¹²

~~III. Competitive importance of programs using limited provider panels.~~

~~Over the last few years, financing and delivery programs that provide health care services through a limited panel of health care providers, have proliferated, in response to increasing demand for ways to moderate the rising costs associated with traditional fee-for-service health care. These~~

¹⁰ A-1221, §§1(b), 2(b), 3(b), 4(b), 5(b), 6(b).

¹¹ ~~The bill may also raise some issues which this comment will not address directly, related to the regulation of mail-order pharmacy service. Rivalry between mail order pharmacies and other providers, such as chain and independent pharmacies, has drawn considerable interest, but few systematic studies of differences in costs and services have appeared, and those that have been reported are difficult to interpret. For example, one study sponsored by a third party claims processor found that mail order service was associated with somewhat lower unit costs, but somewhat higher overall costs (to the employer sponsoring the repayment plan), suggesting that mail order arrangements might produce not only some efficiencies and lower prices, but also some changes in purchasing and usage habits. See Enright, Mail-order Pharmaceuticals, 44 Am. J. Hosp. Pharm. 1870, 1873 (1987).~~

¹² The Commission has no jurisdiction over the business of insurance. Contracts between health plans and service providers, and regulations of those contracts, do not involve the "business of insurance" for purposes of the antitrust exemption of the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15, and the exclusion from Federal Trade Commission jurisdiction, 15 U.S.C. §46. See Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205 (1979).

programs may provide services directly or arrange for others to provide them. The programs, which include HMO's and preferred or contract provider panels under other kinds of plans, typically involve contractual agreements between the payor and the participating health care providers. Even commercial insurers, which in the past did not usually contract with providers, and Blue Cross or Blue Shield plans, which do not contract, usually limit severely the number of providers that are included in their networks. Many of these plans also offer programs that do limit provider participation.

The popular success of programs that limit provider participation appears to be due largely to their perceived ability to help control costs. Economic studies have confirmed that under certain circumstances arrangements that permit selective contracting, competition helps to moderate cost increases.¹³ Competition among different kinds of arrangements for providing services, including those that limit provider participation and cost savings would be passed on to the consumers of health care services, either as lower out-of-pocket costs or improved services.¹⁴ This principle would apply to all types of health care payment programs and health care providers.

Providers compete, ultimately, for the business of patients. A pharmacy or other provider may pursue the business of subscribers to PPO or HMO programs by seeking access to those subscribers. A provider may perceive several advantages to such arrangements. A preferential or exclusive arrangement may assure the provider of enough business to make possible savings from economies of scale.

¹³ Studies have examined the competitive effects of selective contracting, in particular California's experience with permitting hospitals to contract selectively. See, e.g., J. C. Robinson and C. S. Phibbs, An Evaluation of Medicaid Selective Contracting in California, 8 J. Health Econ. 437 (1989). This study found that shifting from cost-reimbursement to permitting selective contracting, particularly in more competitive local markets. This study concentrated on Medicaid experience; however, further studies based on private health insurance experiences confirm these findings. See, e.g., D. Dranove et al., Is Hospital Competition Wasteful? 23 RAND J. Econ. 247 (1992); see also G. Melnick et al., The Effects of Market Structure and Bargaining Position on Hospital Prices, 11 J. of Health Econ. 217 (1992).

¹⁴ In addition, employers that realize savings in their health care costs may pass those savings on to buyers of their firms' goods and services.

for example, by spreading fixed costs over a larger volume of business, it could facilitate business planning by making sales volumes more predictable. The arrangement may payors with whom the provider does business, costs that would otherwise be incurred to generate the same business. To get access to the business and the advantages associated by these programs, pharmacies and other providers services, to get the payors' contracts.

Third-party payors may find such arrangements attractive because they would benefit from the providers' competition. Lower prices and additional services could mean lower costs for the third-party payor. Not only might the prices paid for services be lower, but in addition administrative costs might be lower for a limited-panel program than for one requiring the payor to deal with, and make payments to, all or most of the providers doing business in a program's service area. A payor might find it easier to implement cost-control strategies, such as claims audits and utilization review, if the number of providers whose records must be reviewed is limited. And lower prices and additional services would help make the payor's programs more attractive in the prepaid health care market.

Consumers too may prefer programs with limited or preferred provider panels, if the competition among providers leads to lower prices (which may take the form of lower premiums or deductibles) or other advantages. Consumer preference for such programs would presumably mean that, in the consumers' view,

choice of providers, such as reduced convenience or the occasional need to use a provider that is not part of the payor's contracted service. Limitations on choice are unlikely to be so severe that consumers' access to providers is inadequate. For just as competitive forces encourage providers to offer their services in combination to a payor in order to gain access to its subscribers, competition would also encourage accessibility that subscribers want. To the extent that consumers can change programs or payors if they are dissatisfied with service availability, payors have an incentive to assure that the arrangements they make for delivery of covered health care services satisfy consumers.¹⁵

¹⁵ For consumers in employer-provided health care programs that offer no choices of different levels of service availability, changing programs could require changing jobs. But employers have an incentive to add options if their employees are dissatisfied.

IV. ~~Effects of "any willing provider" requirements on limited-panel programs.~~

~~Any "willing provider" requirements and bans on exclusive or preferential contracting may limit firms' ability to reduce the cost of delivering health care without providing any substantial public benefit. They may make it more difficult for third-party payors to offer programs that have the cost savings and other advantages discussed above.~~

~~Because the bill would require that pharmacy services be available from any registered pharmacy, it would rule out entering exclusive contracts with a panel of particular pharmacy providers. It would also forbid offering an incentive, such as a lower copayment or fee, to use particular providers' services. Thus the bill would deny two means of ensuring that a contracting pharmacy would obtain a substantial portion of subscribers' business. Pharmacies may be unable to achieve economies of scale and offer lower price terms or additional services.~~

~~Even in the absence of economies of scale, requiring that programs be open to all providers wishing to participate on the same terms could discourage efforts to offer lower prices or additional services. Since any provider would be entitled to contract on the same terms as other providers, there would be little incentive for providers to compete in developing attractive or innovative proposals. Because all other providers can "free ride" on a successful proposal formulation, innovative providers may be unwilling to bear the costs of developing a proposal. Thus "any willing provider" requirements may substantially reduce provider competition for this segment of their business.~~

~~Reduced competition among providers for access to the business represented by limited-panel programs could result in higher prices for services through market power. Higher prices for services, as well as the increased administrative costs associated with having to deal with many more providers, may mean that subscribers to prepaid health care programs could face higher prices or reduced services.~~

~~Moreover, requiring programs to be open to more providers may not give the consumer any additional advantages of greater choice, if consumers may already choose other types of prepayment programs with fewer limits on the providers from which they may obtain covered services. Indeed, requiring open participation may reduce the options available to consumers without providing any additional consumer benefit.~~

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diminishing of competition for pharmacy service contracts
third party payors to pay higher prices for pharmacy
services and incur the higher administrative costs of dealing
with a large number of providers. Facing these higher costs,
third party payors may decide not to make these services
available. Thus a result of the prohibitions of A-1221 may be to
limit consumers' ability to select among alternative delivery
systems for pharmaceutical services.

V. Conclusion.

In summary we believe that "any willing provider"
requirements may unnecessarily restrict
consumer choice without providing any
We hope these comments are of assistance.

Sincerely,



Michael O. Wise
Acting Director