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Heads I Win, Tails You Lose

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The main tool for bringing managed care to the CHAMPUS program is a network of seven regional contracts. Dubbed "Managed Care Support" or "MCS" contracts, they provide fee-for-service, PPO and HMO care for CHAMPUS beneficiaries whose health care needs are met outside the military system.

Sailing in uncharted waters, OCHAMPUS has devised a complex, multi-factor formula to adjust the contractor's reimbursement for health care costs. The actual amount paid rises and falls with such elements as inflation, intensity, utilization, use of military facilities, *etc.*

The same is not true for administrative costs. These are fixed throughout the five-year contract term. Under the contract, they do not vary, even if the number of beneficiaries changes. Bidders have sought to persuade OCHAMPUS to provide some relief in this area, or at least put limits on the contractor's risk, but so far, to no avail.

Now the General Accounting Office has entered the picture. In reviewing the program it noticed that health care costs had fallen in the Northwest region encompassing Washington State and Oregon. There were several reasons for the decline, including a lower baseline population and different estimates for the utilization of military treatment facilities.

However, administrative costs did not decline. GAO noticed that administrative costs in the Northwest rose from 15-16 percent of total costs to 20-21 percent when healthcare costs fell. Administrative costs in other MCS regions ranged from 13 percent to 18 percent.

GAO then took OCHAMPUS to fault in a letter to the Secretary of Defense (B-276227, June 24, 1997). It asked why DoD didn't use its contractual powers, specifically the "changes" clause, to reduce administrative costs?

If GAO had bothered to look into the matter further, it would have learned that administrative costs were "firm fixed-price," and that OCHAMPUS had spurned contractor requests to share the risks. Moreover, the use of the "Changes" clause here is inappropriate. The Government bought, and the contractor promised, administration of the contract (including claims processing) regardless of the number of claims or beneficiaries. Thus, the Government's requirements have not changed at all. It simply overestimated what those requirements might be.

This ill-informed approach missed the truly interesting question raised by GAO's analysis. Why is the region with the highest percentage of administrative costs also the region with the highest dollar amount of healthcare costs (Gulf South and Southwest) ? Economies of scale should give this region the lowest percentage. But since GAO is pursuing other issues, we may never know the answer.