COPPERLINE HEALTHCARE

CAPITATION AND RISK SHARING

30

COPPERLINE MEMORIAL HOSPITAL is a community hospital in Green Bay, Wisconsin. Recently, the hospital and its affiliated physicians formed Copperline Healthcare, a physician hospital organization (the PHO). The PHO is close to signing its first contract to provide exclusive local healthcare services to enrollees in BadgerCare (the Plan), the local Blue Cross Blue Shield of Wisconsin HMO. For the past several years, the Plan has contracted with a different Green Bay PHO, but financial difficulties at that organization have prompted the Plan to consider Copperline Healthcare as an alternative. In the proposed contract, the PHO will assume full risk for patient utilization. In fact, the proposal calls for the PHO to receive a fixed premium of $200 per member per month from the Plan, which it then can allocate to each provider component in any way it deems best using any reimbursement method it chooses.

The PHO's executive director, Dr. George O'Donnell, a cardiologist and recent graduate of the University of Wisconsin's Nonresident Program in Administrative Medicine, is evaluating the Plan's proposal. To help do this, Dr. O'Donnell hired a consulting firm that specializes in PHO contracting.

The first task of the consulting firm was to review the PHO's current medical panel and estimate the number of physicians, by specialty, required to support the Plan's patient population of 50,000, assuming

aggressive utilization management. The results in Exhibit 30.1 show that the PHO's medical panel currently consists of 249 physicians, while the number of physicians required to support the Plan's patient population is only 59. Note, however, that the PHO physicians serve patients other than those in the Plan, so the total number of physicians required to treat all of the PHO's patients far exceeds the 59 shown in the right column of the table.

The second task of the consulting firm was to analyze the PHO physicians' current practice patterns. Clearly, utilization, and hence cost, is driven by the PHO's physicians and variation in practice patterns is costly to the PHO. Results of the analysis show significant variation in practice patterns, both in the physicians' offices and in the hospital. For example, Exhibit 30.2 contains summary data on hospital costs by physician for three common diagnosis-related groups (DRGs). Consider DRG 127 (heart failure). The physician with the lowest hospital costs averaged $4,271 in costs per patient, the highest cost physician averaged $7,394, and the average cost for all physicians was $5,319. The consulting firm commented that reducing this variation is important because the PHO is at full risk for patient utilization.

The third task of the consulting firm was to recommend an appropriate allocation of the premium dollars to each category of provider. More specifically, the contract calls for the PHO to receive $200 per member per month, for a total annual revenue of $200 × 50,000 members × 12 months = $120 million. To reduce potential conflicts about how to divide the $120 million among providers, the consulting firm proposed a "status quo" allocation that would maintain the current revenue distribution percentages shown in Exhibit 30.3.

The final task of the consulting firm was to recommend provider reimbursement methodologies that create appropriate incentives. In the contract, the PHO assumes full risk for patient utilization, so the consulting firm recommended that all component providers be capitated to align cost minimization incentives across the entire PHO. Furthermore, capitation of all providers eliminates the need for risk pools, a risk sharing arrangement that the PHO has never used.

In addition to the consulting firm's report, Dr. O'Donnell decided to ask the new PHO operations committee for a short report on the current status of the major PHO providers. He was provided with the following information.

Copperline Memorial Hospital

Historically, the profitability of Copperline Memorial Hospital has been roughly in line with the industry. Last year, when the hospital received about 75 percent of charges, on average, it achieved an operating margin of about 3 percent. However, hospital managers are concerned about its profitability if the Plan's proposal is accepted. The managers believe that the full risk contract requires extraordinary efforts to control costs and that the most effective way to do so is to create a subpanel of physicians for participation in the capitation contract. When asked how the subpanel should be chosen, their reply was to choose physicians who could do the best job of containing hospital costs.

Primary Care Physicians

Many of the primary care physicians are dissatisfied. On average, primary care physicians receive only about 60 percent of charges, and they are concerned they could be penalized by accepting utilization risk for the Plan's enrollees. Primary care physicians know they are paid less and believe they have to work much harder than the specialists. Furthermore, primary care physicians believe the specialists supplement their own incomes by overusing in-office tests and procedures. Some primary care physicians are even talking about dropping out of the PHO, forming their own contracting group, and taking the whole capitation payment from the Plan and contracting themselves for specialist and hospital services.

Specialist Care Physicians

The specialists believe that the primary care physicians refer too many patients to them. The specialists do not mind the referrals as long as their reimbursement is based on charges because, on average, they receive 90 percent of charges. However, if they are capitated, the specialists want the primary care physicians to handle more of the minor patient problems themselves. Also, whenever the subject of subpanels

is raised, many of the specialists become incensed. "After all," they say, "the whole idea behind the PHO is to protect the specialists." Both sets of physicians—primary care and specialists—agree that the hospital is hopelessly inefficient. Said one specialist, "no matter how much revenue the hospital receives, they still seem to barely make a profit."

To respond to the Plan's proposal, Dr. O'Donnell and the PHO's executive committee must decide whether to accept the recommendations of the consulting firm. More specifically, these questions must be addressed:

1. What proportion of the expected $200 per member per month capitation payment from the Plan should be allocated to each component (i.e., hospital, primary care physicians, specialists, and other providers)?
2. Are risk pools necessary? If so, what risk pools or other incentives should be put in place to help control utilization?
3. What payment method should be used for each provider? Should all providers be capitated, should any be capitated, or should some combination of methods be used?
4. Should all of the PHO physicians participate in the contract, or should subpanels be formed? If subpanels are formed, how should they be constituted?
5. What other actions must the PHO undertake to successfully manage this full-risk contract?

Assume that you have been hired to advise Dr. O'Donnell and the executive committee of Copperline Healthcare regarding its plan to address these challenges. At a minimum, your report should address all of the questions listed above as well as the concerns raised by the physicians and the hospital. Furthermore, the report must provide specific recommendations on how to implement these changes because the report will form the basis for an implementation plan if the contract is accepted. A general discussion about premium allocation, reimbursement methodologies, risk pools, subpanels, and so on, is not sufficient.

Specialty	*Number in PHO*	*Estimated Need per 50,000 Enrollees*
General medicine	42	20.9
Pediatrics	15	4.1
Total primary care	57	25.0
Anesthesiology	9	2.5
Cardiology	12	1.4
Emergency medicine	10	2.5
General surgery	13	2.7
Neurosurgery	3	0.3
Obstetrics/gynecology	27	5.4
Orthopedics	11	2.5
Psychiatry	19	1.9
Radiology	8	3.0
Thoracic surgery	0	0.4
Urology	5	1.3
Other specialties	75	10.1
Total specialists	192	34.0
Grand total	249	59.0

EXHIBIT 30.1
Copperline Healthcare: Physician PHO Members and Estimated Needs for 50,000 Enrollees

DRG	*Minimum*	*Average*	*Maximum*
98: Bronchitis/Asthma	$ 2,872	$ 4,018	$ 4,638
127: Heart failure	4,271	5,319	7,394
373: Vaginal delivery without complications	6,498	7,568	8,015

DRG: diagnosis-related group
Note: This table is based on historical costs related to the old severity-unadjusted DRGs. In the future, the cost data will be related to the new severity-adjusted MS-DRGs.

EXHIBIT 30.2
Hospital Costs for Three Common DRGs by Physician

EXHIBIT 30.3
Proposed Allocation of Premium Dollars

PHO administration/overhead	13%
Paid to within-system physicians	
Primary care	10
Specialists	18
Ancillary services	5
Administration/profit	1
Paid to within-system hospital	38
Paid for prescription drugs	10
Paid to out-of-system providers	5
Total premium dollar	100%