HOSPITAL ASSOCIATION OF SOUTHERN CALIFORNIA

Briefs Focus

Special Supplement for HASC Members

# Top 10 Negotiation Points for Medical Providers with Merchant Acquirers/Payment Processors

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## Introduction

When Davis Wright Tremaine LLP lawyers were working with a large hospital group in the Pacific Northwest earlier this year – to help them negotiate processing agreements with credit card payment processors – their detailed work led them to discover that "there was a ton of money being left on the table" by not fully utilizing all potential negotiating tactics, according to Claude Goetz from Davis Wright's New York office.

Combine this with the fact that out-of-pocket medical expenses in the United States are quickly climbing – in 2007 $250 billion was paid in out-of-pocket expenses, with $242 billion paid by cash, checks, and/or credit and debit cards – and that "money on the table" becomes even more significant without learning and applying adequate tactics when negotiating with payment processors.

In addition, electronic payments are expected to grow from the current rate of 46 percent up to 60 percent by 2009, making this topic all the more relevant for HASC members.

After presenting these findings and statistics in the Los Angeles area to positive reviews, HASC invited Davis Wright to share their recommendations at our CFO forum. As a result, participating CFOs recommended that Davis Wright further refine their suggestions for successful negotiations by creating the following "Top 10" points. We hope you find this list helpful and look forward to your feedback.

## Top 10 Negotiation Points

**1.** *Negotiating Leverage* – Credit/debit/charge card payment processors are experiencing pressure on rates from retailers with increasing negotiating leverage due to size (Target, Wal-Mart, etc.). Accordingly, processors are actively seeking higher margin industries, especially healthcare, that will yield both higher revenue per transaction and scale. Use of cards for medical payments is projected to grow by 10–15 percent in the coming year.

**2.** *High Profit Margin* – Providers currently remit to processors between 2 percent and 4_ percent of amounts paid using credit/debit/charge cards. A substantial portion of this percentage is profit margin for the processor. Traditionally, healthcare providers have not pushed back on processors' pricing or non-financial deal terms.

**3.** *Pricing Structures* – Bundled fees are a common way in which processors build in margin. Many processors will accept "a la carte" fees, which can be much more cost effective. Diligence about ancillary aspects of processing, such as reporting required by the provider, is essential here in order to compare bundled services to "a la carte."

**4.** *Transaction Volume* – Processors care a lot about transaction volume. The principal path for a processor to increase profit is by leveraging hard costs over more transactions. Accordingly, even low margins per transaction can be attractive to a processor if significant volume is present.

**5.** *Cap on Cost Escalation* – Processing agreements generally contain provisions that permit the processor to pass-through increases in the cost of providing its services. There is generally no cap on cost pass-throughs and no termination right linked to increases in costs.

**6.** *Floor on Cost Reduction* – Interchange, the principal, fixed portion of the processor s costs in providing acquiring/processing service, is expected to drop significantly in the next few years upon conclusion of pending multi-district litigation. This cost saving should be passed on to, or at least shared with, the provider. Processing agreements generally contain no allowance for pass-through of cost reductions.

# Top 10 Negotiation Points

*(continued)*

**7.** *Reserve Account Protections* – Almost all processing agreements authorize the processor to establish a reserve account using the provider's funds in case the processor becomes insecure about the provider's financial status. Limiting the processor's discretion to establish a reserve account, the terms, size and duration of the reserve account, and the obligations of the provider to which the processor can apply the funds in the reserve account are important protections to be negotiated for the provider. Failure to limit these elements can result in provider insolvency at the hands of the processor.

**8.** *Service Level Agreements* – Processing agreements proffered to the healthcare industry are often silent about service levels and related penalties for failures in system up-time, call center/help desk response times, etc. Many processors will take the position that default and termination are sufficient remedies for providers, but changing processors can be so burdensome that those remedies are not practical.

**9.** Data protection/data ownership – Healthcare providers are accustomed to HIPAA compliance but, in the context of payment systems, they may also have Gramm-Leach-Bliley Act obligations with respect to personally identifiable information of cardholders. Providers and processors must reconcile these obligations and ensure that both are observed. Despite the statutory overlay, data mining still represents an income source and patient/customer data can be a valuable asset. Ownership and use rights to data can provide negotiating leverage and or contention.

**10.** *Termination Provisions* – Rights around termination including limits on early termination fees should be reconciled with providers' rights to terminate for breach, post-termination conversion assistance should be assured at standard rates, and parameters should be established for rate increases at expiration of term.