Reference Pricing: What Does It Mean to You and Your Practice?

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Reference pricing is a term that traditionally identifies marketing and pricing strategies used by the seller. In healthcare, however, reference pricing is a strategy used by the payer. The similarity in both cases is that the seller or payer creates a “reference price” (RP) as a reimbursement strategy for a product.

Reference pricing has been common in the pharmaceutical industry. The following example illustrates this concept. A payer establishes the RP for a class of medications based on a relatively low-priced product in the group. The RP becomes the maximum reimbursement for any product in the group. Manufacturers may charge a price above the RP, in which case the patient must pay the surcharge.

If the manufacturer’s price is less than the RP, the savings may be shared between the payer and the dispensing pharmacist, depending on system design. Note that reference pricing is about payment, controlling payment variation, and possibly improving competition; it does not always address quality.

In orthopaedics, reference pricing can easily be applied to implants. Challenged by the rising costs of orthopaedic implants, hospitals have employed different strategies. Among the methods used to control implant cost are the following:

- Contracting with a single or limited manufacturer(s) to obtain deep discounts
- Favoring surgeons with lower implant costs
- Discouraging a surgeon’s choice of expensive implants
- Restricting high-cost implants from being used in the facility by various mechanisms

A reference pricing strategy may also be used. Orthopaedic implants are categorized, and the hospital determines or negotiates the RP for each class of implants. For example, the hospital may set an RP for basic primary total hip or total knee arthroplasty implants, and any manufacturer can provide implants at or below the RP, but not above.

The CalPERS experience

When the California Public Employees Retirement System (CalPERS) implemented a reference pricing model for hip and knee arthroplasty, it experienced remarkable cost savings and brought the reference pricing model to the forefront for orthopaedic surgeons. CalPERS instituted the RP program in 2011 for its covered 1.3 million public employees, dependents, and retirees. Prior to then, hospital charges to CalPERS for the arthroplasty procedures varied from $15,000 to $110,000, and were rising annually.

CalPERS established an inpatient price threshold for these procedures of $30,000. Of note, this price was set for the hospital costs and did not include the surgeon’s or other physicians’ fees. As in the classic RP model, costs above this amount incurred at non-designated hospitals were paid entirely by the patients.

After initiation of the program, the number of patients selecting “low-price” hospitals increased by more than 30 percent, with a corresponding 30 percent decrease in the number of patients selecting “high-price” hospitals. During this period, prices at the non-designated high-price hospitals were reduced by 34 percent to, not surprisingly, just below $30,000.

This shift in patient selection of hospitals and concurrent reduction in pricing by hospitals resulted in a total estimated savings of nearly 20 percent for CalPERS, as well as decreased cost sharing by CalPERS members.

Trends and opportunities

These results suggest that reference pricing achieved the goal of cost control, at least in this instance, for two common, high-priced, standardized procedures with substantial variation in cost and limited variation in measured or perceived quality. Wider adoption of the reference pricing model seems likely, particularly by self-insured employer health benefit programs that have more latitude in benefit design and are subject to fewer state or federal regulations.

Unlike alternatives such as narrow networks, reference pricing appears to provide the advantage of preserving choice for patients who need expensive medical services that exceed deductibles and maximum copayment amounts. Another reason that reference pricing might be emulated by payers is its potential effectiveness in countering the effects of hospital consolidation, which has resulted in increased market power for hospital chains and a corresponding ability to resist price discounting.

What will reference pricing mean for orthopaedic practices? First, it reinforces larger trends toward reimbursements that promote high-value health care. Reference pricing can drive improved hospital-physician alignment to better control costs associated with orthopaedic care. As payment models such as bundled payments gain in popularity, reference pricing will require enhanced physician-hospital collaboration for episodes of care such as total joints.

In the absence of good quality measures, improving value in health care has been driven more by lower costs than by higher quality. Reference pricing essentially commoditizes orthopaedic services. However, because the CalPERS style of reference pricing is a cost-control tool that allows for competition and pricing above the RP, it can provide an opportunity for entrepreneurial practices to differentiate themselves to motivate patient volume or higher reimbursement.

More robust quality measurement tools and expanded data collection efforts (such as the Level 3 California Joint Replacement Registry) may permit high-performing centers and physicians to be distinguished. Quality measures may enable practicing orthopaedists to meaningfully move the quality needle, and in so doing, increase value for patients and themselves.

Rapid changes in reimbursement carry concerns for the future. However, understanding the motivations and specifics of different payment reform models offers potential opportunities through alignment with hospitals or modifications to practice.

For a link to the study cited in this article, see the online version available at www.aaosnow.org
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For more information...

The AAOS Health Care Systems Committee is sponsoring a webinar on “Reference Pricing: What does it mean, and what does it mean to your practice?” on Thursday January 30, 2014. For more information, visit www.aaos.org/courses.

Bottom Line

- Reference pricing may be adopted as a cost-cutting measure for high-priced orthopaedic procedures.
- Reference pricing may also drive improved physician-hospital alignment, particularly as the popularity of pricing models such as bundled payments increases.
- In response to reference pricing, orthopaedic practices may find ways to differentiate themselves to attract increased patient volume and higher reimbursements.