



**MORE PRICE EROSION
COMING TO LAB INDUSTRY!**

- Blame it on 'reference pricing'
- Higher-priced labs at greatest risk
- Price transparency for patients

FULL DETAILS INSIDE ➤

SPECIAL NEWS ALERT!

From the Desk of R. Lewis Dark...

THE DARK REPORT

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

R. Lewis Dark:

Labs Caught Between Employer Hammer, Payer Anvil ...	Page 2
Alert to All Clinical Laboratories: Beware of 'Reference Pricing'	Page 3
Why Lab Test Prices Declined 32% During 3-Year Study	Page 6
Castlight Health's Database and Price Tool Should Concern Lab Executives	Page 10
Lead Researcher Outlines New Details Of Laboratory Test Price Study	Page 12
Reference Pricing's New Lab Winners and Losers	Page 18
Strategy Lowers CalPERs' Price of Joint Replacement Surgeries	Page 21
Intelligence: Late-Breaking Lab News	Page 23

COMMENTARY & OPINION by...

R. Lewis Dark
Founder & Publisher



Labs Caught Between Employer Hammer, Payer Anvil

STARTING ON JANUARY 1, 2017, THE CLINICAL LABORATORY INDUSTRY will undergo a new experiment in price-setting (and price-cutting) by the federal **Centers for Medicare & Medicaid Services**. On that date, certain labs must begin reporting market price data for each test and each payer to CMS. That data will be used to set Part B clinical laboratory test prices for January 1, 2018 under the Protecting Access to Medicare Act of 2014.

However, that is not the only threat to the existing level of clinical lab test prices. In this special, expanded issue of *THE DARK REPORT*, we report on the early success of a large employer's use of "reference pricing" to cut the prices it paid for laboratory tests by about one-third in just three years! We also define what reference pricing is and explain why employers—as well as health insurers—can be expected to swiftly incorporate it into their health benefit plans, and how laboratories with higher test prices are at greatest risk of losing volume and revenue.

Simply said, the clinical lab industry is poised for a powerful, comprehensive repricing of laboratory test services. In the pages that follow, *THE DARK REPORT* lays out its assessment of reference pricing as a tool that employers and payers can deploy to generate a substantial decline in what they and their patients pay for laboratory tests.

Step back for a moment and look at the situation in another way. Medicare Part B is an important source of revenue for most clinical labs. Consider Medicare as the anvil. Meanwhile, employers and their health benefit plans represent another major source of revenue for labs. Picture employers as the hammer.

Stuck between the hammer and the anvil are clinical laboratories and the prices they charge for their lab tests. The shared goal of the Medicare program (through PAMA market price reporting) and a growing number of large employers (by the use of reference pricing) is to pay significantly less for lab tests.

As the hammer and the anvil begin to beat on lab test prices in the coming years, at greatest risk will be labs with the highest prices. In this category are many hospital labs and hospital lab outreach programs. But no lab will escape unscathed. Lab executives and pathologists should absorb the business intelligence and analysis we present in this special issue of *THE DARK REPORT* and use it to develop a strategy that will help their lab remain financially stable. **TDR**

Alert to All Labs: Beware Of ‘Reference Pricing’

➤ **Credible new study demonstrates patients in reference pricing plans avoid high-priced labs**

➤➤ **CEO SUMMARY:** *“Reference pricing” does not refer to how a lab negotiates prices with its reference lab! Rather, reference pricing describes a specific approach to health plan benefits that incentivizes the consumer to choose lower-cost providers while allowing that consumer to still use a higher-priced provider, so long as that consumer pays the additional costs of the higher-cost provider. If employers’ use of reference pricing becomes widespread, it could cause laboratory test prices to drop sharply.*

WILL THE ENTIRE CLINICAL LABORATORY INDUSTRY BE BLINDSIDED by a new health benefit plan strategy that has the potential to cause a steady downward repricing of the lab industry’s highest volume assays?

This question needs to be asked in response to several studies published in credible peer-reviewed medical journals that demonstrate the power of a new approach that incentivizes consumers to select the lowest-cost providers while allowing them to choose any provider, even the highest-priced providers, so long as they pay the difference in the higher price themselves.

This health benefits model is called reference pricing. Not yet well-known in the United States, reference pricing has the potential to be disruptive to the clinical

lab industry as it operates today—and be disruptive to other sectors of the U.S. healthcare system.

It is possible that wider use of reference pricing could upend the long-established pricing practices of clinical labs and hospital outreach programs. For these reasons, THE DARK REPORT is providing the industry with its first detailed analysis of this new method that employers can use to motivate their employees to select lower-priced labs.

This entire issue is devoted to providing a comprehensive assessment of reference pricing. As a starting point, it is necessary for lab professionals to acknowledge that reference pricing does not describe the process of a laboratory negotiating price levels with a reference lab provider that provides “reference testing services” to that lab.

THIS PRIVATE PUBLICATION contains restricted and confidential information subject to the TERMS OF USAGE on envelope seal, breakage of which signifies the reader’s acceptance thereof.

THE DARK REPORT Intelligence Briefings for Laboratory CEOs, COOs, CFOs, and Pathologists are sent 17 times per year by The Dark Group, Inc., 21806 Briarcliff Drive, Spicewood, Texas, 78669, Voice 1.800.560.6363, Fax 512.264.0969. (ISSN 1097-2919.)

R. Lewis Dark, Founder & Publisher.

Robert L. Michel, Editor.

SUBSCRIPTION TO THE DARK REPORT INTELLIGENCE SERVICE, which includes THE DARK REPORT plus timely briefings and private teleconferences, is \$15.27 per week in the US, \$15.27 per week in Canada, \$16.05 per week elsewhere (billed semi-annually).

NO PART of this Intelligence Document may be printed without written permission. Intelligence and information contained in this Report are carefully gathered from sources we believe to be reliable, but we cannot guarantee the accuracy of all information.

visit: www.darkreport.com • ©The Dark Group, Inc. 2016 • All Rights Reserved

Rather, reference pricing describes a specific health plan benefit arrangement. Used for this purpose, reference pricing is a strategy that an employer or a health insurer can use to motivate patients to select providers with lower prices, while still allowing the patient to go to any higher-priced provider, so long as the patients absorb the higher cost of that service. Stories on pages 6-9 and 12-17 provide details about what reference pricing is, its history, and some early uses of it in the United States.

► Three Aspects To Know

There are three aspects to this newest development that every clinical laboratory executive and pathologist should know. First, certain employers and payers are in the early stages of deploying this model for reimbursing clinical laboratory tests, along with other healthcare services.

Second, use of the reference pricing model demonstrates that employers, employees, and health insurers can pay at least one-third less for clinical laboratory tests once this new model is implemented.

Third, there is credible evidence showing that this new model can lower the cost of lab testing. In July, *JAMA Internal Medicine* published the findings of a three-year study documenting how **Safeway Inc.**, and its employees involved in the study collectively saw a 32% reduction in the average price paid for 285 clinical laboratory tests.

► Credible Study in JAMA-IM

In fact, because of JAMA's credibility and the careful research done in this study, the clinical lab industry can expect this JAMA-published study to be a major factor in encouraging employers and payers to adopt this strategy. In turn, this may accelerate reductions in the prices laboratories are paid for their tests.

Clinical laboratory testing is a perfect target for price-cutting via reference pricing for three reasons. First, most patients

have some lab tests each year, so there is a significant volume of tests with the potential to generate substantial cost savings.

Second, the variability in what different labs charge for the same test can be immense, often a difference of 10 times or more for a particular test. Thus, simply motivating patients to move away from high-priced to low-priced labs can produce worthwhile savings for both employees and the employer.

Third, an employer like Safeway can exclude lab tests done in inpatient, emergency room, and urgent care settings from the reference pricing program. That way, patients getting treated in these settings can continue to get timely access to lab tests without incurring any financial penalty.

High-priced clinical labs should consider the reference pricing strategy to be a significant financial threat. Initially, it can be expected that employers will go after the same 285 tests that are common and highly automated, just as Safeway did. Thus, hospitals and hospital lab outreach programs with high prices relative to Medicare Part B lab test fees will be most at risk.

► Reference Pricing Expansion

However, if reference pricing catches on with employers and health plans, it can be expected that these organizations would expand the panel of tests covered by reference testing to include expensive molecular and genetic tests. For that reason, labs offering these tests will want to monitor the pace with which reference pricing is implemented by an ever-larger number of employers in coming years.

Of special interest will be our exclusive interview with the lead researcher of the study published in JAMA. (*See pages 12-17.*) He provides information about reference pricing not found in the JAMA article. It is a "must read" for lab executives and pathologists who want to understand reference pricing.

What All Lab Executives and Pathologists Need To Know about 'Reference Pricing' for Lab Tests

REFERENCE PRICING IS BECOMING A HOT TOPIC among large employers and health insurance companies for a simple reason: by giving consumers a positive and negative financial incentive at the time they select a healthcare provider, reference pricing produces significant savings to both the employer and the employee.

Yet few clinical lab executives and pathologists know much about reference pricing or how it works. Even fewer understand the potential of reference pricing to disrupt the existing clinical lab marketplace.

➤ Defining Reference Pricing

One good definition of reference pricing comes from Ann Boynton of **UC Davis Medical Center** and James C. Robinson, PhD, of the **University of California, Berkeley**. In a blog at *HealthAffairs.com*, they described the characteristics of reference pricing:

- a) In a reference pricing program, the purchaser (an employer or health plan) “places a limit on what it will contribute towards payment for a particular procedure, assuring that the selected payment limit allows appropriate access for patients.”
- b) This payment limit is based on the distribution of prices for a procedure, such as a specific lab test. Typically the price point is set at the median or another relevant mid-point in the distribution of prices in a local or regional market.
- c) When the consumer chooses a provider, such as a lab, that charges less than the reference pricing program’s limit, the consumer enjoys standard coverage, with minimal cost sharing.
- d) By selecting a provider charging above the designated price point, the consumer must pay the entire difference.
- e) Such excess payments will not count towards the patient’s deductible or the annual out-of-pocket maximum.

- f) Excess payments in these situations are “conceptualized as a network exclusion, but a milder form of those inherent in narrow-network insurance designs.”
- g) Reference pricing typically offers the patient full coverage at cost-effective providers and only partial coverage at more expensive providers. (By comparison, narrow-network strategies offer full coverage at some providers and no coverage at others.)

Boynton and Robinson also wrote that, “Reference pricing is not for all patients. Appropriately constructed programs permit exceptions based on the clinical needs and geographic location of individual patients. For example, **CalPERS** provides exceptions from reference pricing when a member lives more than 50 miles from a facility that offers the service below the price limit. It also exempts the patient if the patient’s physician gives a clinical justification for using a high-priced facility or hospital setting. Safeway exempts from its reference pricing program laboratory tests for all patients with a diagnosis of cancer.”

➤ Reference Pricing History

Many European countries have used reference pricing, primarily to control the prices of pharmaceutical drugs. The oldest reference pricing programs date back to the early 1990s.

Investigations into the effectiveness of reference pricing to improve price competition for prescription drugs in Europe indicate success. One global medical journal wrote, that, “the literature suggests that the introduction of a reference pricing system reduces prices of all medicines that are included in the system. Obviously, price reductions tend to be larger for originator medicines than for generic medicines. Also, greater price reductions have been witnessed in markets where generic medicine competition already occurred prior to the introduction of a reference pricing system.”

Why Lab Prices Declined 32% During 3-Year Study

► Employer's use of reference pricing got patients to choose lower-priced labs over high-priced labs

►► **CEO SUMMARY:** *Researchers studied the effect reference pricing had on an employer's efforts to steer consumers to low-cost clinical labs. The study showed that patients were particularly sensitive to lab test prices—in part because those prices varied widely. Over the course of the study, a grocery chain saved \$2.7 million when the percentage of patients using higher-priced labs dropped from 45.6% in 2010 to 15.6% in 2013, along with a drop in the mean per-test price from \$27.72 in 2010 to \$18.56 in 2013.*

IN MARCH 2011, THE GROCERY STORE chain Safeway, Inc., implemented reference pricing for clinical laboratory tests to make employees more sensitive to the cost of lab tests. By choosing lower-priced laboratories from 2011 through 2013, those employees drove down the price per test by 32%.

The mean per-test price fell from \$27.72 in 2010 (the year before the program began) to \$18.56 in 2013, according to research by James C. Robinson, PhD, and colleagues at the **University of California, Berkeley**. At the same time, the percentage of patients using higher-priced labs dropped from 45.6% in 2010 to 15.6% in 2013.

These findings should catch the attention of lab administrators and pathologists. The study suggests that a major employer or health plan can use reference pricing to achieve an overall reduction of 32% in spending on clinical laboratory tests. This is potentially bad news for labs with high test prices.

Reference pricing is an effective cost-control strategy because the employer,

Safeway in this case, analyzed all of the lab test prices from its network of laboratories. It then set the maximum amount it would pay for each test at the 60th percentile level, the researchers wrote.

Any Safeway worker who chose a laboratory that charged less than or equal to this maximum amount paid no more than the usual deductible. Those workers who chose a laboratory that charged more than the reference price (above the 60th percentile level) had to pay their deductible plus the entire extra amount the lab charged, the researchers explained. (See sidebar, page 7.)

► Lab Test Prices Varied Widely

The study tracked how consumers shop for clinical lab tests. It revealed that patients were particularly sensitive to lab test prices—in part because lab test prices varied widely. For a basic metabolic panel, which was the most commonly prescribed test, prices among different labs ranged from \$5.75 to \$126.44, the researchers wrote. Prices for a lipid panel ranged from \$8.85 to \$74.92. Throughout the three-

year study, the average number of tests employees ordered remained at about five to six tests per year.

For the research, Robinson and colleagues from the School of Public Health sought to determine what effect reference pricing would have on an employer's efforts to steer consumers to clinical laboratories that charge lower prices for diagnostic tests. *JAMA Internal Medicine* published the research online on July 25, in an article, "Association of Reference Pricing for Diagnostic Laboratory Testing With Changes in Patient Choices, Prices, and Total Spending for Diagnostic Tests."

Safeway operates more than 1,300 stores in Alaska, California, Hawaii, Nevada, Oregon, and Texas. It introduced reference pricing for 285 of the most frequently ordered clinical laboratory tests.

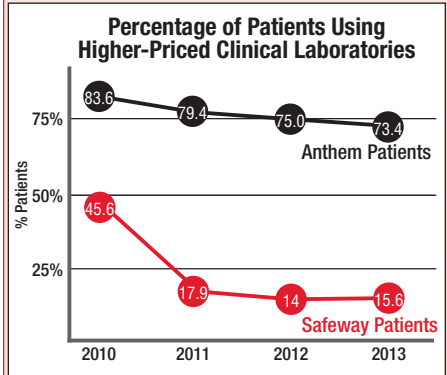
➤ Seeking Low-Cost Tests

"Employers and insurers increasingly are adopting 'reference pricing' policies to create incentives for patients to select lower-priced facilities," wrote Robinson and colleagues. Robinson is the Leonard D. Schaeffer Professor of Health Economics and Director of the Berkeley Center for Health Technology.

Using this strategy, Safeway, its employees, and their family members saved \$2.57 million in three years. Consumers got \$1.05 million (41%) of those savings and the grocery chain got \$1.70 million (59%). Assuming that the savings to Safeway and its workers would be similar if all laboratory tests were included in the study, the researchers estimated that the total savings from reference pricing would be \$4.08 million.

The cumulative savings of \$2.57 million was distributed about equally each year from \$874,496 in 2011 to \$842,755 in 2012 to \$855,624 in 2013. The total savings represented a 35% reduction in spending on clinical lab tests compared with what would have been spent without reference pricing, the researchers wrote.

Study Shows Patients Quickly Favored Lower Test Prices



ONE OUTCOME FROM SAfEWAY'S USE of reference pricing for clinical laboratory tests should catch the attention of every lab executive and pathologist.

Safeway set a maximum price for each of 285 lab tests based on the 60th percentile of the distribution of negotiated prices with the in-network laboratories within each region. It then told employees that, if they selected a lab test priced above that level, they would pay the difference and that payment would not be included as a deductible.

Within the first year of the reference pricing program, the number of Safeway patient's using higher-priced labs dropped from 45.6% to 15.6%. This is evidence that patients can quickly become sensitive to higher lab test prices.

Because of price transparency and the incentives of reference pricing, Safeway employees saved \$320,768 in 2011, \$361,063 in 2012, and \$364,197 in 2013 for a three-year total of \$1.05 million. For patients, these amounts represented an average per-year savings of 40.6% over the three years and ranged from 36.7% in 2011 to 42.6%. For a family accustomed to clipping coupons from grocery-store flyers each week, the effect of a 40.6% savings on any household cost would be substantial.

One strength of this research is the size of the study. Safeway had an average of more than 15,000 patients participate each year and the number of annual tests ranged from 92,606 in 2010 to 79,532 in 2013. For comparison, the researchers collected data from health insurer **Anthem Inc.** Even though Anthem did not use reference pricing to control costs, the percentage of Anthem members using higher-priced labs still dropped.

► Control Data From Anthem

In 2010, 83.6% of Anthem members used higher-priced labs. By 2013, only 73.4% used higher-priced labs. In the same time, Anthem reported that the mean per-test price actually rose from \$28.88 in 2010 to \$29.72 in 2013. The average number of members getting lab tests also rose from 68,082 in 2010 to 84,379 in 2013 and the number of tests rose as well from 387,638 to 476,573, Robinson and colleagues wrote.

The researchers collected lab test claims data for laboratory tests done on nonunionized employees from January 2010 (the baseline year) through December 2013.

The 285 types of laboratory tests accounted for 63% of Safeway's total laboratory test claims. Safeway spends 5.12% of its total medical care budget on laboratory tests, and the tests included in the reference pricing project accounted for 3.04% of the company's total medical spending, the researchers explained.

► Extensive Data on Price

For the study, researchers collected data from Safeway on which laboratory each patient chose and on the type, volume, and price of the 285 most-commonly ordered *in vitro* diagnostic assays. The data included the CPT code for each test or panel; the date of the test; the price; and the patient's age, sex, and home zip code.

"The price data included the total negotiated and paid amount (allowed charge) and, separately, the amount paid by the

employer and the amount paid by the patient," the researchers wrote.

Safeway gave its employees a software tool they could use on a mobile phone or computer to see what each in-network laboratory charged for the 285 covered tests. Employees using the tool could choose any lab and pay the difference between the limit Safeway set and the actual price. If they chose a low-cost lab, they saved money. "Patients selecting a laboratory that charged more than the payment limit were required to pay the full difference themselves," the researchers wrote.

A self-insured employer, Safeway and its workers paid in-network rates for these tests that Safeway's health insurer negotiated on Safeway's behalf. The 285 tests Safeway chose for reference pricing were well-established assays for nonurgent care. Choosing tests for nonurgent care is important because doing so meant the employees could shop for the best price.

► Some Lab Tests Excluded

For this reason, Safeway excluded tests done in the emergency department or in inpatient, urgent care, or other settings in which consumers could not compare prices among different labs. Safeway also excluded genetic tests and those prescribed for treatment of serious conditions such as cancer, renal failure, infertility, and severe mental illness.

It is significant that the researchers compared the Safeway data over the same years (2010 to 2013) to data from a control group (at Anthem) to account for changes over time in the laboratory market that were unrelated to reference pricing, they wrote. Also significant is the amount of data collected. From 2010 through 2013, researchers analyzed a total of 2.13 million claims for the 285 tests, including 344,413 laboratory tests for Safeway employees and 1,781,640 tests for Anthem members.

TDR

—Joseph Burns

Data on Patients' Lab Test Utilization Indicates Day of Reckoning Coming for High-Priced Labs

REPRODUCED BELOW are two tables from the study about the use of reference pricing for lab tests by a large national employer. Lab executives and pathologists should understand that the economic goal of this program was to encourage employees to select labs that offered tests at prices that were at or below the maximum amount the employer would pay for each test, set at the 60th percentile of the distribution of negotiated prices with in-network labs in each region.

The variability in the level of prices charged by different in-network laboratories created the opportunity for the employer and employees to save money when employees selected low-priced labs. Over the three years of the study, the average price per test Safeway and its employees paid dropped from \$27.72 to \$18.56, a decline of 32%. Researchers reported that the savings totalled \$2.57 million over the three-year study period. Of this total, patients saved \$1.07 million (41%).

Table A: Characteristics of Patients and Diagnostic Tests Safeway and Anthem, 2010-2013

	2010	2011	2012	2013
Patients, No.				
Safeway	16,445	15,925	14,479	13,744
Anthem	68,082	76,217	82,777	84,379
Laboratory tests, No.				
Safeway	92,606	89,635	82,638	79,532
Anthem	387,638	436,899	480,530	476,573
Patients using higher-priced labs				
Safeway	45.6%	17.9%	14.0%	15.6%
Anthem	83.6%	79.4%	75.6%	73.4%
Per-test price, mean				
Safeway	\$27.72	\$19.64	\$18.43	\$18.56
Anthem	\$28.88	\$29.22	\$29.28	\$29.72

Table B: Distribution of Prices Paid by Safeway Across Laboratories in 2010 for the 10 Most Commonly Used Diagnostic Tests

(Percentile for each column as determined by each test's price range)

	5th	25th	50th	75th	95th	Variability low to high
Basic metabolic	\$5.75	\$6.15	\$17.15	\$44.00	\$126.44	22 times
Comprehensive metabolic	\$7.18	\$7.68	\$15.98	\$33.37	\$132.48	18 times
General health	\$20.58	\$21.88	\$23.88	\$53.66	\$121.86	6 times
Hepatic function	\$5.56	\$5.94	\$11.32	\$24.51	\$85.14	15 times
Iron test	\$4.40	\$4.71	\$4.71	\$13.62	\$58.47	13 times
Lipid	\$8.85	\$9.46	\$11.73	\$30.03	\$74.92	8 times
Thyroxin free test	\$6.13	\$6.55	\$8.19	\$20.50	\$64.00	10 times
Thyroid-stimulating hormone	\$11.42	12.20	\$28.53	\$55.87	\$101.70	9 times
Total prostate-specific antigen	\$12.50	\$13.36	\$13.36	\$37.27	\$88.75	7 times
Uric acid test	\$3.07	\$3.28	\$3.47	\$9.63	\$30.60	10 times

Source for both tables: Robinson JC, Whaley C, Brown TT. Association of Reference Pricing for Diagnostic Laboratory Testing With Changes in Patient Choices, Prices, and Total Spending for Diagnostic Tests. *JAMA Intern Med*. Published online July 25, 2016. doi:10.1001/jamainternmed.2016.2492.

Castlight Health's Data Should Concern Lab Execs

► Studies show that when patients have data on care costs they choose low-cost providers

►► **CEO SUMMARY:** *Transparency tools, such as those from Castlight Health, help consumers see the significant variation in clinical laboratory test prices. In this analysis, THE DARK REPORT argues that lab executives and pathologists should recognize how two factors are poised to change the status quo in how labs price their tests. One is the credibility of the Safeway reference pricing study, with a 32% price reduction. The other is that Anthem may be poised to implement reference pricing for its 40 million members.*

PUBLICATION OF THE STUDY that demonstrates how use of reference pricing can encourage patients to choose lower-priced labs over high-cost labs is getting national news coverage. But one important part of that study has gone unreported—until now.

As reported in *JAMA Internal Medicine*, **Safeway, Inc.**, introduced reference pricing into its health insurance design for 15,000 employees. Three years later, the company and its employees were spending 32% less for clinical laboratory tests and saved \$2.57 million during the years 2011 to 2013.

What has escaped notice is the essential tool Safeway used to provide its employees with speedy access to the different lab test prices of the in-network laboratories. Patients could use either a mobile app on their smart phone or access a website that offered that information.

This service was provided by a company that should be on the radar screen of every clinical laboratory manager and pathologist. It is **Castlight Health, Inc.**, of San Francisco. Castlight's specialty is col-

lecting and reporting the price data of healthcare services for employers and their workers. Castlight is an early entrant into the market for healthcare big data. It offers an extensive database on the prices healthcare providers charge for care.

This was the database used by Safeway, when, in 2011, it gave its employees access to the Castlight tool. That allowed Safeway employees to see the price charged by all of Safeway's in-network clinical laboratories for 285 lab tests that its employees ordered most frequently. Armed with this information, employees chose lower-priced lab tests, as confirmed by researchers.

► Patients Find Lowest Price

This development is significant in the healthcare marketplace. Castlight Healthcare has created a way for patients to quickly compare the clinical lab test prices any in-network laboratory charges. Patients with high-deductible health insurance plans have an easy way to check lab test prices and choose the clinical laboratory with the best combination of quality and price.

Does the Castlight app help patients find lower-priced providers? Certainly it did for the 15,000 Safeway employees who were studied from 2010 to 2013 by researchers from the **University of California, Berkeley**. (See stories on pages 6-9 and 12-17.)

➤ **Anthem Had The Data**

Another element in this story that has gone unreported is the role of Anthem in providing two essential elements in the study. First, Anthem had the contracts with the labs that were in-network for Safeway (a self-insured company.) So it had accurate data on the wide variation in the prices different in-network laboratories charged for the same test.

Second, Anthem provided the control group for the study. During 2010 to 2013, data from 90,000 patients was collected. This data showed which labs did the test and the price paid for those tests.

Anthem must have been impressed with the 32% decline in the price of tests that benefited Safeway and its employees. That's because, last November, Anthem entered into an agreement with Castlight. Among other elements, it calls for Castlight's transparency tool to be made available on Anthem's consumer website.

➤ **Reference Pricing At Anthem?**

It would be reasonable to assume that Anthem entered this agreement because it has confidence that it can introduce reference pricing to its 40 million members for clinical laboratory tests. If it duplicates Safeway's success, it could potentially experience a similar 32% decline in what it pays for lab tests, in as little as 36 months!

All of this evidence argues that lab administrators should get serious about developing a strategy to serve patients who can price-shop for lab tests with a mobile app—and who are motivated to buy their lab tests at the best price. **TDR**

—Joseph Burns

Castlight Clients Use 'Core Transparency Tool'

FOUNDED IN 2008 IN SAN FRANCISCO, Castlight Health is one of the early players in healthcare big data. One of its goals is to improve the access of patients to information about the prices and quality of healthcare providers.

Castlight considers both employers and health insurers as important customers for its services. The content of its data base and its capability to perform sophisticated analysis with big sets of information—including laboratory test data—has already brought it a growing roster of important client companies.

In fact, one important Castlight customer has substantial power to influence clinical laboratory test prices. That is Anthem, among the nation's largest health insurers with almost 40 million people enrolled in its health plans.

Last November, Castlight and Anthem entered an agreement that calls for Castlight's core transparency tool to be "available to Anthem's affiliated health plan members on its consumer websites." This will make it easier for Anthem to implement reference pricing with its members for clinical lab tests and other healthcare services.

In February, *The Wall Street Journal* reported on how employers are teaming up with Castlight and a handful of similar companies to conduct studies that would identify employees at risk for chronic diseases, such as Type 2 diabetes. Doing so would make it possible to provide them personalized services that would improve their health, such as helping them lose weight.

One secret to Castlight's success is that the company has developed web and mobile solutions that are consumer-friendly and make it easy for patients to compare the prices of healthcare services. Safeway used these solutions to allow its employees to compare the prices of lab tests across all the labs that were in-network.

►► **CEO SUMMARY:** *There is always a story behind the story and THE DARK REPORT went to the lead researcher of the reference pricing study published in JAMA Internal Medicine to get it. In this interview, James C. Robinson, PhD, of the University of California, Berkeley, discusses how the findings of his team's study may encourage more large employers and health insurers to put reference pricing in their health benefit plans to motivate patients to select clinical laboratories that offer lower prices over higher-priced labs.*

The study was led by James C. Robinson, PhD. He is the Leonard D. Schaeffer Professor of Health Economics and Director of the Berkeley Center for Health Technology at the University of California, Berkeley. Robinson and his colleagues from the School of Public Health sought to determine what effect reference pricing would have on an employer's efforts to steer consumers to clinical laboratories that charge lower prices for diagnostic tests.

Because of the impact that this health insurance benefit design, known as reference pricing, will have on how clinical labs set prices for their tests, THE DARK REPORT interviewed Robinson to get additional insights about his findings and their signifi-

"These tests are not on the edge of science in any way. High prices for these types of tests can continue only as long as the payer is asleep at the wheel.

"And payers have been asleep because they have not looked at what clinical labs charge," he continued. "In recent years, employers and payers put most of their effort toward controlling the costs of hospitals and major surgeries. But even after all those efforts, employers and health insurers face continuing cost pressures.

"That is why employers and insurers now look everywhere to reduce costs," he said. "As they do, they see unbelievable variation in clinical lab test prices, just as they have seen from other types of healthcare providers."

In employers' reference pricing study, lab test prices dropped by 32%

Lead Researcher Outlines New Details of Lab Test Price Study

REFERENCE PRICING as an effective and fast-acting strategy to lower healthcare costs is catching the attention of many large employers and health insurers. That was one reason why researchers at the **University of California, Berkeley** conducted a multi-year study of how reference pricing changed the way patients selected their clinical laboratory providers.

In July, *JAMA Internal Medicine* published the findings of a three-year study that documented how **Safeway** and the employees involved in the study collectively saw a 32% reduction in the average price paid for 285 different types of clinical laboratory tests.

Titled, "Association of Reference Pricing for Diagnostic Laboratory Testing With Changes in Patient Choices, Prices, and Total Spending for Diagnostic Tests" (<http://tinyurl.com/hsqldq>), the study also determined that, during this same three-year period, the number of consumers using higher-priced labs dropped from 45.6% to just 15.6%!

These outcomes are an early warning to clinical lab administrators and pathologists. The study's findings suggest that wider use of reference pricing by employers and health insurers could trigger a sustained decline in lab test prices.

cance for employers, consumers, health insurers, and clinical laboratories.

"This research and other studies show that consumerism is coming to every part of healthcare," Robinson told THE DARK REPORT. "For years, labs and lab test prices have been under the radar for many insurers and employers. But consumerism is coming for clinical labs, for a good reason—the variability in the prices different labs charge for the same test.

"What we found in this research is a ten-fold variation in the prices charged by different laboratories for what are very bread-and-butter, non-exotic tests," he said.

In the study, the consumers were employees and family members of the national grocery chain Safeway, which operates more than 1,300 stores in Alaska, California, Hawaii, Nevada, Oregon, and Texas. Safeway introduced reference pricing for 285 clinical laboratory tests that are ordered most frequently.

Over the three years of the research (2011 through 2013), consumers chose low-cost tests so often that Safeway's spending on those tests dropped by 32%! The researchers also had data from 2010, the baseline year.

So, why was reference pricing so successful in driving down lab test prices for

By the Numbers: Key Findings On Changes to Lab Test Prices

OVER THE THREE-YEAR COURSE OF THE STUDY of how reference pricing influenced the selection of clinical laboratory providers by patients, researchers had a control group of Anthem patients that was five times larger than the 15,000 patients in the Safeway reference pricing program. Here are the key data points, as published in *JAMA Internal Medicine*:

STUDY GROUP: SAFEWAY

- Savings from 2011-2013: \$2.57 million.
- Consumers saved: \$1.05 million (41%)
- Safeway saved: \$1.70 million (59%)
- Percentage of patients using high-priced labs dropped from 45.6% in 2010 to 15.6% in 2013
- Mean price-per-test dropped from \$27.72 in 2010 to \$18.56 in 2013
- 15,000 Safeway patients in the study, ordering between 80,000 and 90,000 tests per year

CONTROL GROUP: ANTHEM

- Percentage of patients using high-priced labs dropped slightly, from 83.6% in 2010 to 73.4% in 2013
- Mean price-per-test increased from \$28.88 in 2010 to \$29.72 in 2013
- Up to 84,000 members in the study each year ordered between 387,000 and 476,000 tests each year

It is important to note that all lab test prices used in the study were from in-network clinical laboratories. Thus, out-of-network labs were not a factor. Also, the prices of in-network labs showed a variability of as much as 22 times from lowest price to highest price for the same test.

All the Anthem patients in the control group were in standard health plans (without the reference pricing strategy).

Safeway and its employees? Robinson explained that reference pricing is like the per diem that an employer would pay to its workers who travel. When a worker travels for company business, the employee is usually reimbursed by the employer up to a defined amount per day. The employee can choose any restaurant and hotel, but must pay the difference if spending more than the employer's defined amount.

"When I travel for work, my employer pays a certain amount toward the hotel and meals each day," he commented. "I can spend more if I want to, but they won't pay more. Frankly, that makes me think about how much I'm spending. Do I need to stay at the **Four Seasons Hotel**? Not really. That succinctly describes reference pricing."

Using reference pricing, Safeway paid a set amount per test. Its employees had a mobile app that told them what every laboratory in Safeway's network charged for each of the 285 tests. They could choose any lab and pay the difference between the limit Safeway set and the actual price of the lab test.

If they chose a low-cost lab, they saved money. But if they chose a high-cost lab, they were required to pay the difference. The research showed that reference pricing helped to reduce variation in lab test prices.

► Waking Up to Price Issues

"Any discussion about how to contain inappropriate healthcare utilization is challenging," observed Robinson. "By contrast, significant price variation is the low-hanging fruit. Employers would much rather save money by having patients travel to cheaper clinical labs than get into some esoteric discussion about whether a clinical procedure is appropriate or not.

"That is why tackling lab test prices is easy," he said. "Take the example of whether a consumer should go to **Walmart** to save \$5 instead of **Walgreens**. Then, if

Walgreens reduces its prices by \$5, what could happen? Who makes that decision? Reference pricing allows patients to decide, even if it means they are choosing to pay a higher price for their lab test.

“Because that price awareness is coming to lab testing, high-priced labs must either reduce their prices to something closer to the market or they need to document that their quality and service are better enough to justify the higher price,” he said.

➤ Erosion Of Volume

“To go back to the per diem analogy, the Four Seasons does attract customers even after charging what they charge,” he said. “If they didn’t get customers, they would have to endure some erosion of volume.

“As more employers and health plans decide to introduce reference pricing, every clinical lab will need to make a decision on how to price every different test they run,” noted Robinson. “Is a lab going to set their test prices at the market level? If it chooses higher prices, is it willing to absorb some erosion of volume?”

“The fact that the reference pricing model Safeway used in the study drove down costs sharply is perhaps the most important lesson for clinical labs,” he stated. “There are other lessons as well. One of those secondary lessons is about the utility of cost-sharing for lab tests.

“One goal of our study was to determine how a reference pricing benefit requirement affected the way consumers chose their source of clinical lab tests,” continued Robinson. “Our study also was a test of cost-sharing in general. There are other healthcare services for which we can make the plausible case that cost-sharing is something that can save money without putting the patient’s health at risk.

“To clarify that point, I don’t believe that consumers should share the cost for every type of healthcare service,” he noted. “It’s inappropriate and unethical to require cancer patients to pay 20% for co-insurance on a \$100,000 drug, for example.

Labs Probably Didn’t Notice Patient’s Shift to Cheaper Tests

DID CLINICAL LABORATORIES NOTICE that Safeway employees were shifting their use of clinical laboratory tests away from high-priced labs to low-priced labs during the three years of the study?

“No, and we wouldn’t expect that because Safeway is a big company but its employees are going to be a relatively small share of any local market,” stated James C. Robinson, PhD, lead researcher of the reference pricing study. “The typical clinical lab would not be aware that some lower-priced labs are gaining business and some higher-priced labs are losing business. Labs wouldn’t notice because this redirection of a patient’s lab tests is within the general random fluctuations of their volume.

“I believe that, in communities where a single employer has thousands of employees, then the impact of reference pricing would be visible to labs in that region,” he noted. “Our study provided data that can be interpreted as demonstrating that patients do respond when they can see lab test prices. For a specific test, they will select a low-price lab over a high-cost lab.”

“On the other hand, reference pricing works for those types of healthcare treatments that we call shoppable services, such as lab tests,” said Robinson. “Shoppable services typically involve non-emergency clinical care. That is certainly true of the 285 clinical lab tests we used in the study because they are not complex and, for the most part, we’re not talking about an emotional service (such as cancer care). The consumer is simply choosing between going to facility A or to facility B.

“Also, the quality of shoppable services tends to be approximately the same,” he commented. “I don’t know if there’s wide variation in the quality of lab tests across facilities. If there is, that’s a whole different topic that should be studied. But for

now, we can assume that the quality and service are roughly similar.

“In our study, all of the labs were accredited, in-network providers,” continued Robinson. “Therefore, in all of these ways, clinical lab tests are in a completely different category from high-cost cancer care, for example. Stated differently, it is appropriate to use the reference pricing model to require patient cost-sharing with lab tests.

“When employers see that cost-sharing is appropriate for clinical lab tests at a time when they don’t want to keep paying costs for their health benefit plans, it becomes an easy decision to ask their employees to accept higher cost-sharing in exchange for moderation of the premium,” he added. “Then the employees can do what they need to do to shop for the lowest-priced clinical laboratory tests.

“Once an employer gets the consumer involved in cost-sharing, then the consumer will want help on how to save money,” said Robinson. “That’s why Safeway gave their workers the information they needed to find the low-priced tests and avoid the high-priced tests. Safeway provided that information via a mobile app and a web service. In addition, Safeway also said, ‘You can go to any network lab you want.’

► Incentive To Save Money

“Safeway could do that because it knew that, by giving employees an incentive to save money and by giving them easy-to-understand information about where to get low-priced lab tests, then the employees would save money. And they did exactly that,” Robinson said.

Considering all the strategies that employers have for controlling health costs, reference pricing for lab tests stands out as being effective and without any of the negative consequences of other cost-control efforts, such as high deductibles and narrow networks, he explained.

“Right now, employers have three main strategies they’re pursuing,” he said

“Number one is increasing the deductible through high-deductible health plans. Number two is using narrow provider networks. Number three is contracting with accountable care organizations. Each strategy has strengths and weaknesses.

“The problem with a high-deductible health plan is that it does not help the consumer differentiate between effective or high-value services and ineffective or low-value services (such as those recommended in the Choosing Wisely program),” emphasized Robinson. “Studies show that people with high-deductible health plans use less of the inappropriate care; but they use less appropriate care as well. Thus, among the many concerns about high-deductible health plans is not only the affect they have on price, but that they may also have a negative effect on a patient’s utilization.

► Plan With Narrow Networks

“There is a similar drawback to the strategy of narrow networks,” he observed. “Although a plan with narrow networks somewhat resembles reference pricing, it is a much harsher version that says if the patient goes to the high-priced clinical lab, the plan pays nothing and the patient pays 100% of the charge.

“In the third strategy, the employer enrolls its workers in an accountable care organization. The employer then gives the organization a budget and the providers determine which clinical lab they will refer these patients,” he said.

“Given the considerations of the three strategies of high-deductible health plans, narrow networks, and ACOs, the strategy of reference pricing offers employers and health plans a simpler solution to managing costs,” noted Robinson. “The reference pricing strategy targets only price. There is no incentive not to get the lab test; there’s just an incentive to get the laboratory test at the cheaper price. That’s all it is.” **TDR**

—Joseph Burns

Contact James C. Robinson, PhD, at 510-642-0564 or james.robinson@berkeley.edu.

Much Attention Given to CalPERS' Success With Reference Pricing for Certain Surgeries

WHEN A LARGE EMPLOYER IN California used reference pricing for selected clinical services, patients responded by choosing lower-cost providers.

"In 2013, we evaluated the effect of a reference pricing initiative of the **California Public Employees' Retirement System** (CalPERS) from 2008 to 2012," said James C. Robinson, PhD, Director of the Berkeley Center for Health Technology at the University of California, Berkeley. For the hip and knee study, Robinson and Timothy T. Brown, an assistant adjunct professor in the Berkeley Division of Health Policy and Management, wrote about the initiative in an article in *Health Affairs* in 2013.

"Inpatient hip and knee replacement surgeries are big-ticket procedures and CalPERS is a major payer. Thus, when the reference pricing program was implemented, there was much publicity about the program and significant shifts in patients' choices away from higher-priced facilities and toward lower-priced facilities," Robinson explained.

"About half of the hospitals that were charging above the CalPERS reference price reduced their prices," he said. "In this example, hospitals could see patients making decisions that included price and because orthopedic surgery is a big revenue generator for hospitals, they lowered prices to retain those patients."

Robinson compared the big-ticket approach of the CalPERS program to Safeway's strategy of targeting lab test costs. "The difference was that CalPERS went after big-ticket invasive procedures where they had the opportunity of saving meaningful amounts of money on every case, and the Safeway program was for lower-cost services," Robinson commented.

"But the hip and knee cases represent a small proportion of healthcare services," he explained. "How often does a patient undergo joint replacement surgery, for example?"

"Safeway took a broader view of the opportunity with reference pricing," stated Robinson. "They wanted to help change the culture of their workforce into one in which the employees were thinking about health-care utilization the way they think about other shopping behaviors. By that I mean that consumers are making an informed decision by considering price, quality, and convenience. This is different than the traditional healthcare purchasing mindset, where the patient thinks of a service as something for which someone else will pay.

"This is why Safeway deliberately started with small-ticket services, such as clinical laboratory tests and also imaging," Robinson said. "What lab tests, imaging, and prescription drugs have in common is that everyone uses them. And these are services where there are potential savings, although the savings are modest on a per-unit basis.

"But every employee uses lab tests or drugs," he continued. "Thus, every one of them is exposed to this concept so now they're thinking about the cost savings. If they buy the higher-priced lab test or drug, they pay more out of pocket. Patients are thinking consciously about the purchasing decision because it's their money at the margin.

"This is a primary element of our study with Safeway," emphasized Robinson. "It's a study of how consumers respond to small amounts of money involved in lab tests and drugs. This is not about the patient saving \$1,000. It's about saving just \$10 or \$30.

"Here is another way to think about the need to shift the mindset of patients when purchasing healthcare," he noted. "As a grocery chain, Safeway knows their customers will drive across town to save \$10 on a big bottle of shampoo but patients won't go anywhere to save \$1,000 on an MRI because the employer pays for it. This is the mindset that Safeway hoped would change in response to the reference pricing program."

Reference Pricing's New Lab Winners and Losers

► Which labs will benefit and which will lose if reference pricing were to become widespread?

►► **CEO SUMMARY:** *Expanded use of reference pricing by employers in coming years could trigger a cycle of cuts to lab test prices that would put the most pressure on the lab companies with the highest prices. Many hospital labs are viewed as having high prices. But because they run outreach specimens in the evenings and thus have a low marginal cost per test, they could choose to reduce prices to remain competitive while still producing acceptable profit margins for their parent hospitals.*

BECAUSE ONLY A FEW LARGE EMPLOYERS currently use reference pricing as a way to cut the price of clinical laboratory tests, it is difficult to predict how fast this healthcare cost-control strategy will catch on among big employers and health insurers.

However, if employers and health insurers do expand use of reference pricing for clinical laboratory tests, then one consequence for the lab industry will be the creation of new winners and losers.

► High-Priced Labs At Risk

It doesn't matter whether the use of reference pricing to put downward pressure on lab test prices expands rapidly or goes forward at a measured pace. What will prove true is that clinical laboratories with higher prices will need to reduce their prices or accept less test volume.

The lab industry has plenty of experience with the consequences of sustained declines in lab test reimbursement. A major shakeout results. This happened in the mid-1990s when closed-panel HMOs used full-risk, capitated managed care

contracts to win rock-bottom lab test prices. Facing a significant reduction in their reimbursement, a large number of independent lab companies either sold to a public lab company, merged with a regional lab, or went out of business.

Another cycle of price-cutting in recent years has squeezed many laboratories, particularly hospital lab outreach programs. In this cycle, managed care companies used three strategies to cut the cost of lab testing. One strategy was to use narrow networks to simply exclude higher-priced laboratories.

The second was to negotiate provider contracts that arbitrarily reduced the price paid for lab tests. The third strategy was to create a preferred provider panel and require patients to pay the full cost of the service if they used a non-panel provider.

The consequences of these actions over the past years can be seen in the decision by some hospitals and health systems to sell their lab outreach programs because of diminished profitability. In some cases, these outreach labs had made money for their owners for decades.

Whether High-Ticket Surgeries or Lab Tests, Reference Pricing Encourages Patients to Save

EARLY EVIDENCE INDICATES that reference pricing is to be a powerful tool that employers and payers can use to exert downward pressure on lab test prices. This potential is documented in a growing number of studies published in peer-reviewed journals. These studies document the ability of reference pricing to encourage patients to price-shop for healthcare services and select low-priced providers over higher-priced providers.

These studies include the example of **CalPERS** using reference pricing to drive down the price of joint replacement surgeries and similar high-ticket procedures in California in the years 2011 and 2012. This effort got national publicity at the time it was announced and again when the results were published. In the first 12 months of the program, CalPERS experienced a 30% reduction in the prices of these surgeries, while its patients got the same quality of care as employees in the control year. (See pages 21-22.)

But what has the greatest relevance for lab executives and pathologists is the study of reference pricing for clinical laboratory test prices published in *JAMA Internal Medicine*. That study is the subject of this issue of THE DARK REPORT.

Every lab manager should understand the path Safeway followed. Its use of reference pricing was simple and easy to understand for its employees. The study provides a road map

that other major employers and health insurers can follow.

The financial outcomes from Safeway's use of reference pricing will entice other employers to initiate similar programs. Consider the savings: in a reference pricing program involving 15,000 Safeway employees, it took only three years to cut the prices paid for lab tests by 32%! Total savings were \$2.57 million in 36 months. The savings were divided between Safeway (\$1.70 million, 59%) and its employees (\$1.05 million, 41%).

➤ Substantial Savings

Looked at in another way, for each employee, Safeway and that individual paid an average of \$171.33 less in lab test costs over the three years of the study (or an average cost reduction of \$57.11 per employee per year). These are substantial savings for a healthcare service that typically makes up 3% to 4% of an employer's annual healthcare costs.

Another element will make it easier for other employers and health insurers to implement their own reference pricing programs for clinical laboratory tests. Companies such as **Castlight Health** have large databases to identify price-cutting opportunities. They also have the mobile apps and website services that allow patients to compare prices and select lower-priced providers, including labs. (See pages 10-11.)

Now the arrival of reference pricing provides employers with a new strategy to reduce the price of lab tests. As this happens, it will further aggravate the existing poor financial environment, particularly for those labs with the highest test prices.

The labs most vulnerable to revenue and volume erosion as a result of employer use of reference pricing are hospital labs and hospital lab outreach programs, specifically those labs that continue to use inpatient pricing on their

lab test claims. Because of this high-price strategy, some hospital lab outreach programs generate net collected revenue that produces an average revenue per requisition that is double the \$40 to \$50 per req of commercial lab companies.

Employers will want to use reference pricing to make patients aware of high test prices. Some hospital labs using inpatient prices have test prices that may be up to 20 times more than the lowest-cost labs. These labs could experience a significant

reduction in both revenue and specimen volume.

For these hospital labs to retain their outreach business, they would have to be smarter about their pricing decisions. However, these labs do have a card they can play to improve their price competitiveness. Because these tests are generally run in the evening, hospital labs actually have a low marginal cost per test that would allow them to be competitive using prices nearer to the market level.

► Will There Be Winners?

Most lab professionals would believe that **Laboratory Corporation of America** and **Quest Diagnostics Incorporated** are positioned to benefit from reference pricing programs. That's because each has among the industry's lowest average cost per test.

But success in an era of reference pricing will not be automatic. The Achilles heel of LabCorp and Quest Diagnostics may be their payer mix. It is widely-believed that the two companies offer prices for routine, high-volume tests at or below cost to their biggest managed care customers. These losses are offset, in large part, by revenue from Medicare Part B test claims.

Prices at LabCorp and Quest for their reference and esoteric tests also have better profit margins. Another higher-priced part of their payer mix are tests sold to patients paying cash or who have high-deductible health plans and are out-of-network. What is unknown is how much revenue erosion in these portions of their payer mix might occur if employers implemented reference pricing programs that set the upper limits for prices at the current amounts of the Medicare Part B Clinical Laboratory Fee Schedule.

The one prediction that can be made with confidence is that, going forward, clinical laboratories with the highest prices will be under the most pressure to lower those prices. These labs are at greatest risk of losing revenue and volume. **TDR**

Perfect Storm May Be Heading For Clinical Lab Industry

LOOKING INTO THE FUTURE, the lab industry may soon need to weather a perfect storm which brings together multiple forces, each of which causes cuts to lab reimbursement and pushes down lab test prices.

If this turns out to be the mother of all financial storms for the lab industry, then the most powerful force will be the Medicare program. CMS officials are ready to implement PAMA lab test market price reporting on January 1, 2017. The market data reported by certain labs will be used to establish new Part B clinical laboratory test prices that would become effective on January 1, 2018.

Expectations are that CMS will implement price cuts to the maximum allowed by the PAMA statute. That would be cuts of 15% each in 2018, 2019, and 2020; followed by cuts of 10% each in 2021, 2022, and 2023.

Another force pushing its way into the perfect storm would be expanded use by employers and health insurers of reference pricing. If these programs generated comparable results to those experienced by Safeway, then employers might enjoy a 30% reduction in the prices they pay for lab tests in just a few years. It will be the highest-priced labs that take the biggest financial hit from these reference pricing programs.

Of course, other, more modest forces will feed into the perfect storm. In the years to come, employers and payers will continue to use narrow networks, restrictive coverage guidelines, and outright price cuts to their lab test fee schedule to push down test costs. These time-tested tools will continue to be deployed.

Add up all of these forces and it may make old-timers in the lab business wish for the good old days of HMO capitated, full-risk contracts for lab testing services.

Strategy Lowers CalPERS' Price of Joint Surgeries

➤ **California's CalPERS ran pilot program to tackle large variability in prices for orthopedic surgeries**

➤➤ **CEO SUMMARY:** *Probably the most-watched reference pricing program in healthcare to date was initiated by CalPERS. It focused on the variability in the prices of knee and hip replacement surgeries. Just as Safeway experienced a drop in clinical lab test prices of 32% in its reference pricing program, CalPERS paid 30% less for these surgeries at the end of the first year of the program. These outcomes were realized with no measurable negative change in quality or patient experience.*

IN THE UNITED STATES, REFERENCE PRICING is still in its infancy. Most physicians, hospital administrators, and lab executives are unfamiliar with the details of this healthcare cost-cutting tool.

However, in the short life of reference pricing in this country, there is one example of the program that has attracted national news coverage and plenty of attention with the provider and payer communities. In 2011, CalPERS, which manages the retirement and benefits programs for California state employees, implemented a reference pricing program that targeted joint replacement surgeries.

This example of reference pricing is instructive because it shows clinical lab executives and pathologists how this strategy is used to lower prices for high-cost clinical services. It is at the other end of the spectrum from Safeway's use of reference pricing to lower the prices of clinical laboratory testing, a much less expensive clinical service than joint replacement surgeries.

There were two reasons why CalPERS' reference pricing initiative got wide publicity. First, orthopedic surgeries were a

big cost driver for CalPERS' health benefit program. At 13% of total healthcare spending, muscle and bone disorders were the single biggest spending category and the increase in spending was 39% just for the years 2005 to 2008. Hip and knee replacements made up about a third of this spending.

➤ **Controlling Healthcare Costs**

Second, with 1.38 million members in its benefit programs, CalPERS is among the largest such organizations in the United States. It is considered an innovator in how it approaches managing healthcare and controlling the cost of care. That is why its successes are regularly studied and copied by other big employers.

A third reason why this reference pricing program was closely-watched is that joint replacement surgeries are big money-makers for most hospitals and health systems. Thus, any attempt by a large employer to reduce the prices paid for these procedures could be a direct threat to the financial resources of these hospitals.

To create a baseline for comparing costs, CalPERS worked with its PPO, managed by **Anthem Blue Cross**. A study determined the average costs for hip and knee replacements among California hospitals.

► High Degree Of Variation

Data provided by Anthem showed a high degree of variation in negotiated hospital prices for hip and knee replacements. The range was from a low of \$15,000 to a high of \$110,000. The next step was to develop sufficient coverage by those hospitals that also met a certain cost threshold. The program set a maximum of \$30,000 for these surgeries.

Next, CalPERS included 46 medical institutions as providers in the reference pricing program. This network allowed access to patients throughout the state.

At the end of 2011, the first year of the reference pricing program, Anthem determined that CalPERS had paid 30% less per surgery, compared to the base year of 2010. That generated savings of \$2.8 million.

Quality for these patients was comparable to the base year. **HealthCore**, a research division of Anthem, compared readmission rates for CalPERS patients who underwent these surgeries in 2010 versus 2011 and found no significant difference in quality outcomes.

► Prices Dropped 19%

How did patients respond to the financial incentives of the CalPERS reference pricing program? During 2010, the baseline year, 47% of CalPERS patients went to designated hospitals. That increased to 63% in 2011, the first year of the program.

At the end of the two-year study, it was determined that there was a 21% increase in use of preferred hospitals by CalPERS members. Hospitals responded by dropping their prices. It was reported that CalPERS' average cost for these joint replacements dropped by 19%, from \$35,408 to \$28,695 per admission.

—Joseph Burns

Employers Taking Steps To Use Reference Pricing

ALTHOUGH REFERENCE PRICING has been under the radar of most lab administrators and pathologists, it has already caught the attention of a sizeable number of employers.

In 2014, **Aon Hewitt** conducted its annual Health Care Survey. A total of 1,230 employers covering more than 10 million employees participated. One interesting finding was that 52% of employers confirmed that their “current health strategy is focused on traditional cost-mitigation approaches such as employee cost-shifting.” However, only 21% of respondents believed this would be their preferred approach in three to five years.

What might be their alternative health-care cost control strategy? Aon Hewitt wrote that, “Instead, employers are considering new tactics that require employees to take more action. For instance, the survey found that 68% of employers said they plan to adopt reference-based pricing, while 10% had already adopted this approach.”

Use of reference pricing has also been given a green light by the current federal administration. **The Robert Wood Johnson Foundation** issued a report, “Exploring the Use of Reference Pricing by Insurers and Employers.” The authors wrote, “The Obama Administration recently indicated that the use of reference pricing by large group and self-funded group plans does not violate the Affordable Care Act’s cap on patients’ annual out-of-pocket costs. Some experts say this guidance is likely to encourage additional employers to adopt reference pricing strategies.”

These developments provide evidence that reference pricing is gaining favor among the nation’s large employers. Organizations such as CalPERS and Safeway are the first-movers and their successes will encourage other employers to use the reference pricing strategy.

INTELLIGENCE

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



During the widespread floods in Louisiana last month, **Pathology Group of Louisiana** (PGL) activated its disaster preparedness plan and managed to avoid any interruption of its pathology services. One vital element of that plan was a telephone tree that kept managers and staff in communication. CEO Pika Sdrougias reported that the laboratory facility survived undamaged. But that is not true for many of the lab's 125 employees. "Thirty-one of our employees (24% of the staff) have sustained total loss of their homes and belongings," stated Sdrougias. "The unprecedented floods took everything: their homes, personal possessions; even their cars are now a total loss."

MORE ON: PGL

To help those employees who have suffered these losses, PGL launched a national campaign to secure donations to help their 31 employees and families. Lab professionals and lab companies can help the PGL staff and their families recover. One way is to

contribute to a GoFundMe campaign. The goal is \$50,000 goal. As of press time, pledges totaled more than \$22,000. To help, go to: <http://www.gofundme.com/2k5gsw4>. Another way is to contact PGL's office to learn what is most needed.

CEO LEAVES BOSTON HEART

There's been a change in leadership at **Boston Heart Diagnostics**, the cardiology testing lab based in Framingham, Mass. Last month, CEO and President Susan Hertzberg left the company. Shortly thereafter, CFO Kim Bracuti also left. Stepping into the CEO role is Tom Burnell. He was formerly CEO of **ViraCor-IBT**. Both Viracor-IBT and Boston Heart are owned by **EuroFins Scientific**. In a 2014 front page story in *The Wall Street Journal*, Boston Heart was identified as one of several cardiology testing labs under investigation by the **Department of Justice**, along with **Health Diagnostic Laboratory** (HDL), **Singulex**, **Berkeley HeartLab**, and

Atherotech Diagnostics Lab.

A federal whistleblower case was settled by HDL and Singulex in 2015. Other than the news story in the Journal, Boston Heart has not been publicly associated with any government investigation. Eurofins acquired Boston Heart in 2015.



DARK DAILY UPDATE

Have you caught the latest e-briefings from DARK Daily? If so, then you'd know about...

...why microbiologists at **The University of Westminster** in London researched how hand dryers might spread germs. After testing high-powered hand dryers, they concluded that some devices acted like "virus hand grenades."

You can get the free DARK Daily e-briefings by signing up at www.darkdaily.com.

***That's all the insider intelligence for this report.
 Look for the next briefing on Monday, September 26, 2016.***

★ SPECIAL SESSION! ★

Purchasing a New Total Laboratory Automation System for a Lean Lab with a 25% Staff Vacancy Rate



Sharon Cox

Core Laboratory Supervisor, Saint Francis Health System

Dealing with 25% Staff Vacancy Rate: Why Retiring Baby Boomer MTs Require New Lab Staffing Strategies

Finally, medical technologists of the baby boomer generation are beginning to retire in larger numbers. In this intriguing presentation, you'll learn how a Lean lab—already operating with a 25% staff vacancy rate—is using the newest automation solutions as one effective response to the shrinking lab workforce.

Gain insights on why continuous improvement in today's health system laboratories requires equal attention to current and future staffing challenges. Combining Lean workflow design with new generation automated systems and advanced analytics are just part of the solution.

The lessons learned at Saint Francis Health System Laboratories can be applied in any hospital laboratory environment. Act now to ensure your participation at the nation's biggest and most important meeting on Lean, Six Sigma, and process management in laboratories and hospitals!



It's our 10th Year!
Lab Quality Confab
and Process Improvement Institute

October 18-19, 2016 • Sheraton Hotel • New Orleans

UPCOMING...

- **Meet the Med Tech Who Makes Morning Rounds and Makes a Difference in Patient Care.**
- **Preparing for PAMA Lab Test Price Reporting: Essential Steps to Complete before Jan. 1, 2017.**
- **What's Hot in Molecular Diagnostics: New Instruments, New Assays, More Value.**

Visit www.darkdaily.com