

Teaching Hospitals & Academic Medical Centers

Healthcare Outsourcing Overview: Staying Focused in Uncertain Times

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What's In With Healthcare Outsourcing

With change occurring all around them, teaching hospitals are taking steps to focus their business on their core competency—the delivery of healthcare services. While citizens will always need healthcare, teaching hospitals are not recession-proof. They are exposed to the negative economy and are vulnerable to declining government reimbursement for their services and increased costs associated with the changing laws and regulations that govern the delivery and billing of healthcare services, a trend that will accelerate with healthcare reform. In this uncertain economic and regulatory environment, many teaching hospitals and academic medical centers (AMCs) are exploring outsourcing as a way to deal with these challenges.

Teaching hospitals are outsourcing ancillary tasks to sharpen their focus on the resilient core of delivering healthcare services. Outsourcing arrangements can improve financial results by reducing administrative costs and increasing revenues, efficiency, and service quality. Areas that are strong candidates for outsourcing include any function outside the direct delivery of healthcare that is either underperforming, requires specialized skills, or requires substantial infrastructure or other resources. Outsourcing such functions allows teaching hospitals to focus on treating patients and generally results in increased savings and operational efficiency. There are myriad outsourcing vendors and options, but some of the most common tasks outsourced by healthcare providers include revenue cycle services, human resources (HR), benefits administration, information technology, laundry, housekeeping, food services, and, in some cases, clinical services that the provider is not well-equipped to provide without the assistance of a third party, or that a third party is able to provide at a higher quality and/or at a lower cost than the provider could do by itself.

Revenue Cycle Services

A focus on avoiding errors and maintaining consistency permeates teaching hospitals' objectives. Mistakes in areas such as billing directly impact healthcare providers' bottom line. For example, estimates have shown that billing errors can

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—from a declaration of the American Bar Association

result in a near 10% loss of a physician practice group's revenue.¹ In addition to the financial impact, the increasing complexity of coding adds to the risk that a hospital will be found to be noncompliant and subject to government investigations and fines. In this environment, getting billing right is a high priority. Because electronic systems and data now drive billing, it should be no surprise that many hospitals are outsourcing billing functions to healthcare technology companies that specialize in billing. In addition, hospitals are also outsourcing other parts of their revenue cycle such as the admissions process, coding, billing, collections, and everything in between. These processes are exceedingly complex and constantly subject to changes in technology and regulations. Therefore, it makes sense to leverage a specialist's expertise and capabilities. Healthcare providers have recognized this situation and are increasingly looking to third-party outsourcing providers to handle revenue cycle services. For example, in 2009 Memorial Health University Medical Center, an AMC in Savannah, GA, outsourced its revenue cycle management to McKesson Corporation.²



HR

Hospitals commonly outsource certain HR functions. For example, 52% of hospitals outsource tasks involving benefits administration and computer-based learning systems.³ A smaller number of healthcare providers outsource a broad scope of HR functions. For example, some hospitals are working with outsourcing providers to implement innovative techniques for hiring, retention, training, and other HR functions. Some HR functions such as payroll processing or benefits administration are administratively burdensome and are not unique to healthcare institutions. However, they are critical to a healthcare entity's ability to retain quality healthcare specialists and support staff.

Other functions are unique to healthcare but may be better provided by specialty companies. Examples include nurse staffing companies and physician recruitment firms. Therefore, many HR activities are prime outsourcing candidates.

Information Technology

Outsourcing information technology functions continues to be the dominant form of outsourcing in every area of business, including the healthcare industry. Healthcare delivery is increasingly data driven. Healthcare providers must electronically track medical records, billing codes, electronic monitoring systems, and other data related to patient care and billing. These electronically based administrative activities create an increased need for information technology infrastructure and devices such as servers, desktops, networks, wireless networks, PDAs, and laptops.

Maintaining such infrastructure and devices is increasingly challenging and requires specialized expertise. Having an external outsourcing provider maintain such infrastructure, device, and systems can have many benefits for healthcare institutions. For example, technology outsourcing companies are generally better at attracting and retaining qualified information technology providers. The performance of top talent results in a higher level of technology service delivery. In addition, healthcare institutions are able to decrease or eliminate capital expenditures on technology infrastructure by leveraging the outsourcing provider's infrastructure and only paying for technology services on an as-needed basis. Such outsourcing converts a fixed cost into a variable cost, which can be beneficial during a recession.⁴ Outsourcing information technology services is a mature offering that continues to be popular with healthcare providers, allowing them to save money, modernize, and become more efficient. Last year, Mercy Hospital & Medical Center, Chicago's first teaching hospital, was recognized by the Healthcare Information Management and Systems Society for modernizing its medical information systems by outsourcing various healthcare information systems to Cerner. Through the implementation of the Cerner systems, Mercy Hospital & Medical Center moved into the top 0.5% of hospitals in the United States for its use of electronic medical records.⁵

Laundry, Housekeeping, and Food Services

Contracting with companies that provide essential services such as laundry, housekeeping, or dining services can be cost effective and can substantially benefit healthcare providers. For example, utilizing outside suppliers for laundry has been and continues to be a successful option for hospitals. Before the economy took a downturn, 74% of top hospitals outsourced support services that included laundry assistance.⁶ Because of the continued monetary incentives for outsourcing such a service, the number of hospitals outsourcing laundry services has grown in the last two years.⁷ Such services are generally commoditized and have only a tangential relationship to patient care. So, healthcare providers have little incentive to provide these services in-house. This combined with the cost benefits leads many healthcare providers to outsource such services.

Clinical Services

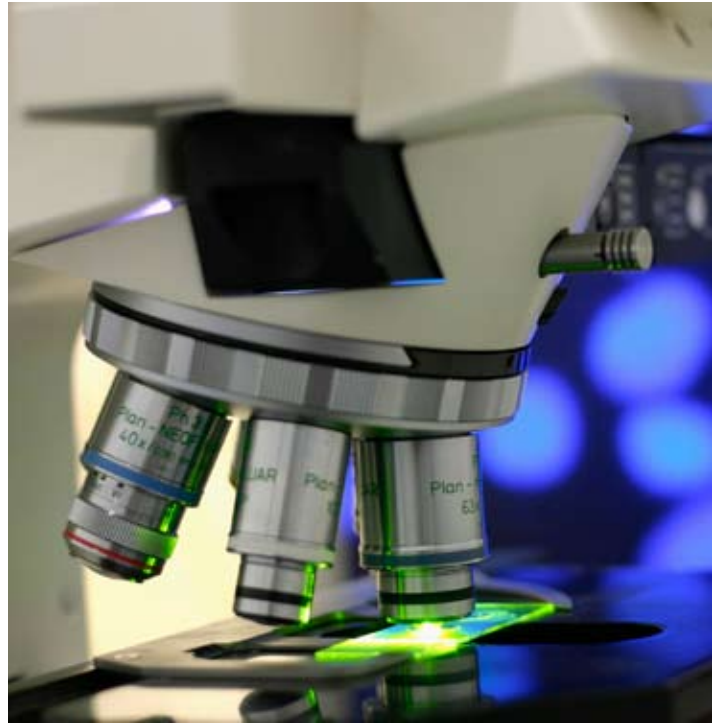
While teaching hospitals generally outsource functions that are not directly related to patient care, certain services that are squarely within patient care are being outsourced out of financial necessity or due to a lack of resources. Declining reimbursement from Medicare, Medicaid, and private insurance companies have made it difficult for hospitals to maintain their historical profit margins for certain clinical services, such as imaging tests. In addition, a lack of capital funds has resulted in the inability of health systems to purchase new and advanced models of imaging equipment. As a result, third-party providers are filling the gap by offering medical scanning services. Third-party outsourcing providers are also offering related services such as interpretation of imaging results or transcription of physician case notes, often from less expensive, overseas locations. Such services offer a cost-effective and efficient alternative to having in-house employees perform these services. Also, because of the difference in time zones, such services can be performed overnight and the results can be ready for the physician in the morning, thus improving the quality of care for patients.

Developing an Outsourcing Relationship

Establishing a successful outsourcing arrangement involves a number of steps, most of which, when done correctly, require a high level of expertise and can take a significant amount of time. At a high level, the typical outsourcing process involves: (1) building an outsourcing team of internal and external experts; (2) identifying the functions to be outsourced; (3) developing the request for proposal (RFP); (4) requesting potential outsourcing vendors to respond to the RFP; (5) evaluating the outsourcing vendors' proposals; (6) building and negotiating the outsourcing agreement; (7) transitioning the services from the company to the outsourcing provider; and (8) executing an effective contract management and governance structure.

Building an Outsourcing Team

Because outsourcing can touch many areas of an organization and involves both business and legal issues, AMCs and teaching hospitals looking to outsource should first build an appropriate team of experts to drive the outsourcing process. Outsourcing a portion of any organization can be seen as operationally risky and, like any dramatic organizational change, can be viewed with skepticism. Outsourcing can also be politically charged both inside and outside the organization. Because of these factors, the most successful outsourcing initiatives start with a high-level business executive (chief executive officer, chief financial officer, chief operating officer, chief information officer) who is committed to outsourcing, if it is the right financial or operational decision for the organization. This executive often appoints a leader who "owns" the outsourcing evaluation and execution process. This leader then builds a team of relevant internal experts: (1) subject matter experts in the potential scope of services to be outsourced; (2) sourcing/procurement professionals; (3) financial analysts; (4) HR; (5) security; (6) risk management; (7) internal audit; (8) tax; and (9) legal. In an



AMC setting, the team may need to include representatives from the medical school and the teaching hospital. The majority of significant outsourcing projects also include external advisors who are experts in outsourcing. These external advisors include experienced outsourcing attorneys and technical advisers. Because organizations only form outsourcing arrangements on a sporadic basis, these external advisers bring valuable market knowledge and help level the playing field between healthcare providers and the outsourcing providers that negotiate such deals on a regular basis. Such advisers' experience can also help tailor the contract to the healthcare environment, addressing the often significant regulatory issues. Outsourcing transactions involve many unique and complex issues that are not typically addressed in other corporate transactions. Just like not all doctors can perform heart surgery, not all transactional lawyers can effectively advise on outsourcing transactions. Therefore, hospitals looking to outsource should hire outside legal counsel that are experts in healthcare outsourcing.

Identifying the Functions to Be Outsourced

Selecting the proper scope of services to be outsourced is the first and sometimes one of the most difficult decisions for the outsourcing team. This decision involves many different considerations. What is the goal of the outsourcing arrangement? What are the risks? Is the function to be outsourced more of a commodity? Are there experienced outsourcing providers that can effectively provide the service? Does the function give the organization a competitive advantage? How much cost savings can be achieved? How much internal expertise will need to be retained to effectively manage the outsourced service? Will the decision to outsource a function have sufficient buy-in from impacted stakeholders? Are there legal restrictions to outsourcing

the function? These and other questions will need to be asked and answered before selecting the scope of services to be outsourced.

Outsourcing Vendor Selection Process

Once the scope of the potential outsourcing is determined, the teaching hospital should create a detailed RFP that is clear about the project's scope, expected levels of service, and the organization's objectives and goals. Many times, the RFP contains a draft of the outsourcing agreement that the outsourcing vendors will be required to sign if they are selected.

A clearly articulated RFP allows an outsourcing service provider to tailor its response to the health-care entity's specific needs. An organization submits the RFP to all potential outsourcing providers. The potential outsourcing providers will then provide comprehensive written proposals responding to the RFP. The teaching hospital will evaluate these proposals and will often ask the outsourcing vendors to orally present their proposed solution to the hospital outsourcing team. The team will then perform due diligence on the potential outsourcing providers, including checking customer references. The hospital outsourcing team will then "down select" the vendors who will move into the negotiating phase.

Teaching hospitals often move multiple potential outsourcing providers into the negotiation phase. In other instances, organizations "sole source" the project—negotiating with only one outsourcing vendor who is particularly well positioned to offer the service. In sole-sourcing negotiations, the outsourcing provider can sometimes have a disproportionate amount of bargaining power. In contrast, competitive bidding among multiple outsourcing vendors often results in more favorable terms for the hospital.

Building and Negotiating the Outsourcing Agreement

Preparing the outsourcing agreement is a multi-step process involving members of the teaching hospital's outsourcing team and other parties. As stated above, the RFP often contains a draft of the outsourcing agreement. Therefore, it is important to get all knowledgeable parties necessary to create the master terms and key exhibits involved prior to the RFP process. The outsourcing

agreement generally consists of master legal terms and various business, financial, operational, and service-specific exhibits. A few of the typical exhibits include: fees, service descriptions, transition plan, service levels, reports, governance, technology and security policies, approved subcontracts, disengagement assistance, and HR terms.

Negotiating an outsourcing deal is often a multi-track process.

The lawyers and key business leaders will generally negotiate the master terms and other key financial and legal exhibits (e.g. fees and HRs). The operational teams and other subject matter experts from both parties will often, in parallel, negotiate the technical exhibits (e.g., service description, reports, and transition plan). Some exhibits, such as service levels, have operational and financial components requiring input from both tracks. In addition, certain issues negotiated in the master terms need to flow into the exhibits and vice versa. Therefore, both tracks need to constantly communicate.

While there is no typical timeframe, negotiating an outsourcing deal often takes three to six months. Larger, more complex deals can take nine to twelve months to negotiate.

One of the most important exhibits in the outsourcing agreement is the service description. A common source of conflicts in outsourcing relationships are disputes centered around which party is responsible to perform a task. In other words, the parties have a different view regarding what is "in scope" under the outsourcing agreement. Such disputes can be minimized with a comprehensive and thoughtful service description. Creating such a service description takes sufficient preparation and planning, allowing the hospital to define the precise functions that the outsourcing provider should perform. A proper service description will help avoid misunderstandings and unexpected expenses.

Outsourcing agreements should also include adequately defined service levels. Service levels are the outsourcing provider's service performance guarantees, measuring service delivery and results. The service levels are continually monitored by the outsourcing vendor and are periodically reported to the hospital, generally on a monthly basis. If the service provider fails to reach a service level, then the hospital typically receives a credit that can be used to reduce the fees



owed to the outsourcing vendor. Traditionally, parties to an outsourcing agreement have a large number of service levels. However, utilizing fewer but more-focused service levels can make enforcement and compliance with the service levels easier on both parties. Using fewer service levels—perhaps no more than two dozen—allows the parties to focus on the issues that are most important to the hospital's business. For example, a hospital entity that outsources its billing functions may use a service level addressing the average days to submit completed claims. This is a service level that has a direct and measurable result on the hospital's cash flow.

There are many ways to price the services offered in an outsourcing deal. When crafting and negotiating the fee structure, hospitals should, when possible, establish pricing mechanisms that track the hospital's business volumes and revenues. For example, a hospital that decides to outsource information technology services can help align interests by tying the fees under the outsourcing agreement to the hospital's monthly patient count (rather than the number of maintained computers). The idea is that the patient count is a representative proxy for the activity level of the hospital, and thus the information technology infrastructure needed to support such activity level. If the hospital is able to get such a fees structure, when business is up, the hospital will pay more. When business is down, the hospital will pay less. This type of structure helps keep expenses in line with revenue and adds needed flexibility in an unpredictable economy.

Service Transition

The next step in the outsourcing process is the transfer of the services from the hospital to the outsourcing provider. This may or may not involve the transition of employees from the hospital to the outsourcing provider—often called “rebadging.” (One day the employee has a badge with the hospital's name, the next day the employee has a badge with the outsourcing provider's name.) Often these transitioned employees continue performing the same job functions that they performed prior to the transition, only now they are being paid by and taking direction from the outsourcing provider. If the transition does not involve the transfer of employees, there will often be a knowledge transfer process whereby the employees performing the function to be outsourced will provide all necessary technical and process information to the outsourcing provider. The outsourcing provider's personnel may also “shadow” the hospital employees, watching them perform their job functions for a period of time.

After the knowledge transfer phase is completed, the outsourcing provider will set up all necessary systems and execute the transition of the outsourced services in accordance with the transition plan set forth in the outsourcing agreement. Depending on the complexity of the services, the operational transition can sometimes be nearly instantaneous (e.g. laundry services) or may have multiple phases occurring over several months (e.g. transition of billing services).

Establishing and Executing an Effective Governance Structure

After the contract is completed and services have been transitioned to the outsourcing vendor, then the real work begins. Establishing and executing an appropriate governance structure between the parties is the only way to ensure the long-term success of an outsourcing arrangement. Successful governance structures account for change, allow for flexibility, facilitate communication, align interests, and quickly escalate potential problems. To effectively implement appropriate governance, a hospital must devote sufficient and knowledgeable resources to diligently managing the outsourcing relationship.

To survive in today's economy and regulatory environment, AMCs and teaching hospitals must make savvy business decisions. Outsourcing certain business functions can be the right business decision for many healthcare providers. Implementing a successful outsourcing strategy takes time and requires careful planning and skilled advisors. But once they are implemented, outsourcing arrangements can decrease costs, increase flexibility, and allow teaching hospitals to focus on their core competency of delivering quality patient care.

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- 6 VHA Inc., Press Release, VHA Inc. Study Reveals Hospital Spending for Contracted Services (Jan. 17, 2008), available at www.vha.com (follow “News” hyperlink; then follow “VHA Press Releases” hyperlink).
- 7 See generally Jenny Burns, *In the Wash: Laundry Tops List of Outsourced Services*, NASHVILLE BUS. J., July 17, 2009, available at <http://nashville.bizjournals.com/nashville/stories/2009/07/20/focus2.html?b=1248062400%5E1862856> (noting that laundry has been no. 1 on MODERN HEALTHCARE's list of top outsourced tasks for two years).