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Edward E. Hollowell

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HYDE: EXCLUSIVE CONTRACTS

EDWARD E. HOLLOWELL*

The United States Court of Appeals for the Fifth Circuit held in *Hyde v. Jefferson Parish Hospital District No. 2*¹ that a public hospital which had entered into an exclusive contract with a medical corporation to provide anesthesia services at the hospital was in violation of section 1 of the Sherman Act. The *Hyde* decision stands in stark contrast to decisions throughout the country which have consistently upheld the right of a hospital to enter into an exclusive contract with physicians for providing certain medical services at the hospital.²

Exclusive contracts are common in the hospital-based specialties of anesthesiology and pathology. Courts have recognized the value of exclusive contracts in promoting better patient care by, for example, providing continuous availability of professional services,³ promoting better and more uniform standards by the technicians,⁴ and reducing scheduling problems.⁵ However, a practitioner who is not a member of the group with whom the hospital has entered into an exclusive contract is barred from practicing his specialty at the hospital. It is well-settled that a physician does not have an unqualified right to practice his profession in a public hospital,⁶ but a hospital cannot exclude a physician or surgeon from practice therein by rules, regulations or acts of the hospital's governing authorities which are unreasonable or discriminatory.⁷

Exclusive contracts have been subjected to numerous attacks by

* Partner in the firm of Hollowell & Silverstein, Raleigh, N.C.

1. 686 F.2d 286 (5th Cir. 1982), cert. granted, 103 S. Ct. 1271 (1983).

2. The Fourth Circuit Court of Appeals in *Harron v. United Hosp. Center, Inc.*, 522 F.2d 1133 (4th Cir. 1975) (*per curiam*), cert. denied, 424 U.S. 916 (1976), labelled a Sherman Act challenge to an exclusive radiology contract "frivolous" and affirmed the conclusion of a lower court that an exclusive anesthesiology contract was reasonable and justified. See also *Capili v. Shott*, 620 F.2d 438 (4th Cir. 1980), *aff'g*, 487 F. Supp. 710 (S.D.W. Va. 1978). The Seventh Circuit Court of Appeals vacated a district court preliminary injunction against enforcement of an exclusive anesthesiology contract in *Dos Santos v. Columbus-Cuneo-Cabrini Medical Center*, 684 F.2d 1346 (7th Cir. 1982).

3. *Blank v. Palo Alto-Stanford Hosp. Center*, 234 Cal. App. 2d 377, 44 Cal Rptr. 572 (1965).

4. *Benell v. City of Virginia*, 258 Minn. 559, 104 N.W.2d 33 (1960).

5. *Adler v. Montefiore Hosp. Ass'n. of Western Pennsylvania*, 453 Pa. 60, 311 A.2d 634 (1973), cert. denied, 414 U.S. 1131 (1974).

6. *Hayman v. City of Galveston*, 273 U.S. 414 (1927).

7. See *Paine v. Brunswick County Hosp. Auth.*, 470 F. Supp. 28 (E.D.N.C. 1978).

practitioners who are prohibited from practicing their specialties in hospitals because the hospital has entered into an exclusive contract with another practitioner or group for the provision of those services. Exclusive contracts have withstood attacks based on procedural due process,⁸ the physician's right to treat his patient and the patient's right to select his physician,⁹ illegal corporate practice of medicine,¹⁰ unlawful interference with the right of the physician to practice medicine,¹¹ and violation of civil rights.¹² Exclusive contracts have been increasingly subjected to challenges on another front: they restrain trade and competition in violation of the antitrust laws. With the exception of the *Hyde* case, however, the hospital's decision to contract exclusively has been uniformly upheld by the courts against antitrust attacks.

In *Hyde* an anesthesiologist applied for anesthesia privileges at East Jefferson General Hospital in Metairie, Louisiana. His application was recommended favorably by both the credentials and the executive committees of the medical staff. The hospital board, however, voted to deny his application on the ground that the hospital had an exclusive contract with an anesthesia group. The physician brought suit in federal district court after he learned that his application had been denied. His complaint alleged, among other things, that the hospital's exclusive contract was violative of antitrust laws and that the district court should order the hospital to appoint him to its medical staff. The district court dismissed the physician's claim,¹³ but that decision was reversed on appeal.¹⁴

PER SE V. RULE OF REASON

The Sherman Antitrust Act is the antitrust statute that is most relevant to the issues of medical staff membership and clinical privileges.¹⁵

8. *Adler*, 453 Pa. 60, 311 A.2d 634 (1973).

9. *Bennell*, 258 Minn. 559, 104 N.W.2d 633 (1960).

10. *Rush v. City of St. Petersburg*, 205 So.2d 11 (Fla. Dist. Ct. App. 1967); *Centeno v. Roseville Community Hosp.*, 107 Cal. App. 3d 62, 167 Cal. Rptr. 183 (1979).

11. *Letsch v. Northern San Diego County Hosp. Dist.*, 246 Cal. App. 2d 673, 55 Cal. Rptr. 118 (1967).

12. *Cupitt*, 620 F.2d 438 (4th Cir. 1980).

13. *Hyde v. Jefferson Parish Hospital District No. 2*, 513 F. Supp. 532 (E.D. La. 1981). *Hosp. Dist. No. 2*, 513 F. Supp. 532 (E.D. La. 1981), rev'd, 686 F.2d 286 (5th Cir. 1982), cert. granted, 103 S. Ct. 1271 (1983).

14. *Hyde*, 686 F.2d 286 (5th Cir. 1982).

15. 15 U.S.C. §§ 1-7 (1976) The Federal Trade Commission Act, 15 *id.* §§ 41-58 (1976 & Supp. V 1981), may apply to some anti-competitive behavior involving medical staff membership and clinical privileges; however, the FTC has no jurisdiction over nonprofit organizations. This may limit its ability to bring antitrust complaints against nonprofit hospitals. *Id.* § 44 (1976). *But see* *American Medical Ass'n v. FTC*, 638 F.2d 443, 448 (1980), *aff'd*, 102 S. Ct. 1744, *reh'g denied*, 102 S. Ct. 2048 (1982) (business aspects of the American Medical Association fall within the scope of the FTC Act even if they are secondary to the charitable and social aspects of their work). The other federal antitrust laws, the Clayton Act, 15 U.S.C. §§ 15-18 (1976 & Supp. V. 1981), and the

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Section 1 of the Act prohibits any "contract, combination . . . or conspiracy" that constitutes a "restraint of trade or commerce."¹⁶ Section 2 prohibits monopolization, attempts to monopolize, and combinations or conspiracies to monopolize trade or commerce.¹⁷ Over the years, courts have determined that certain types of restraint of trade are violative of antitrust in and of themselves ("*per se*") and there is no necessity for weighing the restraint on trade against the benefits to competition and the public ("rule of reason"). The court held in *Hyde* that the exclusive contract was an unlawful "tying arrangement" which is a *per se* violation of the Sherman Act. A tying arrangement is an agreement by a party to sell one product but only on the condition that the buyer also purchases a different product. In this case, the court stated that the users of the hospital's operating room (the tying product) are also compelled to purchase the hospital's chosen anesthesia service (the tied product). The court stated that these are two distinct services which a buyer should be able to obtain separately. Such tying arrangements are *per se* violations of the antitrust laws, but only if the following conditions exist:

1. There are two separate products, the tying product and the tied product;
2. There is a sufficient market power in the tying market to coerce purchase of the tied product;
3. There is involvement of a not insubstantial amount of interstate commerce in the tied market;
4. There are anti-competitive effects in the tied market.

SUFFICIENT MARKET POWER

The definition of "relevant market" is critical to the determination of whether or not there is sufficient market power in the tying market to coerce purchase of the tied product. The evidence showed that only thirty percent of the patients from the immediate locale of the hospital utilized that hospital's services, and the district court therefore defined the relevant market as the greater metropolitan New Orleans area. Since there were twenty other hospitals in that area to which surgeons could admit their patients and patients could choose if they were at all dissatisfied with the anesthesia service offered at the defendant hospital, the district court held that the exclusive contract affecting only one hospital out of twenty in the area did not cause anti-competitive effects in the market and did not show that the hospital had sufficient market

Robinson-Patman Act, *id.* § 13 (1976 & Supp. V 1981), deal with specific kinds of anti-competitive behavior that are not likely to arise in medical staff membership and clinical privileges cases.

16. 15 U.S.C. § 1 (1976).

17. *Id.* § 2

power in the anesthesia market to coerce purchase of the anesthesia services.

In determining the relevant geographic market, the court of appeals stated that, since patients usually select their hospitals based more on location than on price or quality, the immediate geographical area the hospital serves should be the relevant market area considered. In addition, the court stated that, to show an antitrust violation in cases involving the health care industry, market domination was not required and only a showing of appreciable restraint on free competition within the immediate geographical area was necessary. The court reasoned that the health care industry does not function as a competitive market in the same sense as other industries to which the traditional economic analysis is applied. It noted that several market imperfections in the health care industry favor public, nonprofit entities like the defendant hospital. It found that the prevalence of third-party payment of bills and the lack of complete information regarding the quality of medical care prevents patients from realistically comparing the quality or the cost of medical care of hospitals. The court reasoned from these observations that the patient would be more likely to purchase his medical care from a nonprofit entity that has no apparent profit motive to cut quality. In an apparent *non sequitur*, it then stated that these factors lead patients to select the hospital closest to home and concluded that the relevant market for the defendant hospital was the immediate locale of the hospital. It found anti-competitive effects of the exclusive contract in this market because the patients and the surgeons who practice at the defendant hospital have no choice of anesthesiologists other than the hospital's chosen group. The court stated that this prohibition of competition reduces the incentive for improving or initiating new techniques or procedures.

BUSINESS JUSTIFICATION

Business justifications excuse restraints unless there is a less restrictive way to accomplish the end which the business justifications purport to serve. The court rejected the hospital's argument that the exclusive contract was justified by concerns for quality patient care. The court noted that the hospital realized a certain amount of financial profit out of the arrangement and asserted that a profit was "actual basis" for the hospital's decision to enter into the exclusive contract. The court, therefore, declared the exclusive contract illegal and granted the plaintiff's request for an injunction to permit him to practice at the hospital.

DOS SANTOS

Just one month before the Fifth Circuit decision in *Hyde*, the Sev-

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enth Circuit indicated in dicta that an exclusive contract for anesthesia services at a hospital did not violate the antitrust laws. In *Dos Santos v. Columbus-Cuneo-Cabrini Medical Center*¹⁸ an anesthesiologist brought suit challenging, under antitrust laws, an exclusive contract for provision of anesthesia services at a hospital. The lower court granted a preliminary injunction against the enforcement of the exclusive contract, but the Seventh Circuit Court of Appeals vacated the preliminary injunction on the grounds that the legal requirements for a preliminary injunction had not been met, i.e., there was no showing of irreparable harm, the preliminary injunction was not in the public interest, and the harm to the defendant hospital would be greater than the harm to the plaintiff anesthesiologist.

The court indicated that, on remand, the case must be analyzed under the "rule of reason" because the court viewed the combination as vertical. A vertical combination is one between, for example, a manufacturer and a supplier, as opposed to a horizontal combination, which would be between providers of the same product who are competitors. Applying this definition to the case, the exclusive contract was vertical because it was between the hospital "seller" and the anesthesiology group which supplied one of the products which the hospital sold--anesthesiology services. Vertical combinations are not *per se* violations of antitrust laws; rather, they are subject to the rule of reason analysis.

In addition, the court's definition of the relevant market in *Dos Santos* was distinct from that in *Hyde*. The district court in *Dos Santos* apparently found that the geographical market was limited to the hospital. By limiting the market to the hospital, the exclusive contract gave the anesthesia group a monopoly in the market, leaving the group free to set the prices and determine the quality of services without competitive pressures. In rejecting this theory, the Seventh Circuit Court of Appeals indicated that the hospital was the real purchaser of the anesthesia services and not the patient because the patient generally takes no part in the selection of a particular anesthesiologist and because the expense of anesthesia services to the patient is ordinarily at least partially insured or otherwise payable by a third-party. Therefore, the patient in these circumstances receives the service but does so without making any significant economic decision. It may thus be more appropriate for antitrust purposes to treat the hospital as the purchaser in view of the hospital's responsibility for assuring the availability of anesthesia services for its patients, its incentive to maximize the use of its surgical facilities and its potential liability for negligent rendition of anesthesia services in its operating room. If the hospital rather than the individual patient is regarded as a purchaser, the relevant market could

18. 684 F.2d 1346 (7th Cir 1982)

be defined as the area in which the anesthesia group operates and in which the hospital can practicably turn for alternative provision of anesthesia services.

The Seventh Circuit in *Dos Santos* cited with approval the district court decision in *Hyde* concerning the pro-competitive effects of exclusive contracts. The district court in *Hyde* had concluded that, if anything, exclusive contracts may have a positive effect on competition.

A closed department may enhance competition among the hospitals in the market by increasing the quality of medical care available. It may also serve to benefit competition among anesthesiology groups if the terms of the exclusive contract are not for unreasonable periods of time. Such a system would serve to encourage anesthesiologists to improve the quality of their services in order to obtain contracts with hospitals.¹⁹

HYDE IN THE SUPREME COURT

The grant of certiorari in the *Hyde* case²⁰ provides an opportunity to bring the law in the Fifth Circuit into line with other decisions. Even if the Supreme Court should affirm the finding of an unlawful tying arrangement, however, its holding would probably leave a hospital free to use an exclusive contract as long as it did not itself have a share in the profits of the contracting physician group. Nevertheless, a decision based on such a rationale would call into question the vertical integration of other services within hospitals. Only the relatively arbitrary line distinguishing a single complex service from the offering of discrete services might then stand between an institution and a finding of an illegal tie-in. The problem with the *Hyde* case is precisely that many ancillary technical, medical, and even housekeeping services provided by hospitals might be treated as tied products, thus subjecting the hospital to *per se* condemnation in a suit brought by an alternative provider demanding access to the hospital's patients.

When the *Dos Santos* court suggested that the hospital, rather than the patient, should be regarded for antitrust purposes as the purchaser of anesthesia services, it was addressing the relevant market issue and was not considering the appropriateness of applying tying theory in the hospital setting. Nonetheless, its reasoning may be applicable to the question whether, in the case of an exclusive arrangement, there are in fact two products that should be separately obtainable. If the hospital itself is to be considered a buyer of anesthesia services, then perhaps the patient should not be regarded as a buyer entitled to purchase operating room services and anesthesia services separately. In addition to being theoretically attractive, the view that the hospital is accountable

19 513 F. Supp. 532, 541 (E.D. La. 1981).

20 The Supreme Court has granted certiorari in the *Hyde* case 103 S. Ct. 1271 (1983).

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to patients in the competitive market for procuring the various inputs that together constitute hospital care increasingly accords with marketplace realities. Competition among anesthesiologists is likely to be more intense when the hospital is the buyer.

The best way to resolve the antitrust status of exclusive contracts would probably be to employ the principles developed in other exclusive-dealing cases rather than the more restrictive rule applicable to tying. As the Federal Trade Commission has suggested in its amicus brief in *Hyde*,²¹ the test should focus on the aggregate share of the market for anesthesia services foreclosed, the duration of the contracts, and the efficiency considerations and business circumstances that led to the particular arrangement. Viewed in this light, the concern is with the foreclosure of other anesthesiologists and with competition in the market in which hospitals contract for their services. Presumably this market will be larger than that in which patients shop for surgery. It seems likely that few violations would be found under such an analysis.

The courts should begin to recognize that tie-ins that are burdensome to consumers can be extracted only if the seller sacrifices some of his potential monopoly return on the tying product in order to induce acceptance of the tie-in. Thus, it is seldom in a seller's interest to use a tying arrangement to sell a second product or service that a purchaser would prefer not to have. Only if the purchaser is indifferent will the tie-in be costless to the seller, and, if it is also costless to the purchaser, it is not clear what purpose the antitrust laws serve in prohibiting the arrangement. It is possible that the Supreme Court's decision in the *Hyde* case will indicate whether antitrust law in the current era is intended to promote fairness and equal opportunity for competitors such as Hyde himself or is instead predominantly concerned with consumer welfare. If the latter object is deemed paramount, the Court should approve hospitals' use of exclusive contracts.

²¹ The Justice Department has also filed an amicus brief taking a similar position. The FTC's views of exclusive contracts also appear in an advisory opinion. Letter to Robert E. Nord, Esq., *In re Burnham Hosp.*, Feb. 24, 1983.