



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

**Bureau of Competition
Health Care Division**

February 13, 2008

Robert E. Bloch
Mayer Brown LLP
1909 K St., N.W.
Washington, D.C. 20006

Re: Kaiser Foundation Health Plan, Inc., Advisory Opinion

Dear Mr. Bloch:

This letter responds to your request on behalf of Kaiser Foundation Health Plan, Inc. for an advisory opinion on whether, under the Nonprofit Institutions Act (“NPIA”) exemption to the Robinson-Patman Act, Kaiser may lawfully purchase discounted pharmaceuticals for use in connection with a proposed program to provide health care services to persons covered under health benefits plans offered by self-insured employers (the “proposed program”). While your initial request appeared to seek a Commission opinion regarding the proposed program, you subsequently clarified that you were seeking a staff opinion pursuant to Section 1.1 (b) of the Commission’s Rules of Practice (16 C.F.R. § 1.1 (b)).¹ For the reasons explained below, and within the parameters and conditions set out below, it is our opinion that the NPIA exemption would apply to pharmaceuticals purchased by Kaiser for use in connection with its proposed program. We therefore would not recommend that the Commission challenge under the Robinson-Patman Act the purchase or sale of discounted drugs for use in that program, if implemented consistent with the discussion below.

I. The NPIA and the Robinson-Patman Act

The Robinson-Patman Act generally prohibits price discrimination in the purchase and sale of certain commodities, where the effect of the price discrimination “may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.”² The NPIA exempts from this prohibition “purchases of their supplies for their own use by schools, colleges, universities, public libraries, churches, hospitals, and charitable institutions not operated for profit.”³ Under the NPIA, eligible nonprofit entities therefore may purchase – and vendors may sell to them – supplies at reduced prices for the nonprofit institutions’ “own use,” without running afoul of the Robinson-Patman Act’s prohibitions.

¹See Letter from Robert E. Bloch, Mayer, Brown, Rowe & Maw LLP [hereinafter “Mayer Brown”] to David M. Narrow, FTC (September 1, 2006) at 1.

²15 U.S.C. § 13.

³15 U.S.C. § 13c.

In analyzing whether Kaiser is entitled to purchase discounted pharmaceuticals under the NPIA exemption as part of its proposed program, we first describe Kaiser's traditional HMO business. We then describe Kaiser's proposed program, including the ways that it differs from Kaiser's traditional HMO business, based on the information you have provided.⁴ Finally, we analyze and discuss our opinion regarding Kaiser's eligibility to purchase discounted pharmaceuticals under the NPIA exemption in conjunction with the proposed program, informed by prior court decisions, including one directly addressing the applicability of the exemption to purchases of pharmaceuticals under Kaiser's traditional HMO business.⁵

II. Facts

A. Kaiser's Historical and Current Operation as a Health Maintenance Organization

Kaiser is a non-profit California corporation that, together with its affiliates, is the largest integrated health care delivery system in the country. It has approximately 8.5 million members⁶ and, though it operates in nine states and the District of Columbia, the majority of its members reside in California. Until now, and as described by the U.S. Court of Appeals for the 9th Circuit in its 1984 decision in *De Modena v. Kaiser Foundation Health Plan, Inc.*, Kaiser and its affiliates have provided care "in a manner substantially different from the traditional fee-for-service method of health care in which a consumer pays a separate charge for each medical service or good provided by the doctor or hospital."⁷ In contrast to traditional fee-for-service provision of health care services, Kaiser has operated as a health maintenance organization ("HMO"), through which it and its affiliates – including the Permanente Medical Groups, which provide Kaiser's physician services, and Kaiser's hospitals – provide comprehensive, continuing, and preventive care to Kaiser members in exchange for a set monthly prepayment.⁸ Additionally, Kaiser members have had the option of participating in a pharmaceutical plan. As part of that plan, and for an extra monthly charge, they can purchase drugs at discounted rates at

⁴Unless otherwise noted, the factual description of Kaiser and its affiliates, and Kaiser's current and proposed programs, are based on the information submitted in support of its current request for an advisory opinion, as well as relevant legal precedent. We have not conducted an independent investigation regarding Kaiser and its affiliates, or the operation of its programs.

⁵See *De Modena v. Kaiser Foundation Health Plan, Inc.* 743 F.2d 1388 (9th Cir. 1984), *cert. denied*, 469 U.S. 1229 (1985) (hereinafter "*De Modena*").

⁶See Letter from Robert E. Bloch, Mayer Brown, to Markus H. Meier, FTC (June 12, 2006). We use the term "members" to refer to those persons covered under Kaiser's HMO programs to provide health care and related services, though we understand that participants in the proposed program also will be identified as "members." See E-mail from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 19, 2007).

⁷*De Modena*, 743 F.2d at 1390.

⁸See *De Modena*, 743 F.2d at 1390, 1393.

Kaiser hospitals or at non-hospital pharmacies operated by Kaiser affiliates.⁹ You have informed us that Kaiser continues to carry out the majority of its business in this manner, and that its current operations do not differ substantially from the description provided by the court in *De Modena*.¹⁰

B. Kaiser's Proposed Program

To meet what it sees as changing needs in markets in which it currently operates its HMO programs, Kaiser now proposes a program to allow it to offer its same set of services to persons covered under self-funded health benefits plans offered by employers. Kaiser expects that employers similar to those that now purchase its HMO plans will be the customers for this program. These customers include large public or private sector employers that elect to directly pay for the use of services covered under their health benefits programs, instead of purchasing insurance products through which they pay an insurance premium for coverage and thereby pass on the risk of variations in use of services and benefit costs to the insurer.

Kaiser states that, under its proposed program, it intends to offer a plan that is as similar as possible in scope, quality, and operation to what it currently offers to members under its traditional HMO program.¹¹ Kaiser emphasizes that enrollees in the proposed program will be treated exactly the same as traditional Kaiser HMO members. According to Kaiser, there will be no difference in the range of care available to persons covered under the proposed program and that available to members covered under Kaiser's traditional HMO plan. It will provide to enrollees the "full panoply" of health care services, including preventive care, just as it does for its HMO members.¹² The same professional staff will treat enrollees in the proposed program as treat HMO members, and will do so in the same manner and at the same locations used by HMO members.¹³ Additionally, enrollees in the proposed program will have access to all the other Kaiser programs available to HMO members, including educational programs, financial

⁹*See id* at 1390.

¹⁰*See* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 1, 2006) at 6.

¹¹*See* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 1; *see also* "Kaiser Foundation Health Plan," Presentation to the FTC (February 2, 2007) at 18.

¹²*See* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 1.

¹³*See* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 1, 2006) at 2, 6.

assistance programs, and care management programs. All rights or benefits to which Kaiser HMO members are entitled likewise will apply to enrollees in the proposed program.¹⁴ Thus, from the perspective of provision of care to enrollees, Kaiser believes that the proposed program will be indistinguishable from its traditional HMO business.¹⁵

Kaiser states that it anticipates that some employers may request certain benefit or coverage limitations regarding their self-funded health benefits plans. In self-funded health benefits plans, it is the employer that, in the first instance, decides the nature and scope of coverage to be provided to employees and others covered by the employer's plan. While Kaiser anticipates that such requests will be infrequent, it states that requests from employers for Kaiser to provide a scope of benefits that is more restrictive than Kaiser's traditional HMO coverage will be considered using the same standards as it applies to such requests from those purchasing its traditional HMO products.¹⁶

Kaiser's traditional HMO program and its proposed program differ, however, regarding their financial structure and operation. Under its HMO program, Kaiser receives monthly prepayment of "dues" for "membership" of each individual covered by its programs – essentially an insurance-type premium – and then bears the full financial risk of providing needed health care services to the covered population during the time period covered by the prepayment.¹⁷ Kaiser is required to operate in this fashion, at least in California, by that state's Knox-Keene Act, under which Kaiser is licensed to operate as an HMO.¹⁸ By contrast, Kaiser will not bear this type of

¹⁴See Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 3.

¹⁵In this regard, you have assured us that "Kaiser will provide the same level of services and care to all members of self-funded plans as it would be required to provide" under the relevant laws for HMOs operating in California, Colorado, Georgia, Hawaii, Maryland, Virginia, Oregon, Washington, Ohio, and the District of Columbia, the jurisdictions in which Kaiser currently operates its HMO program, and plans to offer the proposed program. See E-mail from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 19, 2007); see also E-mail from Robert E. Bloch, Mayer Brown, to Ellen Connelly, FTC (October 26, 2007). Kaiser expects that nearly all self-funded employers will contract for the full range of services as required under each jurisdiction's relevant law regarding HMOs. As discussed below, however, some employers may decide to offer their employees a more limited scope of covered services under the proposed program. In those cases, Kaiser will establish an administrative mechanism to distinguish and keep accurate account of any self-funded employer plan that does not agree to provide the applicable level of HMO coverage and therefore, in our opinion, would not qualify for the NPIA-exempt purchases by Kaiser regarding enrollees in that employer's plan. Kaiser will inform its pharmaceutical suppliers manufacturers of any such non-qualifying employer programs, and establish a protocol to reconcile any purchases from the suppliers to ensure that Kaiser has not obtained the benefit of the NPIA exemption in purchasing pharmaceuticals at discount for use by persons covered by such non-conforming programs. See E-mail from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 19, 2007).

¹⁶See Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 1.

¹⁷See *De Modena*, 743 F.2d at 1390.

¹⁸See Knox-Keene Health Care Service Plan Act of 1975, § 1375.1 (as amended Feb. 2005). Unlike California's requirement of prepayment for plans licensed under the Knox-Keene Act, the other jurisdictions in which Kaiser currently operates its HMO program do not have a prepayment requirement for those programs. However, as a matter of "administrative convenience," for example in contracting with multi-state employers, and to

“insurance” risk for the provision of covered services to enrollees under its proposed program. Rather, the employers will contract with Kaiser to provide a range of covered services under the employers’ plans, and the employers then will pay Kaiser on a fee-for-service basis for the services Kaiser actually provides. Under this arrangement, the employers themselves will retain the obligation to pay for whatever benefits are provided under their self-insured health benefits plans.¹⁹

In order to offer its proposed program in California without conflicting with the prepayment requirement of the Knox-Keene Act, Kaiser plans to offer the proposed program through a Kaiser subsidiary, the Kaiser Permanente Insurance Company (“KPIC”). KPIC is licensed in California as a health and disability insurance company, and does not have the prepayment requirement applicable to programs offered by plans licensed under the Knox-Keene Act. An employer wishing to participate in the proposed program will contract with KPIC for administration of the program. KPIC, in turn, will contract with Kaiser and its affiliates for the provision of covered health care services to enrollees in the employer’s plan.²⁰

Kaiser states that the revenues received by KPIC from contracts with employers under the proposed program will consist only of “fees for administrative services, such as enrollment and eligibility services, benefit determinations, claims processing and adjudication, provider network administration, medical management, member appeals resolution, and administration of continuation plans such as COBRA and Medicare.”²¹ These administrative services will be performed by KPIC or by a third-party with which KPIC contracts, and charges for administrative services provided by KPIC for Kaiser under the proposed program will be paid from the self-funded employer’s plan account. Also as part of this administrative function, KPIC periodically will transfer monies to Kaiser from an employer’s plan account to cover the charges for the health care services provided by Kaiser to enrollees in the employer’s plan.²²

assure uniformity in program administration, Kaiser plans to employ the same contracting and administrative structure in all locations where it implements the proposed program. *See* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 2-3.

¹⁹In self-insured programs, the employer essentially acts as the insurance company regarding the risk of variations in the total cost of covered services for the covered population of employees and dependents. Self-funded health benefits programs generally are not subject to state HMO or insurance regulatory requirements, including requirements as to scope of benefits or coverage that must be provided. Rather, they are subject to certain types of regulatory oversight by the U.S. Department of Labor under ERISA, the federal Employee Retirement and Income Security Act of 1974. *See generally*, 29 U.S.C. Chapter § 1001, *et. seq.* (2007).

²⁰*See* Letter from Robert E. Bloch, Mayer Brown, to Markus H. Meier, FTC (June 12, 2006) at 2; *see also* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 1, 2006) at 6.

²¹Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 2.

²²Kaiser states that it annually will negotiate with the regional PMGs a budgeted amount projected to cover the PMGs’ provision of medical services to persons covered under self-insured employers’ plans. This amount will be based on numbers of covered lives and the covered populations’ utilization histories. Kaiser, through KPIC, periodically will prepay a set amount to the PMGs for provision of those services. At least each year, Kaiser and the medical groups will renegotiate the prepayment amount to more closely approximate the actual cost of providing

Although KPIC itself is a for-profit California corporation, its operating rules state that “the sole purpose of KPIC is to support and enhance the growth and development of Kaiser Permanente’s prepaid group practice programs – *i.e.*, the integrated health-care delivery system.”²³ KPIC does not distribute its earnings to its shareholders, and if it ever were to make such distributions at some point in the future, those distributions would be made only to Kaiser, as the holder of all of KPIC’s preferred stock.²⁴

The Permanente Medical Groups (“PMGs”) consist of seven separate for-profit professional physician corporations and one for-profit physician partnership. Kaiser, or one of its subsidiaries, contracts with the PMGs exclusively in each region where Kaiser operates to have the PMGs and their physicians provide care to Kaiser members under its HMO programs. Medical and other covered health care services likewise will be provided to enrollees in the proposed program by the PMGs and their physicians.²⁵

Kaiser also will do all purchasing and dispensing of pharmaceuticals for use in connection with the proposed program.²⁶ Kaiser will bill the self-funded employers at market-rate prices, and not

covered services to the covered self-insured enrollees. By this approach, Kaiser will approximate how it operates with respect to the PMGs in annually setting capitation amounts for the PMGs’ treatment of its HMO members – an amount that is a portion of Kaiser’s set premium that is prepaid by HMO members. Under the proposed program, however, Kaiser will receive payment from the employers’ plans based on fee-for-service charges for the specific services actually provided to enrollees under the plans. Therefore, there may be a difference between what Kaiser actually takes in on a fee-for-service basis from employers, and the prepayment amounts paid by Kaiser to the PMGs for those services. Kaiser states that any adjustments to reconcile the difference between those amounts will be made in such a way as to assure that the financial adjustments do not affect the PMGs’ or their physicians’ incentives regarding the services to be provided to patients covered under the proposed program. In this regard, Kaiser states that it will set aside payments from self-insured employers in a separate fund. From that fund, Kaiser will be reimbursed for its administrative services under the program, as well as for the prepayments it makes to the PMGs. Kaiser states that “ownership of . . . [any remaining] funds in the SF [self-funded] Account will be apportioned appropriately between Health Plan [Kaiser] and Medical Group [PMG] according to a negotiated methodology designed to fairly reflect the parties’ roles in relation to the professional and administrative components of such services.” Disparities between receipts and the actual cost of providing care also will be used to adjust the next year’s prepayment levels to the PMGs, either up or down. *See* E-mails from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (January 11, 2008 and January 18, 2008); Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 13; *see also* E-mail from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 19, 2007).

²³*See* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 1, 2006) at 1. KPIC has preferred and voting common stock. All of the preferred stock and 50% of the voting common stock is held by Kaiser. The PMGs own the remaining 50% of KPIC’s common stock. KPIC is governed by a Board of Directors, which consists of three Kaiser representatives and three representatives of the PMGs. KPIC’s President is a Kaiser employee and, according to Kaiser, effectively it is Kaiser that runs KPIC on a day-to-day basis.

²⁴The PMGs, which are holders only of KPIC common stock, are not entitled to receive any distributions of earnings that KPIC might make. *See* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 2.

²⁵*See* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 1, 2006) at 2.

²⁶*See* Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 2.

at the NPIA-discounted prices it pays for the drugs, for any pharmaceuticals used in the treatment of enrollees in the proposed program. The difference between what Kaiser pays for the NPIA-discounted pharmaceuticals and what it takes in by being reimbursed for the drugs from the self-funded plans at market prices will be kept by Kaiser and used to lower its overall operating expenses, thereby potentially benefitting all Kaiser members and enrollees.²⁷

III. Analysis

To determine whether Kaiser's proposed program falls within the NPIA exemption, we must address two questions: (1) whether the entity or entities that will be purchasing the discounted pharmaceuticals qualify as eligible nonprofit institutions under the statute and, if so; (2) whether the pharmaceuticals purchased for the proposed program pursuant to the NPIA exemption will be used for a purpose that qualifies as for the eligible entity's or entities' "own use."

Our determination of what qualifies as "own use" in this case is guided by the Supreme Court's opinion in *Abbott Laboratories v. Portland Retail Druggists Association, Inc.*²⁸ There, in assessing whether a hospital's purchase and use of discounted drugs was for its "own use" so as to fall within the NPIA statutory exemption, the Court observed that the analysis should focus on the function performed by the institution in its purchase and resale role. The Court stated, "their own use" is what reasonably may be regarded as use [by the eligible institution] in the sense that such use is a part of and promotes [its] intended institutional operation."²⁹ The Supreme Court in *Abbott Laboratories* emphasized, and the court of appeals in *De Modena* subsequently reiterated, that exceptions to the Robinson-Patman Act are to be construed narrowly, and the NPIA exemption was not "to be applied and expanded automatically to whatever new venture the nonprofit . . . [institution] finds attractive in these changing days."³⁰

To help us determine both whether the purchase of discounted drugs for the proposed program is by an eligible entity, and whether the purchase and use of discounted drugs for Kaiser's proposed program will be for its "own use," we look to the Ninth Circuit Court of Appeal's previous analysis and discussion of those issues in *De Modena*,³¹ which applied the Supreme Court's *Abbott Laboratories* analysis to Kaiser's traditional HMO business.

In *De Modena*, the issue before the court was Kaiser's eligibility to purchase NPIA-discounted pharmaceuticals for use in connection with its HMO business. Examining the requirements an entity must meet to qualify to make discounted purchases under the NPIA, the court concluded

²⁷See *id.* at 1-2.

²⁸*Abbott Laboratories v. Portland Retail Druggists Ass'n., Inc.*, 425 U.S. 1 (1976) ("*Abbott Laboratories*").

²⁹*Id.* at 14.

³⁰See *id.* at 13 (quoted in *De Modena*, 743 F. 2d at 1392).

³¹See *De Modena*, 743 F.2d 1388 (9th Cir. 1984).

that Kaiser's purchases of pharmaceuticals for resale to its HMO members fell within the exemption. The court first discussed the nonprofit status of Kaiser and HMOs generally, and concluded that they were eligible entities within the language and intended scope of the NPIA exemption.³² Then, finding HMOs, like Kaiser, to have the extraordinarily broad institutional function of providing a complete panoply of health care to their members, the court concluded that "any sale of drugs by an HMO to one of its members falls within the basic function of the HMO."³³ Key to the court's decision was that, through its HMO plan, Kaiser obligated itself to provide "continuing and often preventive care" to its members in exchange for prepayment.³⁴ Distinguishing this type of plan from the more common arrangement for providing health care services outside an HMO arrangement, the court said, "[w]hereas fee-for-service hospitals provide health care on a temporary and usually remedial basis to their patients, HMO's provide continuing and often preventive care for their members."³⁵ Thus, Kaiser's mission of providing the complete panoply of services to its members, including continuing and preventive care, on an ongoing basis appeared to be the crucial factor in the court's finding that the purchase and sale of pharmaceuticals to Kaiser's members was for its "own use" as an HMO, within the meaning of the NPIA.

Kaiser's current proposal, however, diverges from its typical method of doing business as an HMO. The analysis in *De Modena* dealt with the applicability of the NPIA to Kaiser's traditional HMO program, where Kaiser receives a prepayment, maintains all the financial risk of variations in the costs of treating its members during the coverage period, and covenants to provide them with the "complete panoply of health care" services on an ongoing basis during that period.³⁶ Thus, *De Modena* does not directly address the question of the NPIA's applicability to Kaiser's proposed program. Nevertheless, as we discuss below, the court's opinion in *De Modena* provides helpful guidance in resolving the issues raised by Kaiser's proposal.

A. Eligibility of Kaiser for Exemption from the Robinson-Patman Act Under the NPIA

As noted above, the NPIA, by its terms, applies to pharmaceuticals purchased by, or sold to, eligible institutions.³⁷ We therefore must first determine if the purchaser of the discounted drugs under the proposed program will be an NPIA-eligible entity. Though nonprofit integrated health delivery systems or HMOs, such as Kaiser, are not explicitly enumerated as eligible institutions in

³²*Id.* at 1391-92.

³³*Id.* at 1393.

³⁴*Id.*

³⁵*Id.*

³⁶*See id.*

³⁷*See Abbott Laboratories*, 425 U.S. at 14.

the NPIA's statutory language, the court in *De Modena* concluded that nonprofit HMOs generally, and Kaiser specifically, qualified as charitable, nonprofit institutions eligible to purchase discounted pharmaceuticals under the NPIA.³⁸ Based on the information that you have provided, we have no reason to believe that Kaiser's status as an eligible nonprofit institution under the NPIA has changed since the *De Modena* decision.³⁹

As we understand the proposed program, only Kaiser, the NPIA-eligible entity, will participate in the purchase and distribution of the NPIA-discounted pharmaceuticals.⁴⁰ Analysis of Kaiser's proposed program is complicated, however, by the involvement of various other entities that themselves clearly are not eligible for the NPIA exemption. These include the for-profit PMGs, whose physicians will provide medical services to program enrollees, for-profit KPIC, through which Kaiser is proposing to offer its program to self-insured employers, and potentially at least some of the self-funded employers, who will be making the program available to their employees.⁴¹ Thus, we must examine whether Kaiser's proposed program still falls within the NPIA exemption, despite the involvement of various ineligible entities, and the possibility that some of the program's financial benefit from the exemption could run to those ineligible entities.

The mere involvement of ineligible entities in the proposed program does not necessarily render the program ineligible for the NPIA exemption. The PMGs, for example, at the time of the *De Modena* decision, provided, and currently provide, the medical services under Kaiser's NPIA-eligible HMO program, and PMG physicians prescribe the drugs that Kaiser purchases at a discount under the NPIA for its HMO program. The court in *De Modena* expressly addressed this issue, concluding that the involvement of the for-profit PMGs did not make Kaiser a for-profit institution ineligible for the NPIA exemption.⁴² Similarly, KPIC's involvement in the proposed program will be solely as a Kaiser-controlled subsidiary, acting as an agent on behalf of Kaiser, to implement the proposed program for Kaiser in accordance with state regulatory law requirements, which prevent Kaiser from doing so itself. As noted previously, KPIC has no independent

³⁸See *De Modena*, 743 F.2d at 1391-92.

³⁹You have informed us that Kaiser continues to operate in substantially the same manner as described by the court in *De Modena*. See Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 1, 2006) at 6.

⁴⁰See Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 2.

⁴¹Some self-insured employers may be nonprofit entities that themselves would be eligible entities under the NPIA. We do not here address the question of whether, if savings from the purchase of NPIA-discounted drugs were to accrue to an NPIA-eligible nonprofit employer offering a self-funded health benefits plan to its employees, this would be permissible under the NPIA.

⁴²See *De Modena*, 743 F.2d at 1391. ("That the [Kaiser health plans] and Kaiser Hospital must fulfill their need for certain medical services by contracting with doctors who seek a profit does not make the [health plans] and Kaiser Hospitals themselves for-profit organizations.").

business function other than to facilitate Kaiser's ability to provide certain comprehensive and ongoing health care services. Likewise, any distribution of profits that KPIC might generate from any of its activities would go solely to Kaiser for use in furthering its nonprofit institutional mission.⁴³

Furthermore, Kaiser will ensure that the financial benefit of its NPIA-discounted drug purchases under the proposed program will not accrue to KPIC, the PMGs, their employed physicians, or to the self-insured employers. It will do so, in part, by charging market-rates to employers for the pharmaceuticals dispensed to enrollees in the proposed program. The benefit of the discounted purchases will accrue only to Kaiser, lowering its overall operating expenses in providing health care services to those receiving services under all of its programs. This aspect of the proposed program's operation is crucial to the applicability of the NPIA exemption to the program. Should entities not eligible for the NPIA exemption participate in the purchase of the discounted pharmaceuticals, or share in any financial benefit from the purchase of discounted drugs under the NPIA exemption, the arrangement would not, in our opinion, qualify under the NPIA.⁴⁴

B. Discounted Pharmaceuticals as Supplies for Kaiser's "Own Use"

Next we must determine whether the purchase of NPIA-discounted pharmaceuticals by Kaiser for its proposed program can properly be considered as being for its "own use," as required by the language of the statute. The starting point for analysis of the "own use" requirement is the Supreme Court's opinion in *Abbott Laboratories*, and the relevant inquiry under that precedent is whether the drugs purchased under the exemption will be part of, or promote, Kaiser's intended institutional function.⁴⁵

As the Supreme Court in *Abbott Laboratories* emphasized, not all activities of an NPIA-eligible institution will qualify as meeting this test, and supplies used for purposes not meeting the "own use" test will not qualify for the NPIA exemption.⁴⁶ Nevertheless, in *De Modena*, the court of appeals characterized HMOs, including Kaiser, as having an "extraordinary [sic] broad institutional function."⁴⁷ The court concluded that "any sale of drugs by an HMO, such as Kaiser-Permanente, to one of its members falls within the basic function of the HMO," and that its purchase of drugs for resale to its members "are purchased for the HMO's 'own use' within the meaning of the Nonprofit Institutions Act and thus qualify for protection under the Act."⁴⁸ The court noted that "[h]ealth maintenance organizations (HMO's), such as Kaiser-Permanente, are

⁴³See Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 1-2.

⁴⁴See discussion in § III.B.3, below.

⁴⁵*Abbott Laboratories*, 425 U.S. at 14.

⁴⁶*Id.* at 13.

⁴⁷*De Modena*, 743 F.2d at 1393.

⁴⁸*Id.*

designed to provide a complete panoply of health care to their members,” including “continuing and often preventive health care,” and contrasted this function with fee-for-service hospitals, which provide services “on a temporary and usually remedial basis to their patients.”⁴⁹

We therefore examine the similarities and differences between Kaiser’s HMO program, for which the purchase and sale of NPIA-discounted drugs was held in *De Modena* to be for Kaiser’s “own use,” and its proposed program for employers’ self-funded health benefits plans.

1. Scope of Services Provided by Kaiser Under the Proposed Program

As described above, Kaiser asserts that it has structured its proposed program so that the health care and related services available and provided to enrollees under the proposed program will be identical to those currently provided to Kaiser members under its HMO program. Thus, Kaiser will provide enrollees with “a complete panoply of health care” services, including preventive health care services, which was a key factor in the *De Modena* court’s identification of Kaiser’s basic institutional function underlying its eligibility for the NPIA exemption. To assure that this is the case, Kaiser has committed that it “will provide the same level of services and care to all members of [i.e., enrollees in] self-funded plans as it would be required to provide under state law for HMOs in the states [and D.C.] where Kaiser offers the self-funded plans.”⁵⁰

While Kaiser seeks to provide the same full range of services under its proposed program as it does under its HMO plan, Kaiser acknowledges that in some instances it is possible that individual employers may request that Kaiser provide a more limited scope of benefits for the employer’s self-funded health benefits plan, just as employers sometimes do under Kaiser’s traditional HMO programs. Where this occurs, Kaiser will decide whether or not to honor requests to remove a particular service from the scope of coverage offered by an employer under a self-insured plan by applying “the same criteria that are applied today when employers seek to modify the services offered in a traditional HMO plan,” and Kaiser states that it will maintain ultimate control over the package of services offered to self-insured employers under the proposed program.⁵¹ Kaiser, however, is unwilling to absolutely commit prospectively that it will only contract with employers whose self-funded health benefits plans provide a scope of coverage that would meet mandated minimum HMO benefits or coverage requirements.

To the extent that Kaiser agrees to provide services for a self-funded plan that will not cover a range and level of services that would be required to be offered by an HMO program operating in the jurisdiction in which the proposed program is offered, Kaiser acknowledges that the NPIA

⁴⁹*Id.*

⁵⁰See E-mail from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 19, 2007). Kaiser informs us that all jurisdictions in which it currently does business have mandated minimum benefit levels for HMO programs. See E-mail from Robert E. Bloch, Mayer Brown, to David M. Narrow and Ellen Connelly, FTC (September 30, 2007).

⁵¹See Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 1.

exemption will not apply to drugs provided under that plan. To deal with those potentially “non-conforming self-funded plans,” which Kaiser expects to be the exception, it will establish an administrative mechanism by which it will be able to distinguish and keep account of the use and provision of pharmaceuticals under the plan. Kaiser will notify suppliers of pharmaceuticals for use by enrollees in such non-conforming plans, and establish a protocol to reconcile purchases.⁵² This will ensure that suppliers do not face potential exposure to liability for selling discounted drugs where such sales would not be covered by the NPIA, and that Kaiser does not receive the financial benefit of purchasing discounted drugs where the exemption would not apply.

2. Provision of Services to Members on a Continuing Basis

Another factor in the *De Modena* court’s description of Kaiser’s and HMOs’ basic institutional function was that their method of operation obligates them to provide services to members on a continuing basis.⁵³ The court contrasted this obligation to the situation where health care services are provided, for example by hospitals, on a “temporary and usually remedial basis,” with payment made on a fee-for-service basis. While the court in *De Modena* did not directly discuss the significance of the prepayment component of Kaiser’s HMO program, it appears to be relevant to the analysis because it was the means by which Kaiser contractually incurred the obligation to provide its health care services on an ongoing basis, in contrast to one-time, or episodic provision of services on a fee-for-service basis. The court implicitly considered the prepayment aspect of Kaiser’s HMO plan in noting Kaiser’s concomitant obligation to provide its health care services on an ongoing basis, which is a direct result of such prepayment.⁵⁴ Nevertheless, it is not entirely clear from the court’s opinion that prepayment is an independently necessary aspect of an NPIA-qualified HMO program’s operation.

Kaiser argues that its intended institutional function is premised on its provision of comprehensive health care services to consumers on a nonprofit basis, not its use of prepayment as a way of charging for those services.⁵⁵ Under its proposed program, rather than using the prepayment mechanism to assure provision of care to enrollees on an ongoing basis, Kaiser will both contractually obligate itself to provide, and the contracting employers to pay for, those services on an ongoing basis and in the same manner and scope as Kaiser does under its traditional prepaid HMO arrangements. Though billing and payment for services provided under the proposed program will be on a per-unit (i.e., fee-for-service) basis, Kaiser (through KPIC) will enter into contracts of the same length with the self-funded employers as it does with its

⁵²See E-mail from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 19, 2007).

⁵³*De Modena*, 743 F.2d at 1393, and at n. 7.

⁵⁴The court described Kaiser’s use of prepayment, in the form of monthly “dues” paid by Kaiser “members” for access to Kaiser’s ongoing health care services, contrasting this practice with fee-for-service health care, where consumers “pay a separate charge for each medical service or good provided by the doctor or hospital.” *De Modena*, 743 F.2d at 1390.

⁵⁵See Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 1, 2006) at 3.

HMO program customers, thereby obligating itself (and the employers) to provide services on an ongoing basis for the term of the contract. Kaiser will prepay the PMGs that treat enrollees in the proposed program, just as it does for the PMGs for treating members under Kaiser's HMO program.

Kaiser also will institute safeguards in its contracts with the PMGs regarding the proposed program to ensure that there are no incentives for physicians to treat enrollees in the program differently from members covered under Kaiser's traditional HMO program.⁵⁶ Although providers of health care services will not be completely blinded to a patient's benefit plan, self-funded enrollees will be identified as Kaiser members, and Kaiser asserts that the providers of services under the proposed program will have no financial incentive that might affect what services to provide to the enrollees under their care, as normally could be the case where the providers of services are paid on a fee-for-service basis. Physicians providing medical services through the PMGs are all salaried, regardless of whether they are treating HMO members or self-insured plan enrollees. Additionally, existing quality and utilization review standards and programs, which Kaiser uses to encourage proper levels of treatment for members of its HMO plans, will apply to the proposed program.⁵⁷ Thus, while the somewhat different financial operation of the proposed program could result in the PMGs receiving some additional monies beyond the prepayment amounts under the proposed program, this should not affect the services provided by PMG physicians and other providers, whose salaries are not affected by these funds, and who continue to operate under the same quality and utilization standards for services provided to all Kaiser members and enrollees.

Insofar as Kaiser, through the proposed program, and without a prepayment component, is able to offer and obligate itself and its affiliates, as well as contracting employers, to provide Kaiser's traditional comprehensive range of services on a continuing basis to additional persons not otherwise able to access its traditional HMO program, we believe that the proposed program helps to promote what the court in *De Modena* called Kaiser's "extraordinary [sic] broad institutional function."⁵⁸ We therefore do not read *De Modena* as holding that the prepayment aspect is independently essential for Kaiser's programs to be part of, or promote, Kaiser's

⁵⁶See Letter from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (May 30, 2007) at 3; E-mail from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (January 11, 2008); see also E-mail from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (September 19, 2007).

⁵⁷See E-mails from Robert E. Bloch, Mayer Brown, to David M. Narrow, FTC (January 11, 2008 and September 19, 2007). Though Kaiser will not bear financial risk for the proposed program, it will prepay the PMGs for the estimated cost of providing the care to enrollees in the program for the contract term, just as it does under its HMO plan. Kaiser has not finalized the details of the PMGs' compensation structure but, as it does so, it will ensure through provisions of the contracts between Kaiser and the PMGs that compensation to the PMGs operates in a way that will avoid any incentives to the PMGs (or their individual physicians) to treat the patients under the self-funded program differently than HMO patients.

⁵⁸*De Modena*, 743 F.2d at 1393.

intended institutional function.⁵⁹ Our conclusion in this regard is premised on Kaiser's and employers' contractual obligations under the proposed program to assure that enrollees receive the same comprehensive scope of services on a continuing basis as do Kaiser's members under its traditional HMO programs. Absent such obligation, we would not view the proposed program as furthering what the court in *De Modena* characterized as Kaiser's "extraordinary [sic] broad institutional function."⁶⁰

3. The Effect of Involvement in the Proposed Program of Entities Not Eligible for the NPIA Exemption on Meeting the NPIA's "Own Use" Requirement

The administration of the proposed program will involve for-profit entities that are not themselves eligible for the NPIA exemption. *De Modena* made clear that the mere participation of for-profit entities in Kaiser's arrangement for providing health care services (i.e., the PMGs) did not invalidate Kaiser's eligibility for the NPIA exemption. The involvement of such entities in the proposed program, however, could be problematic if they, rather than Kaiser, were the purchasers of the drugs under the program, or if any of the financial benefit of Kaiser's purchase of NPIA-discounted drugs were to accrue to them. We previously have noted that, under the proposed program, Kaiser itself – not KPIC or the PMGs – will be the purchaser of the NPIA-discounted drugs. Likewise, any financial benefit from the purchase of discounted drugs, which will be paid for by the self-insured employers at market prices, will be retained by Kaiser itself, and not shared with, or retained by, KPIC, the PMGs, or their physicians.

A similar concern could arise regarding the employers offering self-insured health benefits plans to their employees under the proposed program. If for-profit employers, or other customers that themselves were not eligible entities under the NPIA, were to contract with Kaiser under the proposed program and be charged only the NPIA-discounted costs of pharmaceuticals provided to their employees under the program, in our opinion, this would disqualify the arrangement from eligibility for the statutory exemption. In that case, the savings from the discounted purchases would directly benefit entities not eligible for the NPIA-authorized discounts, and the purchases more properly would be characterized as for the employers', rather than Kaiser's, "own use."

⁵⁹ It is possible that the court in *De Modena* would disagree with our analysis, and conclude that the prepayment component was integral to Kaiser's basic institutional function as an HMO, or that absent the prepayment (i.e., "insurance") aspect of the program's operation, it would be the self-insured employers, rather than Kaiser, that were providing the comprehensive and ongoing services to enrollees under their self-insured plans. Nevertheless, we believe that our interpretation of the scope of Kaiser's basic institutional function to include offering its same HMO package of services to self-insured employers through an alternative financing arrangement necessitated by California's regulatory structure is not inconsistent with the *De Modena* court's decision, and also is consistent with the court's expansive characterization of Kaiser's basic institutional function in interpreting and applying the NPIA exemption to Kaiser's operation. Moreover, because Kaiser will be selling the drugs obtained at discount to enrollees in the proposed program at market and not discounted prices, application of the NPIA to this arrangement appears less likely to result in the loss of sales by retail pharmacies that are potential alternative suppliers of those prescription drugs to enrollees – the type of "secondary-line" harm to competition or competitors that is among the concerns underlying the Robinson-Patman Act's prohibitions. See generally XIV Herbert Hovenkamp, *Antitrust Law* ¶¶ 2301-2302, 2331, 2333, 2342 (1999).

⁶⁰ *De Modena*, 743 F.2d at 1393.

Kaiser, however, has stated that drugs provided to enrollees under the proposed program will be billed to the self-funded employers at market prices, and the savings from the discounted purchases will go only to Kaiser, to be used to reduce its overall operating expenses. In this way, the financial benefit of the discounted drug purchases under the proposed program will be shared by all of Kaiser's customers, and Kaiser will not be placing itself at any competitive advantage over area retail pharmacies or other competitors in its sale of pharmaceuticals to patients covered by the proposed program. This use of the savings from the proposed program's discounted drug purchases appears to be consistent with the courts' understanding of the purposes of the NPIA exemption.⁶¹

IV. Conclusion

Based on the facts you have provided, and consistent with the analysis and caveats discussed above, it is our opinion that the NPIA exemption would apply to pharmaceuticals purchased by Kaiser for use in connection with its proposed program. We therefore would not recommend that the Commission challenge under the Robinson-Patman Act the purchase or sale of discounted drugs for use in that program if implemented consistent with the discussion above.

This letter sets out the views of the staff of the Bureau of Competition, as authorized by the Federal Trade Commission's Rules of Practice. Under Section 1.3(c), the Commission is not bound by this staff opinion and reserves the right to rescind it at a later time.⁶² In addition, this office retains the right to reconsider the questions involved and, with notice to the requesting

⁶¹See *De Modena*, 743 F.2d at 1394, noting that the exact intent of Congress in enacting the NPIA exemption is "less than crystal clear from a reading of the legislative history," and quoting from *Abbott Laboratories* (425 U.S. at 23 (Marshall, J., concurring): "[A]t least one Justice has concluded that the Act was passed because 'Congress was primarily interested in directly aiding nonprofit institutions by lowering their operating expenses, but not interested in indirectly aiding such institutions by providing them with the means of raising additional money.'" The *De Modena* court also observed that "Congress passed the . . . [federal HMO Act] . . . to ensure that consumers have a free choice among various methods of obtaining medical care . . . [and] we decline to interpret the somewhat open-ended language of the Nonprofit Institutions Act in a way which would impinge upon the free choice of consumers of medical goods and services." *De Modena*, 743 F.2d at 1394. Consistent with that view, our interpretation allows Kaiser to provide its program of comprehensive and continuing health care services to a group of consumers – employees of self-insured employers, and those employees' dependents – who otherwise would be unable to have access to Kaiser's approach to providing medical goods and services, as well as providing Kaiser with a means of reducing its overall operating expenses by allowing it to purchase pharmaceuticals at a discount for use by those individuals.

⁶²16 C.F.R. § 1.3(c).

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party, to rescind or revoke the opinion if implementation of the proposed program results in substantial anticompetitive effects, if the program is used for improper purposes, if facts change significantly, or if it would be in the public interest to do so.

Sincerely,

Markus H. Meier
Assistant Director