ISSUE BRIEF

Certificate of Need and Health Systems: Short Term Protection, Long Term Risk

For many states with certificate of need (CON) statutes, pressure for reform continues to mount. In some states, such as North Carolina and Virginia, CON reform advocates have become more organized in recent years and a flood of CON reform legislation has made its way to the statehouses. Despite this activity, CON laws in many states continue to endure, backed by strong support from state hospital associations.

Even without substantial legislative changes, ASC supply continues to grow in CON states. The increasing pressure on CON regulation may help accelerate the growth. In some states, novel approaches are taking hold. Examples of unconventional methods for circumventing the standard CON process include:

- Legislative exemptions for one-off projects
- Demonstration projects for single specialty centers
- Expansion of procedure rooms
- Unlicensed surgery centers

For health systems in CON states facing potential repeal or reform of CON, the uncertainty can cause stagnation. Health system leaders often take a "wait and see" approach to CON. While its natural for health system leaders to protect their organization's ability to fulfill its mission, the protection CON provides them will erode over time. The good news: health systems have control over their own destiny today. Rather than sit and wait, health systems in CON states should be planning for CON reform today. At the top of planning "to-do" list is often ambulatory surgery centers (ASCs). For many patients, freestanding ASCs are high quality options that are more convenient and much less costly.

Risks of Inaction

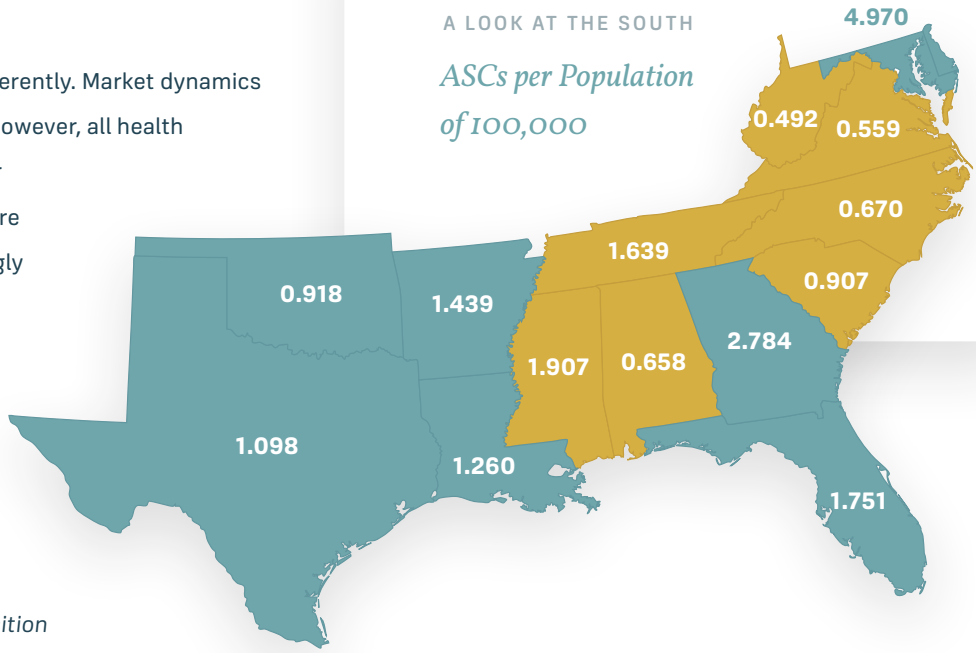
Every market has unique characteristics, but many health systems without an ASC strategy face a growing risk of ceding market share. Many states which regulate ASCs have a lower supply of ASCs than those that do not. This is especially true in the southeast. What will happen in competitive markets if surgery centers become unregulated by CON? We know payers, patients, and physicians will quickly push for more lower cost ASCs. Non-CON states provide a possible window into the future for competitive markets. In some markets in non-CON states, health systems purposefully built or acquired their way into strong market share in ASCs. In others, slow to act health systems now have minimal ASC market share.

Strategy Formulation

Every health system is different. Leaders think differently. Market dynamics are different. As a result, no strategy is identical. However, all health systems should initially consider patient needs for convenience, cost, quality, and site of service before developing the specific strategy. Payers increasingly care about site of service and patients are increasingly aware of lower cost options.

A LOOK AT THE SOUTH

ASCs per Population of 100,000



"Health systems are rapidly moving from an asset based approach to a consumer based approach. Many hospitals have held a long-standing position to protect existing assets through the CON process, but sometimes, that position conflicts with the mission to deliver value to its community," says DJ Hill, Compass Surgical Partners CEO. *"More and more health systems recognize that high quality lower cost venues will actually serve to expand the mission."*

The next step is to have a framework against which to model various options. Ideally, there is no short-term trade-off between patient benefit and financial contribution to the enterprise. By using ASCs to grow market share, win in value-based purchasing contracts, and, oftentimes, alleviate capacity issues, hospitals can find accretive solutions from day-one. However, hospitals shouldn't restrict expanding ASC capacity even if a longer lead time before financial return exists.

The ideal ASC evaluation tool considers three major factors: **1)** direct financial contribution, **2)** impact on capacity, and **3)** impact on market share. Each of these has a set of variables and probabilities associated with it. For example:

- Will the hospital eventually lose volume in the status quo?
- When will site neutral payment rates go into effect for HOPD vs. ASC?
- What is the "halo" effect for ancillary services if the ASC helps bring new surgeons under the system's wing?
- What is the windfall in shared savings programs?

The best approach should include year-over-year goals for both ASC-based procedures and outpatient surgery market capture and an evaluation tool to compare ASC proposals against alternatives. This approach allows health systems to tie ASC strategy to the expected market shift over time. A system may elect to implement a phased approach, implementing an ASC that is financially accretive on day one, then phasing in other projects as the environment supports them.

CASE STUDY

A TALE OF TWO CITIES (IN NON-CON STATES)

The following is based on two large metro markets, one in Texas and one in Florida.[1]

Texas market: A large health system executed broad strategy to build or buy across market. **Result:** 25 ASCs, controls ASC market, massive market-wide physician engagement tool.

Florida market: No broad ambulatory strategy from dominant health systems. Market moved away, non-hospital competitors filled void. **Result:** 50% of all outpatient surgery in the market done in ASCs. Hospitals have less than 5% share of ASC market.

[1] Ambulatory surgery centers are not regulated under Florida's CON statute

Common Mistakes

Three common mistakes health systems make with regard to CON and ambulatory surgery centers:

1. FAILURE TO ENGAGE WITH PHYSICIANS IN THE PLANNING PROCESS

Systems that refuse to include physicians in planning, including both employed and independent physicians, lose out on an opportunity to expand their ambulatory market.

2. SLOW EXECUTION

The CON process can drag out for two or more years, involve expensive litigation, and is often followed by a another year or two planning period before breaking ground. It is not uncommon for systems in CON states to take over five years to get a new ASC to market.

This is, in part, an execution problem. Oftentimes, there are CON acquisition options that might allow health systems to get through the process faster. Once through, systems should be ready to execute quickly.

3. LET THE TAIL (CON) WAG THE DOG (ACTUAL STRATEGY)

Every CON state has a different set of rules and processes for CON approval. In general, however, health systems in CON states often base their strategic positions around CON. A common scenario: system leaders find a certificate of need may be available for a given service, then initiate a planning process around the potential CON. It should be the reverse. A certificate of need should be sought after a system has decided to pursue a given strategy. CON simply becomes part of the execution rather than a driving force.

CASE STUDY

WHAT HAPPENS IN CON STATES WHEN NEW ASCS ENTER THE MARKET?

The following example is from a competitive, urban market in a southeastern CON state.

SCENARIO:

- Three hospitals operate in a single county (A, B, and C)
- Three new ASCs opened in the county between 2011-2014
- Hospitals A and B each have a joint venture with one of the newly licensed ASCs
- The other ASC was independent from hospital affiliation and is owned and managed by a large physician group
- Hospital C does not own, manage, or affiliate with any ASCs in the county

RESULT:

- Hospitals A and B, which became joint venture partners in ASCs, recaptured all of their lost volume plus additional volumes in the ASCs.
- Hospital C lost over 20% of its surgical volume to the three new ASCs, much of it lucrative orthopedics volume.

FACILITY	2012	2013	2014	% CHANGE
HOSPITAL A	18,935	15,904	14,560	
ASC A (Hosp A Joint Venture)	158	5,276	6,647	
Hospital A Total	**19,093**	**21,180**	**21,207**	**11%**
HOSPITAL B	21,409	21,101	18,437	
ASC B (Hosp B Joint Venture)	-	411	3,148	
Hospital B Total	**21,409**	**21,512**	**21,585**	**1%**
HOSPITAL C	**12,159**	**10,394**	**9,132**	**-25%**
ASC D (UNAFFILIATED)	-	**632**	**1,850**	**193%**

Secrets to Success

Certificate of need can provide vital benefits to health systems, especially those operating in rural areas. However, certificate of need sometimes creates an environment that limits hospitals' ability to innovate, get ahead of emerging trends, and ultimately, compete with other health systems or non-hospital owned facilities. According to Mr. Hill, *"Successful organizations will be highly competent in creating and managing physician partnerships, use CON to their advantage rather than let it stifle their ability to innovate, and will implement a coherent strategy for rolling out ASCs as the market continues to shift toward lower cost venues."*

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