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Paper 1: Market Share Adjustments – Supporting Competition in Health Care Based on Price and Quality

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1. Introduction

1.1 - The purpose of the proposed Market Share Adjustment is to provide a basis for increasing and decreasing the Approved Regulated Revenue (ARR) of hospitals operating under Global Budget Rate Arrangements to facilitate the channeling of patients from low value to high value hospitals by so-called "Market Sponsoring Organizations" (MSOs). MSOs would be organizations qualified by the HSCRC as having financial incentives and other mechanisms designed to improve efficiency, cost-effectiveness and quality by directing patients to low cost, high quality providers.

1.2 - Adjustments to these hospitals' Approved Regulated Revenue are necessary to align their incentives with entities operating under SSPs (such as ACOs, PCMHs and Medicaid Managed Care Organizations), seeking to direct patients to low cost and high quality settings and thereby maximize the value of hospital care for their covered members.

1.3 - As informed buyers of hospital services, with incentives to obtain maximum value from their purchasing power, MSOs can "create or sponsor" the development of a market by exerting collective pressure on hospitals to meet the demands of their members for low cost and high quality care.

1.4 – Although the proposed Market Share Adjustment has primarily been developed for use in circumstances in which market demand is being channeled by MSOs from low value to high value hospitals, the methods proposed in this paper could also be applied to other circumstances that result in a shift of patient volumes, such as the closure of a service at a particular hospital and relocation of patients receiving that service to another facility, or other discrete and readily identifiable events.[1] The HSCRC staff may also wish to consider adjustments to a hospital's Global

[1] We believe it would also be in the interest of entities to coordinate with a Partnering Hospital to obtain a Market Share adjustment from the HSCRC for a shift in patient volume not covered by a shared savings arrangement. For instance, if Primary Care Panels participating in CareFirst's PCMH also wanted to shift a substantial volume of other

Budget for circumstances that are determined to be "beyond the control" of a particular hospital (such as a wholesale migration of patients from one facility to another because of perceived reduction in quality at the hospital traditionally treating these patients).

1.5 - In this paper we draw a distinction between shifts in patient volumes result from a competitively-induced channeling of market demand (a shift that comes as a result of the development of a "competitive market") and shifts in patient volumes that are not market driven. We believe it is important to make this distinction because, under the constraints of a population-based payment system, it will not be in the Commission's interest to accommodate most of the types of shifts in patient volume from one Global Budget hospital to another. For instance, large health care systems both in and outside of Maryland often pursue a strategy of acquiring physician practices or providing bonuses to physicians for increased referrals or a redirection of services to system hospitals. For the most part, these types of activities have little to do with improving efficiency and are primarily directed at increasing overall service volumes at system hospitals to generate additional marginal revenue in excess of marginal cost. In these circumstances, "market share" adjustments applied to the Global Budgets of these hospitals would not be consistent with the goals of population-based health payment and would only serve to perpetuate the unproductive (and uncompetitive) business strategies pursued under the current Fee-for-Service payment system.

1.6 – Increases in the Global Budget of a high value hospital (now receiving additional patients) should be funded through commensurate reductions in the Global Budgets of the low value hospitals that formerly treated these patients. Shifts in patient volume from Modified CPC hospitals to Global Budget hospitals will be automatically handled through the HSCRC's Volume Adjustment methodology.

2. Proposed Methodology

2.1 - The proposed Market Share Adjustment will involve two organizations: an MSO and a Partnering Hospital identified by that MSO as an efficient and effective provider of specific services. To receive a Market Share Adjustment, a Partnering Hospital (along with the MSO looking to redirect patients) would apply to the HSCRC for an increase to the Partnering Hospital's Approved Regulated Revenue as its Covered Services increase as a result of the patient channeling by the MSO.

2.2 – The Market Share Adjustment is designed to support the overall objectives of the Demonstration by ensuring that any increase in the Global Budget of a Partnering Hospital is a result of a true shift in market share to that Hospital which has been driven by an MSO's incentives to improve efficiency, cost-effectiveness and quality—and is not simply an increase in the Covered Services to MSO Members.

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commercial, Medicare and Medicaid volumes to the Partnering Hospital, they could similarly apply (along with the Partnering Hospital) to the HSCRC for an adjustment to the Partnering Hospital's Global Budget.

2.3 - The Partnering Hospital and the MSO would first specify the number of the Covered Services provided in a Base Year both by the Partnering Hospital and by other "Competing" hospitals that provided Covered Services to the MSO Members (e.g., in the case where orthopedic surgery services were being redirected, the MSO would specify the root DRGs for inpatient orthopedic services and principal CPT codes of outpatient orthopedic services).[2]

2.4 - Covered Services: The MSO would then calculate the level of its Covered Services to its Members in a Base Year and in a Performance Year. In most cases, we anticipate that Market Share Adjustments will be accomplished on a retroactive basis, whereby the HSCRC would make both one-time budget adjustment (associated with patient volume increases experienced during the performance year) and permanent adjustments to a qualifying hospital's Global Budget.

a) The level of Covered Services will be defined as the number of "Adjusted Cases" (i.e., Case Mix Adjusted Discharges for inpatient services and Equivalent Case Mix Adjusted Discharges for outpatient services for the particular year).

b) The number of Adjusted Cases of Covered Services will be calculated per Weighted Member of the MSO based on the age cohorts and related weights used to derive the Demographic Adjustments of the TPR system. The purpose of this calculation would be to ensure that the additional volume is justified by the underlying population and does not merely reflect increased use per capita.

2.5 - The MSO Adjustment requires that the Adjusted Cases of Covered Services per Weighted Member including Adjusted Cases treated at both the Partnering and the Competing Hospitals decline from a Base Year to a Performance Year (this is to ensure that the patient redirection results in an overall system savings).

2.6 - Assuming this last requirement is met, the Market Share Adjustment of the Partnering Hospital will also depend upon whether the level of Covered Services per Weighted Member of the Partnering Hospital from the Base Year to the particular year of the Demonstration has decreased or increased. If it has decreased, there will be no Adjustment because the Partnering Hospital will have incurred no additional expenditures for the Covered Services.

2.7 - If the level of Covered Services per Weighted Member of the Partnering Hospital has increased, the Market Share Adjustment to the hospital's Approved Regulated Revenue will equal a percentage amount calculated as the product of three factors:

a) The proportion of the Partnering Hospital's Base Year Adjusted Cases associated with Covered Services to the MSO Members;

b) The percentage increase in the volume of MSO Adjusted Cases per Weighted Member from the Base Year to the particular year of the Demonstration; and

[2] Competing Hospitals are those hospitals from which the MSO could redirect a substantial number of its Covered Services.

c) A variable cost factor (VCF) specified by the HSCRC.[3] The VCF will be set by the HSCRC at a level that exceeds the hospitals' variable costs. However, since the incremental payments of the MSO Adjustments will be debited against the all payer cap and, for Medicare Covered Services, against the Medicare cap, the VCF will need to be set conservatively.

2.8 – It is anticipated that some MSO entities (such as PCMH Panels) may not necessarily make commitments to refer patients to a high value hospital right away. However, over time as these groups send more and more patients to a particular high value hospital, the MSO entity may wish to work with that hospital to seek a Market Share Adjustment for the one Performance Year in which the growth in referrals actually occurred. Therefore, the HSCRC may wish to allow a qualified MSO to join with a Partnering Hospital any time during a particular Performance Year and have the Market Share Adjustment calculated for the entire Performance Year, making the Market Share Adjustment on a retroactive basis.

3. Potential Sources of Funding Market Share Adjustments

3.1 - There are two potential funding sources for the Market Share Adjustments. The first would involve the establishment, by the HSCRC, of a Contingency Fund that would be calculated as a percentage of aggregate hospital gross revenues in each year of the Demonstration (say 0.5%).

3.2 - A second and perhaps more equitable means of funding Market Share Adjustments of this nature would be through commensurate reductions in the revenue of Competing Hospitals that have a reduction in their Covered Services per MSO member. We believe this second means of funding Market Share Adjustments represents the preferred approach because it would appropriately reduce the Approved Regulated Revenue of low value hospitals and avoid a situation where these hospitals might otherwise realize windfall profits associated with the removed cases (and associated costs).

4. Potential Alternative Applications of the Market Share Adjustment Mechanism

4.1 – As noted, the proposed Market Share Adjustment should be used primarily for competitively induced shifts in hospital services from low value to high value hospitals. This adjustment mechanism can also be used to account for shifts in volumes that are not the result of a competitive response to market conditions. For instance, in the case of a hospital closing an Obstetrics service it would be necessary to reduce the revenue base of that hospital and increase the revenue base of a nearby hospital (or hospitals) that absorb these Obstetrics patients.

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[3] A standard VCF (e.g., 60%) should be approved by the HSCRC for use in this methodology and applied consistently across all hospitals receiving an Adjustment. The HSCRC should not entertain case-specific claims by hospitals of higher variable costs because these claims will be invariably impossible to substantiate in a reliable way and will draw the HSCRC staff into relatively unproductive time commitments. Moreover, high VCF adjustments for the receiving hospitals could require compensating cost reductions at the hospitals losing the volume that would exceed their ability to remove costs.

4.2 - This adjustment could also be used in the case of the approval of a CON for, say, a new Open Heart Surgery unit, to make the necessary adjustments in the revenues of the affected hospitals.

4.3 - In other instances that are determined to be largely "beyond the control of a hospital", such as epidemics or other service shifts not motivated by market demand or by a service closure, the HSCRC should allow hospitals to petition the Commission for adjustments to that hospital's Approved Regulated Revenue should (per a HSCRC staff recommendation) the facts and circumstances warrant such an adjustment.

4.4 – As noted, we anticipate that Market Share Adjustments, in most cases, will be applied retroactively.