COMPTROLLER ALERT AUGUST 2012

HIDDEN COSTS IN USING THIRD PARTY ADMINISTRATORS TO ADMINISTER WORKERS' COMPENSATION PROGRAMS

The Office of the State Comptroller ("OSC") has found that workers' compensation third party administrators ("TPAs") may be utilizing undisclosed side agreements with third party vendors which require payments back to the TPA, resulting in hidden (and potentially increased) costs to public entities.

The Initial Complaint that OSC Received

Workers' compensation TPAs oversee the workers' compensation claims administration process, which includes contracting with third party vendors for specific health care services. Such third party vendors include, for example, managed care and bill repricing companies. Managed care companies use the services of a medical professional such as a nurse to ensure that appropriate and consistent medical care and treatment are being provided. A bill repricer adjusts payments to health care providers based upon usual, customary and reasonable rates or agreed upon network rates.

A government entity informed OSC that it had discovered that its workers' compensation TPA was receiving money back from the managed care and bill repricing vendors to which the TPA had referred claims, pursuant to undisclosed side agreements (referred to as "revenue share agreements"). The government entity informed OSC that it settled this and other potential legal claims against the TPA in return for a substantial payment, after informing the TPA that it was planning to commence legal action against it based in part upon the existence of this undisclosed, shared revenue. (The TPA noted to us that it disputed the claims and that the settlement of the matter was without any admission of liability or wrongdoing.)

OSC's Review

Upon reviewing this TPA's contracts with other public entities, OSC found other examples of these undisclosed revenue share agreements. In fact, industry experts claim that this practice is pervasive among TPAs, indicating that numerous other public entities in New Jersey may have incurred these hidden costs.

Our review found that the public entities we examined did not obtain information during the TPA procurement process as to whether prospective TPAs were a party to any revenue share agreements with third party vendors. Without such information, public entities are not in a position to accurately determine whether they are obtaining the most cost effective workers' compensation services, or whether another arrangement (such as

"unbundling," as discussed below) would be more cost effective.

Specifically, OSC reviewed contracts between the TPA in question and three public entities (one municipality, one county and one school district). These contracts provide for a fixed fee to be paid to the TPA and for the public entities to pay additional "allocated expenses." These allocated expenses, according to the contracts, include the cost of paying third party vendors. None of the reviewed contracts disclosed that the TPA was receiving funds back from some of these vendors and none of the three government entities had been made aware that their TPA had in fact been receiving such compensation.

The TPA subsequently amended its standard contract language after being contacted by OSC regarding this matter and after receiving notice of the dispute with the complaining government entity as discussed previously. The new language sets forth that the TPA "may have business agreements with vendor service providers" which "may" include "financial considerations" such as "cost sharing." The TPA subsequently added to those disclosures, adding a section titled "disclosure of business arrangements" to its contracts that stated that the amounts involved in its agreements with the vendors "may be material." While this language begins to address the revenue sharing issue, it is somewhat opaque. Other TPAs' public contracts may suffer from the same lack of clarity.

Criticism by Industry Experts

These revenue sharing arrangements have been criticized by industry experts who have stated that they are potentially wasteful of public funds and compromise the ability of public entities to determine if their workers' compensation program is being administered in a cost effective manner. As these experts have pointed out, such arrangements create perverse incentives in that TPAs are in the precarious position of deciding whether to refer a case to a vendor with which the TPA has a revenue share agreement or to another vendor that has not entered into any such agreement but may be better suited to perform the service in question. As a result, there arises a potential conflict between minimizing client costs and maximizing the TPA's revenue.

Some industry experts have called for separately contracting for TPA and other third party services, which is known as "unbundling." One New Jersey county, for example, reportedly experienced a savings of approximately $15,000 per year after it "unbundled" its TPA and managed care services.

Recommendations

A. In procuring workers' compensation TPA services, public entities should require disclosure of any financial arrangements a TPA has made with third party vendors, such as managed care and bill repricing vendors. Specifications should be written to require full disclosure of such agreements and compensation. Moreover, the contracts should have a continuous disclosure requirement under

which the TPA is obligated to inform the public entity if it enters into such agreements during the course of its contract with the public entity. This transparency will enable public entities to better determine whether they are using the most cost effective workers' compensation program.

B. Public entities should periodically review whether they are in fact obtaining the most cost effective TPA services. Among other alternatives, public entities should consider soliciting separate proposals for TPA services, managed care services and bill repricing services. Such "unbundling" may be less costly than retaining one company to coordinate all of those services.