

*From the Desk of R. Lewis Dark...*

# THE **RD** DARK REPORT

**RELIABLE BUSINESS INTELLIGENCE, EXCLUSIVELY  
FOR MEDICAL LAB CEOs/COOs/CFOs/PATHOLOGISTS**

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*Commentary & Opinion by...*

**R. Lewis Dark**

**Founder & Publisher**



## *A Pox on Millennium Talk*

I DECIDED TO BE DIFFERENT TODAY. Most of you probably figured I would use this last opportunity before January 1 to make my millennium predictions and ruminate about the last one thousand years or so.

Not so! My contrarian nature says you've probably already had enough of the new millennium, and the old millennium as well. Other than some legitimate Y2K concerns affecting the laboratory and the hospital, I expect this December 31st will pass with no more fuss or bother than any of the others.

In fact, that is really what I would like to talk to you about today. I don't always understand what the twitter is about when the calendar changes from day one to day two. After all, the sun still rises and sets on a predictable schedule. Certainly the IRS and our kids continue to insist on their regular contributions.

Just as our yearly calendar represents a predictable cycle of change, management of a laboratory and a pathology group also represents a similar cycle of predictable change. For all the decades I have seen come and go, this crusty curmudgeon can assure you that the management problems you deal with today are no different than those I dealt with throughout my career. People issues, payroll concerns, market share, product cost and quality—these occupied my business meetings decades ago, just as they occupy your business meetings today.

What is different about managing laboratories today than “way back when?” My guess is the one big difference from my days fresh out of college and the business meetings you hold today is this: the rate at which new variables hit your business, and require you to respond.

I believe most of this is related to the speed at which information can be gathered, assessed and communicated. Look, when I got out of college, only a few big companies even had computers. It was common to maintain data bases on 3x5 cards. There were no copy machines, no faxes, no cell phones, no pagers. Thus, information flowed much slower.

Seen from this perspective, probably the most daunting challenge facing you now is the stress of reacting to so much information, coming at you ever faster and faster. That might be why I say “Pox on the new millennium.” Our once-predictable cycle of change is undergoing radical acceleration by an unrelenting and growing flow of information.

# 1999's Top Ten Stories Reflect Speed of Change

*Clinical lab industry undergoing another cycle of fast and far-reaching transformation*

By Robert L. Michel

**CEO SUMMARY:** *This year's round-up of the lab industry's Top Ten most important stories lacks any compelling single theme. THE DARK REPORT's conclusion? 1999 was a transition year. No new outside forces rattled the lab industry, allowing lab executives and pathologists to concentrate on implementing their particular laboratory's business plan. However, early hints at transformational forces showed themselves in 1999.*

IT'S TIME ONCE AGAIN TO PRESENT our list of the Top Ten most important stories for the year. The Top Ten story list demonstrates that 1999 was a relatively quiet year for laboratories and pathology groups.

THE DARK REPORT's Top Ten stories draw attention to the most important forces shaping the laboratory industry. For 1997, the big story turned out to be laboratory compliance. Compliance has dominated the radar screens of lab executives almost continuously. In contrast, both 1998 and 1999 have been relatively quiet years.

However, THE DARK REPORT views 1999 as a seminal year for future events. As our Top Ten story picks reveal, there are a number of transformational forces beginning to emerge.

Seen from that perspective, 1999 is a transitional year. Technology introduced this year will cause today's accepted management models of laboratory organization to be replaced by new models. As examples of this, we point to technologies now enabling web-based lab test ordering/results reporting and routine chemistry and hematology point-of-care (POC) testing.

As usual, THE DARK REPORT presents its Top Ten story list in no particular order of importance. We recommend that our clients and readers reflect on the range of themes that these stories represent. The Top Ten story list demonstrates that management challenges for laboratory and pathology during the next five years will be extensive and far-ranging!

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R. Lewis Dark, Founder & Publisher.

Robert L. Michel, Editor.

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## 1 Quest Diagnostics Gobbles Up SmithKline Beecham Clin Labs

IT WAS ROLE-REVERSAL TIME IN 1999 for **Quest Diagnostics Incorporated**. Acting boldly, Quest CEO Kenneth Freeman spent \$1.3 billion to acquire **SmithKline Beecham Clinical Laboratories (SBCL)** from **Smith-Kline Beecham, PLC**.

If not the biggest lab industry story for 1999, it certainly attracted the most attention. When news of the acquisition was made public last February 9, it was widely reported by both the financial and lab industry press.

But many journalists and laboratorians missed a fascinating twist to this story. Quest's purchase of SBCL is a magnificent example of role reversal. To understand why, turn back the clock to January 31, 1996. That was the day the *Wall Street Journal* reported that

**Corning Corporation** was looking to sell its "faltering" **Corning Clinical Laboratories (CCL)** division (now Quest Diagnostics). The most likely buyer? SmithKline Beecham. (See *TDR, February 5, 1996*.)

In early 1996, SBCL was the strongest of the three blood brothers. That was certainly not the case by February 1999. It took only 36 months for Quest Diagnostics (CCL) to build the financial capability necessary to acquire and absorb SBCL.

Quest acquired its prize on August 16, 1999. Since that date, a new leadership team was chosen from Quest and SBCL executives. Now it faces the daunting task of consolidating two national laboratory systems, creating a unified corporate culture, and making money.

## 2 Tidal Wave of Hospital Lab Consolidation Crests by 1999

CONSOLIDATION OF HOSPITAL OWNERSHIP was the direct cause of widespread hospital lab consolidation. Beginning in 1995, the twin consolidation movements literally reshaped the American hospital and laboratory systems.

This consolidation tidal wave crested by the start of 1999. The raw numbers are astounding. THE DARK REPORT wrote this in its April 5, 1999 issue:

*According to **SMG Marketing Group**, a Chicago-based healthcare information and marketing company, there are now 604 integrated health systems (IHS), a number which increased by 40% between 1995 and 1998! More importantly, the rate at which hospitals are joining systems increased at twice the rate. SMG says*

*that 3,760 hospitals were in systems by January 1999, an 83% jump from 2,060 hospitals in April 1995.*

Since there are only 4,800 acute care, non-government hospitals in the United States, this means that multi-hospital systems now operate 80% of the nation's hospitals! That doesn't leave much room for further consolidation of either hospital ownership or hospital laboratories.

Instead, THE DARK REPORT expects hospitals to push their labs toward more sophisticated management, with the goal of improving care quality while lowering costs. This shifts emphasis away from today's management emphasis on the operational efficiency of how the lab collects specimens and performs tests.

## 3

## Wall Street Bargain Hunters Return to Clin Lab Industry

CERTAINLY 1999 SAW WALL STREET once again invest money in commercial laboratory companies. 1999 was the first time in several years when more investment money poured into the lab industry than flowed out.

But do these investments signal the beginning of a financial boom for the lab industry? THE DARK REPORT thinks not. It is our belief that a significant portion of these investors are "bottom-fishing." After several years of widespread financial losses and bankruptcies among commercial laboratory companies, these investors believe bargains are to be found.

The size of the successful deals financed is telling. The year's big transaction was the acquisition of **SmithKline Beecham Clinical Laboratories** by

**Quest Diagnostics Incorporated**. This \$1.3 billion acquisition was easily financed. Another big transaction was **Kelso & Company's** purchase of **Unilab Corporation**. In taking Unilab private, Kelso spent about \$420 million.

In the pathology segment, **AmeriPath, Inc.** continues to roll along, doing group practice acquisitions and posting profits. **IMPATH, Inc.** also posted strong performance and closed several lab acquisitions.

Despite investor optimism, the laboratory industry will continue to struggle for adequate reimbursement. Excess laboratory capacity is still abundant, and physicians are under pressure to utilize fewer tests. This certainly limits the upside profit potential from investments in laboratory companies.

## 4

## Phlebotomist Reuse of Needles Shows Vulnerability of Labs

IT WAS EVERY LAB MANAGER'S WORST nightmare. On April 16, 1999, **Smith-Kline Beecham Clinical Laboratories** (SBCL) and California's **Department of Health Services** (DHS) held a joint press conference.

The purpose was to announce that a phlebotomist at an SBCL draw station in Palo Alto, California had reused butterfly needles on patients. (*See TDR, April 26, 1999.*) Before it was over, the story was national news and caused an uproar in the San Francisco Bay Area that refused to go away.

Eventually some 15,000 people would be offered free blood testing. Lawsuits, still pending, were filed against SBCL and the phlebotomist. DHS filed charges against the phle-

botomist and fined SBCL \$102,000 for its part in the affair.

THE DARK REPORT considers this a timely warning to laboratory executives and pathologists. It is a reminder that every laboratory organization is vulnerable to rogue actions by its employees.

The Palo Alto phlebotomist affair demonstrates that the lab industry requires a high degree of public trust to function. It evokes memories of the Tylenol poisoning case. And it shows how fast that news of any risk to public health can bring a laboratory (in this case, SBCL) under intense media scrutiny. That is why all laboratories and pathology practices should assess their vulnerability and develop prevention programs and crisis response plans.

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## Total Lab Automation (TLA) Fades in Favor of Other Options

HERE'S A TOP TEN STORY that's gone unreported, except in THE DARK REPORT. It involves total laboratory automation (TLA).

In our first issue for 1999, we declared "TLA to be DOA". (See *TDR, January 11, 1998*.) During the balance of the year, we heard no one step forward and contradict our assessment that the first generation of TLA had failed to deliver a cost-effective solution to laboratories.

To the contrary, both *CAP Today* and *MLO* published stories where TLA advocates admitted, however grudgingly, and with plenty of waffle-words, that TLA itself was probably still not ready for prime time. Instead, applying automation technology to laboratory work modules was to be the focus.

THE DARK REPORT has long agreed with that scenario. There is much faster return on investment (ROI) and increased flexibility from automating and mechanizing selected portions of the clinical laboratory.

But even we were surprised at how quickly another technology appeared during 1999 that would further erode the economic rationale supporting TLA. That is point-of-care (POC) testing for high volume, routine chemistry and hematology tests. (See *TDR, November 22, 1999*.)

A new technology mix of modular lab automation, routine chemistry at POC, and the multiplex technology of companies like **Luminex**, will change the form of labs to the degree that TLA becomes a less relevant solution.

6

## Anatomic Pathology Evolving Into a National Marketplace

IT'S BEEN A LONG TIME IN COMING. After many years of predictions, 1999 marks the year that anatomic pathology began to "go national."

Although the vast majority of anatomic pathology continues to occur locally, there is an ever-growing number of pathology companies which offers services on a national basis.

THE DARK REPORT has regularly predicted that clinical and operational integration of healthcare services will cause pathologists to consolidate their individual groups into regional super-practices.

This is happening, and as consolidation occurs, a number of pathology-based companies are organizing to offer anatomic pathology services on a national basis.

For example, **AmeriPath, Inc.** continues to grow through acquisition. These acquisitions allow it to expand into new regional markets. **DIANON Systems, Inc.**'s expansion into anatomic pathology is another example of a national AP competitor. **IMPATh, Inc.** represents a different business mode. Its services are designed to support community hospital-based pathologists. But IMPATh is organized as a national provider.

The message should be clear to all anatomic pathologists. Traditional boundaries that once defined local markets are crumbling. This means local pathology group practices need a two-dimensional business plan that targets local and national opportunities.

## 7

## Internet Gold Rush Brings E-Commerce to Healthcare

THIS WAS THE YEAR THAT THE INTERNET established itself as the dominant new force for reshaping business and commerce across the globe.

This was also the year that the Internet gold rush aimed itself at healthcare. Entrepreneurs and Wall Street financiers think the \$1 trillion American healthcare system is ripe and ready to be plucked.

Sitting dead center in the crosshairs of these profit seekers is the clinical laboratory industry. For years, laboratorians repeatedly pointed out that clinical laboratory data is usually 80% of a patient's permanent healthcare record. They've also pointed out that laboratory transactions make up a high proportion of all clinical and operational transactions.

Even if payers and physicians haven't listened, profit-driven Internet entrepreneurs have. Armed with this knowledge, an ever-increasing number of Internet companies are working to provide laboratories, physicians, and hospitals with Internet technology and web-based products.

The big dog in this hunt is **Healtheon/WebMD**. But LIS vendors such as **Sunquest, McKesson/HBOC, Meditech, Cerner**, and **SMS** have yet to weigh in with their next generation of web-based lab products. There are also many home-grown initiatives by labs themselves.

Add this all up and it becomes clear that Internet products and services will soon give clinical labs and pathologists a lot of new business tools.

## 8

## Hospital Laboratory Outreach Programs Come of Age in 1999

PROBABLY THE BEST-KEPT SECRET IN THE laboratory industry is that professionally-managed and market hospital laboratory outreach programs are profitable and thriving.

Across the United States, there can be found a small cadre of laboratory administrators who appreciate the multiple benefits that a solid lab outreach program delivers. They use it as their secret weapon to deliver job security to their medical technologists and lab staff.

Hospital lab outreach programs also boost the in-house capabilities of the laboratory. It puts profit dollars on the table for the hospital administrator, and it strengthens the relationship between physicians and the hospital.

Throughout 1999, THE DARK REPORT provided examples of successful hospital laboratory outreach programs. One enterprising lab director, Joseph McCauley of **West Hills Hospital and Medical Center**, even used outsourcing as a way to get his 236-bed community hospital into the outreach business. (*See TDR, August 9, 1999.*)

THE DARK REPORT predicts that hospital labs operating solid outreach programs will survive and preserve their operating autonomy with a higher degree of success than hospital labs which don't have outreach programs. Moreover, clinical integration makes hospital lab outreach programs a threat to commercial laboratories, including the two blood brothers.

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## Many California Physicians Endure a Financial Meltdown

FINANCIAL WOES OF CALIFORNIA physicians are relevant for an important reason. Healthcare initiatives that succeed in California are copied elsewhere. What fails in California is avoided elsewhere.

On October 11, THE DARK REPORT disclosed that at least one in ten private physician group practices in California was expected to declare bankruptcy or close down by the end of 1999. These statistics were provided by the **California Medical Association** and validated by **Price WaterhouseCoopers**.

This remarkable situation is compelling evidence that the California model for managed care has proved an abject failure. As a result, laboratory

executives and pathologists should expect a variety of consequences, some good and some bad, as managed care plans in other parts of the country assess and respond to the California experience.

We may soon see the end of capitation, at least in the form it was used throughout the 1990s. We may also see the end of unlimited risk arrangements for providers. In California, this accounts for significant provider and physician losses.

Most importantly, we may see legislative remedies that require payers to establish reimbursement levels which are based on the true cost to provide healthcare services, as validated by independent actuaries. That would directly benefit the lab industry.

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## Routine Chemistry & Hematology Ready for Point-of-Care Sites

MOVING HIGH VOLUME, routine chemistry and hematology out of the core lab and to the point-of-care (POC) has not been a possibility. At least not until now.

Most lab experts and futurists were caught napping by the impending introduction of a credible new POC chemistry instrument. Its manufacturer claims that decentralized testing, utilizing this POC instrument, can compete in cost and performance with core lab testing.

THE DARK REPORT published the lab industry's first look at **Careside, Inc.**'s point-of-care solution for moving routine high volume testing out of the core lab. (*See TDR, November 1, 1999.*) If Careside's technology solution works, it promises to give lab executives a viable way to move much

high volume, routine testing out of the central lab and into a POC setting.

Even if Careside's solution doesn't fully deliver, THE DARK REPORT believes that the "Pandora's Box Principle" is now at work. Simply put, competing chemistry and hematology instrument manufacturers will need to respond to this competitive threat with their own POC solution.

As that occurs over the next couple of years, lab managers will have a variety of feasible options for decentralizing routine testing. Wherever POC routine testing provides competitive advantage, aggressive labs will be willing to use it to steal clients from competitors. Opening this Pandora's Box may accelerate the move to "distributed testing" **TDR**



## Diagnostics Update

# Court Rules Against Roche In PCR/Taq Patent Dispute

*California judge finds that Roche's patent was based on incomplete data and fraud*

DECEMBER 7, 1999 WAS NOT an auspicious day for **Hoffmann-LaRoche**. One of its patents related to the PCR testing process was ruled invalid by a Federal District Court.

The ruling involved Roche's '818 *Taq* patent, an enzyme used in the PCR process. The Court found that the patent holder had intentionally withheld material information and distorted important facts in obtaining the patent.

"We obviously were pleased with the court ruling," stated Brenda Furlow, Corporate Counsel for **Promega Corporation** of Madison, Wisconsin. "Prior to this decision, it was impossible for us to sell *Taq* to the diagnostic market in a price-competitive environment. Roche will now have to charge the same royalty for PCR, regardless of the source of the *Taq* it uses."

### Will Appeal Court's Ruling

This lawsuit was originally filed by Promega after it was sued by Hoffman-LaRoche in 1992. Roche had sued to overturn Promega's license agreement to sell *Taq*. Hoffman-LaRoche announced that it would appeal the Federal District Court ruling.

PCR (polymerase chain reaction) was invented by Kary Mullis at **Cetus Pharmaceuticals**. Patents were granted in 1989. Hoffman-LaRoche paid \$300 million to Cetus in 1992 to acquire the PCR and *Taq* patents.

It is still too soon to evaluate whether Promega's legal victory against Roche will have much impact on the diagnostics and clinical laboratory industry. This court ruling might affect related PCR patents held by Roche. But that has yet to be determined.

### Patents Cover *Taq* and PCR

Roche holds patents on both *Taq* and the PCR process. Laboratories must buy *Taq* from licensed vendors. Labs pay a royalty for the PCR process. PCR royalties can be as much as 15%.

Since small amounts of *Taq* are used in the testing, potential savings from reduced *Taq* prices are not great. In fact, annual world sales of *Taq* are estimated at about \$40 million for Roche, \$35 million for **Perkin-Elmer**, and \$4 million for Promega.

"The only thing that would make this an earth-shaking decision is if the courts subsequently overturn Roche's patents covering the basic PCR process itself," stated David Hillyard, M.D., Co-Medical Director of the Core Molecular Lab at **ARUP Laboratories** in Salt Lake City. "At this time, that's an unlikely probability."

Pathologists and lab executives should keep a closer eye on this legal fight. Future decisions may set important legal precedents on a variety of issues involving the licensing of diagnostic-related patents.

# LabCorp and CIGNA Ink New Provider Agreement

*CIGNA adds to its national laboratory panel for the first time in four years*

**CEO SUMMARY:** After four years of working with SmithKline Beecham Clinical Labs as its sole designated laboratory provider, Cigna Healthcare recently opened the door to Laboratory Corporation of America. *THE DARK REPORT* believes this development is first evidence that the nation's largest managed care companies are finding sole source lab contracts may be overly restrictive for their patients.

**M**AYBE A LITTLE COMPETITION IS a good thing. News that CIGNA Healthcare, Inc. added Laboratory Corporation of America to its national provider panel indicates a shift in thinking at the healthcare giant.

This is the first time in four years that CIGNA is contracting directly with another national laboratory besides SmithKline Beecham Clinical Laboratories (SBCL), now owned by Quest Diagnostics Incorporated.

"This new agreement with CIGNA is right in line with our strategy of establishing relationships with anchor health plans in regional markets where LabCorp already has a strong presence," stated Pamela Sherry, LabCorp's Vice President of Investor Relations.

## **CIGNA's Business Goals**

"By design, LabCorp and CIGNA designed this relationship to be complementary with CIGNA's national business objectives, while flexible enough to meet the local needs of CIGNA's regional plans," observed

Karen McFadden, Vice President, National Managed Care for LabCorp. "It's a good example of the 'think global-act local' business strategy."

## **Tailored Local Services**

According to McFadden, the new CIGNA agreement gives LabCorp the opportunity to approach local CIGNA health plans. LabCorp will work with them to create a specific laboratory services package that supports each local plan's needs in its regional market.

"We expect this agreement will be rolled out market-by-market," explained McFadden. "Local CIGNA plans will have the option to choose between SBCL and LabCorp. Regions where LabCorp already has a well-developed service infrastructure will be at the top of the list.

One important aspect of this new contract involves laboratory data. "CIGNA was particularly interested in the fact that LabCorp is already delivering more than just utilization data to its managed care clients," McFadden stated. "Beyond the test results, CIGNA

will get data packaged by individual parameters. This will allow them to assemble the data sets needed to meet HEDIS and NCQA requirements.”

### **Worthwhile Savings**

“LabCorp’s advanced information management capability translates into worthwhile savings for CIGNA,” continued McFadden. “For example, frequently insurers like CIGNA must pay \$20 to \$30 to pull and audit individual patient charts to get data needed for HEDIS and NCQA reports. Our information management package gives them the necessary lab test data sets without requiring audits of the patient’s file.”

Another interesting aspect to the LabCorp-CIGNA agreement is the linkage of patient eligibility data with LabCorp’s billing and collections. “CIGNA will regularly refresh its beneficiary eligibility file for us. Nightly we will run that file against that day’s new test requisitions.”

“This will allow LabCorp to identify the specific health plan for the patient,”

***“When it comes to national contracts, LabCorp is ready to deliver the next generation of information management tools. We believe payers, physicians, and even patients will recognize the added value LabCorp offers.”***

**—Karen McFadden**  
VP, National Managed Care

she continued. “Is a patient’s particular policy reimbursed by capitation? Discounted fee-for-service? Are there co-pays or deductibles? Matching CIGNA’s eligibility file directly against our test requisitions will allow us to correct a large number of billing issues before they occur.

“The benefits are obvious. Patient satisfaction with CIGNA increases, because its lab test bills are accurate,” said McFadden. “There are reduced costs for both CIGNA and LabCorp in submitting and processing claims for laboratory testing.”

Laboratory executives and pathologists should take careful note. As LabCorp delivers these types of advanced laboratory information management capabilities, it is helping its users (payers, physicians, and patients) extract extra value from laboratory testing.

Moreover, these services help both the payer and the laboratory lower the cost of providing care. It demonstrates that the benefits from value-added laboratory services benefit customer and laboratory alike.

### **Sole Source Lab Contracts**

From the larger perspective, THE DARK REPORT believes CIGNA’s move to expand its laboratory provider panel for the first time in four years indicates that sole source lab contracting has failed to fully meet either CIGNA’s needs or expectations.

Further, the arrangements between CIGNA and LabCorp to move data management above the level of basic results reporting, utilization monitoring, and claims processing reflect an important development. The marketplace is raising the bar of customer expectations. Winning labs will respond to these changed expectations.

It brings the laboratory industry another step closer to prediction of THE DARK REPORT: that the value of clinical laboratory services will move beyond simply producing a high quality test result at a fair price. Instead, sophisticated lab information services will be the primary source of revenues and profits. **TDR**  
Contact Pamela Sherry at 336-584-5171 ext. 4855 and Karen McFadden at 336-222-7566 ext. 7764.

# Lab Network in Florida Becoming Tough Player

*Network leaders forge ambitious plans to solidify their hold on local markets*

**CEO SUMMARY:** Throughout the 1990s, a growing number of hospital laboratory administrators learned the value of a professionally-managed lab outreach program. In a few markets, these savvy lab leaders moved to the next level: using regional laboratory networks to solidify their local market dominance while competing against the national labs for region-wide managed care contracts. Here's an update on one such regional laboratory network in Florida.

**N**ETWORK LEADERS of the **Florida Reference Laboratory Network (FRLN)** are preparing to turn up the heat on commercial lab competitors in the Sunshine State.

"All the pieces are falling into place," stated Steve Wilson, Director of Business Development at **Consolidated Laboratory Services (OLS)** in Jacksonville, Florida. "After several years of tinkering and experimenting, our six hospital members are now united around a winning strategic plan.

"We want to take individual strengths we now have in separate local markets and meld them into a state-wide service infrastructure," he added. "In achieving that, we expect to become as tough as any lab competitor in the state."

## **FRLN Has A New Partner**

FRLN is comprised of six hospital system members, along with a new partner. "After a selection process, we are pleased to announce that **Specialty Laboratories** is a full-fledged member of FRLN," observed Gary Onofry, Financial Controller at OLS.

"Specialty is contributing three things to FRLN. First, it will be our reference testing provider. Second, like all members, it will assume some risk for reference and esoteric testing covered under capitated contracts held by FRLN. Third, Specialty will bring us a common information systems platform to link our hospital labs and our outreach clients."

## **Strategic Business Plan**

FRLN's strategic business plan emerged after a lot of trial and error, during the five years of its existence. "Like many regional lab networks, we spent a lot of months talking, building trust, and studying our business opportunities," noted Wilson.

"However, unlike many networks, there was always a core group of hospital labs which were willing to operate as a de facto network while organizing meetings proceeded," he continued. "This gave us practical experience and insights for developing our network's business plan."

Wilson says that, in the end, there was one common denominator to the labs which stayed with FRLN. "Each of our members operates a thriving and profitable outreach program. But more than that, in their local markets, they are a full competitor to national and independent commercial laboratories."

"These are successful outreach programs with professional sales and marketing," added Onofry. "They perform in excess of one million tests per year. Because they make worthwhile profits, their hospital administrators want to protect this business and increase it.

### Thriving Lab Outreach

"During our five years as a network, hospital labs without outreach programs came to meetings, but could not bring themselves to commit the necessary time and resources," continued Onofry. "So it is not a coincidence that each of our six hospital members operates a thriving lab outreach program."

On a go-forward basis, FRLN's legal counsel is preparing to request an opinion letter from the **Federal Trade Commission** (FTC). "We are asking the FTC to rule, in advance, that our business plan meets antitrust laws governing healthcare networks," stated Wilson.

"We anticipate that the FTC opinion letter will be issued in the summer," he noted. "Once it is received, FRLN will formally incorporate a limited liability corporation (LLC). This will become the primary contracting and administrative vehicle for our network."

### Messenger Model Network

"FRLN operates on the messenger model. In our current ad hoc arrangement, an FRLN member laboratory directly contracts with a managed care plan," explained Onofry. "That member then subcontracts with other members, but has full liability for the contract.

"Once the LLC is formed, managed care contracts will be held by the LLC.

## All FRLN Members Operate Thriving Outreach Programs

*Each member of the Florida Reference Laboratory Network (FRLN) operates a successful and professional laboratory outreach program.*

- *Baycare Healthcare  
Tampa*
- *Consolidated Lab Services  
Jacksonville*
- *Mercy Hospital  
Miami*
- *DSI Laboratories  
Fort Meyers*
- *Sacred Heart Hospital  
Pensacola*
- *Weusthoff Healthcare System  
Rockledge*

*Joining these six hospital lab organizations as a full partner in the FRLN network is Specialty Laboratories, Inc. of Santa Monica, California.*

That limits the liability of our network members," said Onofry. "The LLC also expands our business options."

According to Wilson and Onofry, the stage one goal for FRLN is managed care contracts. "Our target is to have one million lives under contract," explained Wilson. "The test volume generated by one million lives will help fill the existing unused capacity of our member laboratories.

"If we have the opportunity to bring more than one million lives under contract, that will require us to make some decisions," he said. "For example, do we want to expand the capacity of our laboratories to handle this? Could we possibly be a broker for that testing? We certainly don't want to limit our thinking, nor our ability to increase revenue and profits for the network and its members.

## Florida Payers Increasingly Request Sophisticated Lab Data and Reports

*"AT MANAGED CARE TIME, we hear a different story from HMOs now," commented Steve Wilson, Director of Business Development at Consolidated Laboratory Services (CLO). "It's less about the cost per test and more about the type of useful information our laboratory network can provide to them.*

*"Three years ago, managed care plans talked to us primarily about service—draw sites, stat labs—and price," he explained. "Now that's all on the back burner. Payers talk to us first about data and information capabilities, second about service and coverage.*

*"As a regional lab network, we got the message," Wilson said. "We needed an effective way to link the information systems of our six laboratories and create useful data sets from the laboratory testing we do. Without this, managed care contracts would be tough for us to win."*

"FRLN is designed to make money as a network, while at the same time allowing its members to gain maximum internal advantage from a laboratory that operates at full capacity," he continued. "We will use every tool available to keep our member labs as competitive and efficient as possible."

### Simple Business Truth

"FRLN exists because our members understand a simple business truth: united we stand, divided we fall," Wilson said. "In each of our regional markets, our member's outreach program is either dominant or a major player.

"The network is our way of banding together so that we can continue to serve the needs of our hospitals and our local physicians," he continued. "The successes of our individual lab outreach programs concern commercial laboratory competitors, because they've lost market share."

*"This is one reason why FRLN selected Specialty Laboratories to be our reference lab and a full partner in our network," stated Gary Onofry, Financial Controller at CLO. "First, our labs and clients will connect to each other through Specialty's information system platform. Second, Specialty will collect all our test data in their repository. With their help, we will generate a variety of reports to meet the needs of our managed care plans. We've already learned that payers respond to these services by increasing capitation rates to acceptable levels.*

*"We also believe that the central data repository is important to our network in another way," noted Onofry. "This data repository gives us a way generate laboratory information that we might sell to pharmaceutical companies, clinical trials companies, and other healthcare entities."*

"In fact, we've noticed a change in attitude in recent years," offered Onofry. "It used to be intensely competitive. National labs paid little attention to us. Now they are very interested. We hear from them regularly and they talk to us about joint ventures, partnerships, and the like."

"Maybe we have their attention now because each FRLN member lab is very strong in its particular market," responded Wilson. "FRLN allows us to combine these regional strengths into a statewide service organization that will be very competitive.

### Strong Relationships

"After all, look at what we started with. FRLN labs have strong relationships with the local physicians," he said, "and these doctors are already hooked up to our hospitals. As FRLN becomes a statewide competitor, it gives us the opportunity to expand our share of the market."

In evaluating the business strategies of Florida Regional Laboratory Network, several themes emerge.

First, during the past five years, efforts to develop shared testing among interested hospitals proved fruitless. Lack of motivation and trust among many of the hospital labs which attended organizational meetings was responsible.

### **Six Willing Partners**

Second, the network established common ground among six willing partners. The glue which binds this group together is their common interest to protect their existing outreach business. It is the profit motive, supported by hospital administrators who want to protect and increase profits coming from their outreach programs.

Third, because FRLN's labs compete head-to-head with the national labs, they understand the need for raising the service bar to remain competitive. That is why they are willing to cede some independence and fund the next level of information-based lab services. They see the competitive threat to their existing business and they are taking active steps to protect it.

### **Organized Like A Business**

Fourth, this network is organized like a business. It is designed to generate cash flow that covers network expenses and generates a surplus to its partners. This makes it easier for hospital CEOs to commit up-front capital and support the network's goals.

THE DARK REPORT believes that FRLN is an example of the upcoming new generation of regional laboratory networks. These networks are built around hospital labs which operate lab outreach programs.

Their lab administrators are much more in tune with marketplace issues, profit management, and service innovation than hospital labs which only perform in/outpatient testing.

## **FRLN Pathology May Evolve Into a Comparable Network**

*BY DESIGN, ANATOMIC PATHOLOGY is not part of the Florida Reference Laboratory Network. For the foreseeable future, FRLN has chosen to let individual members deal with pathology at the local level.*

*"FRLN's members see a three-prong strategy for controlling costs," said Steve Wilson, Director of Business Development at Consolidated Laboratory Services (CLO). "First, control over the cost of routine testing, accomplished by increasing specimen volume into each lab.*

*"Second, by controlling reference and esoteric test costs through our partnership, where the reference lab member is willing accept risk," he continued. "Third, pathology can contribute to improved cost performance. After the LLC forms, we hope to encourage and help the pathologists to form a parallel pathology organization. Given the historic independence of pathology groups, this will obviously need to be championed by the pathologists themselves."*

Examples of this new generation of lab networks are **Midwest Provider Laboratory Network (MPLN)** in Indiana (organized primarily by four labs with significant outreach business), and **Joint Venture Hospital Laboratory Network (JVHLN)** in Detroit (which involves labs from eight of the city's nine health systems).

### **Think, Act, And Manage**

What is common to this emerging class of regional laboratory networks is that their hospital lab administrators think, act, and manage like commercial lab managers. They are market sensitive, open to innovation, and concerned about generating profit. **TDR** Contact Steve Wilson and Gary Onofry at 904-308-5608.

# Specialty Labs Moving To Web-Based Services

*Fast-growing company among the first to offer Internet solutions for hospital labs*

**CEO SUMMARY:** *Competition for hospital reference and esoteric testing remains intense. Three years ago, Specialty Laboratories made an early bet on Internet technology. It believed that being first to offer faster and less complicated access to laboratory informatics resources would give it a competitive edge among hospital laboratory clients. Here's a look at the management strategies behind Specialty Lab's decision.*

**W**ITHIN THE SOFTWARE INDUSTRY, "vaporware" is the term used to describe software and upgrades announced by a company which are not ready to sell to customers.

At **Specialty Laboratories, Inc.** of Santa Monica, California, executives are quick to point out their support software system for hospital laboratory clients is not vaporware, but the real thing. To defend that statement, they point to the installed base of clients already using Specialty's software services.

## Up And Running

"We currently have 1,000 installations up and running among our clients," stated Dan Angress, Vice President of Marketing at Specialty. "We are also proud of the fact that we have an exclusive arrangement with VHA and offer our DataPassportMD™ system over their private network."

Specialty's installed base of users makes it one of the first labs in the United States to introduce web-based support on a wide scale. To accomplish

this in 1999, Specialty's executive team had to make some risky decisions several years earlier.

"In 1997, we looked for ways to differentiate ourselves from other reference laboratories," recalled Angress. "What kind of added-value services could we bring to our clients?"

"Nobody familiar with the lab business should be surprised at the one gripe that topped the list of most hospital lab administrators," he continued. "It was the expense and frustration of dealing with CPU-CPU links between their lab and their primary reference testing providers. Even PC workstations were an expensive option, with lots of maintenance.

"We realized that, if Specialty could use Internet technology to make life easier for our hospital lab clients, we would have a competitive market edge," noted Angress.

"We also realized that this Internet technology would have a greater long term benefit," he added. "We can piggyback a host of other added-value services onto our web-based system. These would



also be valuable for our specialist physician clients who order esoteric tests.”

Back in 1997, it was a bold choice to design this system around the Internet. “Although the technology was not fully embraced by the industry,” noted Angress, “we recognized that it could allow us to control data at one site and make changes quickly and efficiently [the thin server concept].

### Access The System

“Moreover, if clients proved reluctant to use the Internet, we were prepared to set up an extranet, a private network, and let them access the system via direct phone connections,” he said. “That flexibility helped. It is one reason we were able to get 1,000 installations operational in the 18 months since we introduced this system.”

Specialty’s DataPassportMD (DPMD) is designed to meet the reference testing needs of hospital labs. It handles all basic functions, along with some enhanced services.

According to Angress, hospital labs connect in three basic ways. One, they can use the hospital’s existing T1 lines and their own ISP (Internet service provider). Two, they can connect using a PC workstation. Three, if they already have a CPU-CPU link, then the hospital lab can use DPMD to order or query for results and pending tests.

### Robust and Reliable

“We have 18 months experience with this system and we’ve done three version upgrades,” noted Angress. “It is robust and reliable. We are now ready to launch a web-based outreach system so hospital labs can connect with their physician office clients.

“Helping hospital labs link with physician offices is another way that Specialty wants to differentiate itself from competitors,” he explained. “Beta testing of our outreach system is completed. The system is ready to offer to any serious hospital prospect.

## Lab Outreach Programs Face Several Choices

*“We agree with THE DARK REPORT’s recent prediction about web-based test ordering and results reporting,” stated Dan Angress, Vice President of Marketing at Specialty Laboratories.*

*“Hospital labs with outreach programs will need to select a vendor and a product to link with their physician office clients,” he continued. “But no one yet knows for sure if doctors want all the information that some of these vendors can offer.*

*“And each of these products comes with a different pricing model,” added Angress. “Healtheon/WebMD offers a transaction-based model. **Advanced Health Technologies, Abaton.com, Specialty and others offer a system and hardware which can be purchased. Some lab outreach programs may opt for their existing LIS vendor’s solution.***

*“We believe that hospital lab outreach programs cannot sit and wait to see what shakes out before they decide on a solution,” concluded Angress. “The marketplace is moving too fast. That is why we are aggressively bringing our outreach solution to market. We think its content and ease of use will appeal to hospital labs.”*

“Because we know the hospital lab business inside and out, we’ve designed this outreach system to meet the unique needs of hospital labs and their physician office clients,” noted Angress.

“Since many outreach programs compete head-to-head with commercial labs, this outreach system will give them the added-value punch they need to maintain and expand their client base,” he said. “We designed this outreach system to allow the hospital laboratory to differentiate itself with its physician clients by using its own logos and a look specific to their lab.”

As a business strategy, Specialty's Internet-based informatics platform was designed to streamline connections between hospital lab and reference lab. However, Specialty has not overlooked the potential to use laboratory data to create added-value services.

## Relational Data Base

"Because our server functions as a relational database, clients can access and work with data previously unavailable," said Angress. "For example, a simple query will tell a hospital how many TSHs were performed last month, and by which doctors. As a result, our hospital and specialty physician clients will be able to slice into their data in a variety of new ways."

THE DARK REPORT believes that Specialty's data repository, and others like it, represent the foundation for the next generation of laboratory industry profits. Gathering lab test data from regional and national sources, these repositories will be mined for utilization patterns, disease management purposes, and cost reduction opportunities.

Further, the speed at which this will occur should not be underestimated. For example, Specialty's 1997 business strategy, to design and introduce an Internet-capable reference lab/client lab information link, has certainly been successful. Not only does it support 1,000 operational installations, but it is linked into VHA's private network.

## Outreach Connectivity

Specialty's second phase business strategy is to offer the outreach connectivity product. Assuming that Specialty's hospital client base proves as receptive to this product as it did the DataPassportMD, then it is reasonable to expect a steady flow of installations.

Phase one and phase two strategies set up Specialty's phase three plan: to use these lab data systems as the plat-

form to offer more sophisticated information management services to its laboratory and physician clients.

As manager of the master repository for clinical data flowing from its clients, Specialty is well-positioned to give these same clients the ability to study lab test data. This would allow hospital labs and other clients to package this knowledge and sell it to managed care companies, pharmaceutical companies, and clinical trials companies.

In this respect, Specialty follows the same path as **IMPATh, Inc.** of New York City. IMPATh's primary service is supporting community hospital-based pathologists do evaluations of difficult-to-diagnose cancer cases. IMPATh then puts these cancer cases into a state-of-the-art relational data base. (*See TDR, February 1, 1999 and June 7, 1999.*)

## Support Its Clients

By the end of this year, IMPATh's data base will have more than 600,000 cancer cases, with full clinical work-ups. IMPATh packages this data into different forms and sells it, earning additional revenue. Specialty's relational data base will allow it to support its clients in a similar fashion.

THE DARK REPORT continually predicts that future profits and success for both commercial laboratories and hospital labs will derive, not from performing and reporting simple lab test results, but from converting these test results into more sophisticated tools for diagnostic, prognostic, and patient monitoring purposes.

From this perspective, the business strategies of Specialty Laboratories bear watching. Compared to most laboratories in the United States, its battling average for innovation and execution ranks it among the leaders. **TDR** Contact Dan Angress at 310-828-6634 or dangress@specialtylabs.com.

# INTELLIGENCE

**LATE & LATENT**  
 Items too late to print,  
 too early to report



## **Pathology Consultants of America, Inc.**

announced a promotion and a new hire. Bill McDowell was promoted to Vice President and Chief Development Officer. The new member to PCA's management team is Edward D. Dooling. Dooling will be Vice President of Sales, Marketing and Managed Care. PCA, a pathology physician management company in Nashville, Tennessee, is preparing to intensify its sales and marketing efforts in the anatomic pathology community.

### **ADD TO: PCA**

Perceptive readers will note that both McDowell and Dooling are veterans of **DIANON Systems, Inc.** in Stamford, Connecticut. Through the years, DIANON has earned a justified reputation for the productivity and professionalism of its national sales force. Apparently that accomplishment was not lost on Pathology Consultants of America, Inc., (PCA) as they recruited to fill these positions.

## **"NEEDLE-FREE" TEST THEME OF EPITOPE'S PUBLIC MARKETING**

"Needle-free testing" is a phrase increasingly used to describe **Epitope, Inc.'s** OraSure® oral specimen collection technology. Consumers react favorably to a laboratory test which does not require drawing blood. OraSure is increasingly used to screen for HIV-1 antibodies. The public reaction to Epitope's OraSure test assay demonstrates that direct-to-consumer marketing of laboratory tests and laboratory services is steadily increasing.

### **TENET TO EXIT DOCTOR MANAGEMENT**

One source of lost client accounts for many laboratories is the acquisition of physician practices by hospitals and physician practice management companies. However, THE DARK REPORT has long predicted that hospitals would find the ownership of physician group practices to be a money-loser. (See *TDR, December 4, 1995.*) **Columbia/HCA** has already disclosed their intention to

divest their physician practices. Now **Tenet Healthcare Corp.** will do the same. Tenet announced on November 30 that it was shedding its doctor management business and will take a charge in the third quarter. "We lose money on just about every [physician] practice, lots of money," said Paul Russell, Senior Vice President at Tenet.

### **BREAKING NEWS: LabCorp**

This issue of THE DARK REPORT provides coverage of **Laboratory Corporation of America's** agreement to become a national laboratory provider with **CIGNA**. (See pages 9-10.) As we went to press, LabCorp announced a national managed care contract with **Humana, Inc.** of Louisville, Kentucky. LabCorp will be a preferred laboratory provider for Humana's **Employers Health Insurance Company (EHI)**. This agreement gives LabCorp access to EHI's 1.4 million beneficiaries throughout the United States. The agreement also gives LabCorp access to Humana's ChoiceCare Network.

***That's all the insider intelligence for this report.  
 Look for the next briefing on Monday, January 3, 1999***

# THE **LABOR** REPORT

## ***UPCOMING...***

- ***Squeeze Play: Why Small Pathology Group Practices Are Under Increasing Financial Stress.***
- ***Capitated Lab Contracts: Insiders Predict They'll Soon Die From Natural Causes.***
- ***First Look at the 2000 Executive War College Program and Faculty.***
- ***Unilab Corporation: A Last Look as This Public Company Becomes Private.***