Contract management is a challenging but critical component of cost control

Loopholes in supply contracts can wreak havoc with a supply budget, but attention to detail and proper terminology can help OR managers take charge instead of being charged unnecessary fees.

“Not managing your agreement will cost you 12% to 25% of the spend or 100% of any savings achieved,” Girard F. Senn, BSN, RN, said at the OR Business Management Conference in New Orleans in February. Senn, a former OR director, has helped hospitals manage implant agreements for the past 8 years. During an engaging and interactive session, he explained the details of contract terms and the impact of those terms on the bottom line.

In the spine and total joint biologic world, there are more than 400,000 catalog numbers, and about 200 new numbers hit the market daily, according to Senn. Citing a recent example of a hospital that overpaid $250,000 in just 3 months, he said that, based on audits, he finds hospitals on average overpay 8% of what they’re spending.

How can OR directors and business managers gain the upper hand in their supply contracts?

Manage the process
In setting up a contract, it’s important to understand the legal terms and exactly what they mean because that will help you manage the process, he explained. “Arrangement” is the legal term for a contract, and key pieces of a contract are the offer, agreement, and consideration.

The typical process for a supply contract involves sending a request for proposals and receiving bids from vendors, ie, the vendor is offering the OR a price. A different approach is for OR managers to state the price they want, thereby making an “offer” to the vendor to sell them the product.

“You set legal precedence by making the offer,” he said. If a vendor doesn’t agree to your price but voluntarily brings in the product, it means that vendor is agreeing to the price. The vendor will bring the product in order to avoid alienating the surgeon who expects it, he explained. “As long as you have documented your offer to the vendor, you don’t need their signature,” he said, “but it’s important to be in agreement with your physicians before you go down this path.”

Approaching a contract this way allows an OR manager to short-pay the vendor and seal the deal. However, he cautioned, if the hospital’s accounts payable (AP) department doesn’t pay the vendor because of a price mismatch, the OR manager hasn’t fulfilled the contract and thus has handed back legal precedence to the vendor.

Know your ‘constructs’
It’s important to communicate with surgeons before sending out a contract to ensure the specifics of the implants required. For example, what exactly is a pedicle screw—ie, is it cannulated, polyaxial, or fixed? Does it have extended tabs? Knowing this information up front puts you in a better position to compare bids from vendors.

“You have to have a good alignment with your physicians in order to have a
meaningful discussion about constructs,” Senn notes. “When you write constructs, you’re saying ‘this is what I’ve contracted for.’”

The vendors’ perspective, however, is that they’ll provide half of the catalogue, but they may bring in something else later. In the purchase agreement, Senn explained, it’s important to spell out that 50% of the catalog is agreed to, and if the vendor brings in anything in addition to that, it will be paid at the construct price. “Your construct always takes precedence over the vendor’s price schedule,” he stressed.

**Terms and conditions**

Pricing agreements and purchase agreements are often used interchangeably, he said, but they’re 2 different things. A pricing agreement focuses on the price you’re going to pay, whereas a purchase agreement covers not only price but also key terms and conditions to manage that price going forward.

Each purchase order (PO) should represent 1 patient. This makes it much easier to track information, he explained. For example, having the patient billing number on the PO will allow you to match discharge data—information such as payers, length of stay, patient age, activity, and doctors—to the actual implants used. These are the details you’ll need when you write the contract, and having this information readily available in the electronic medical record will save a lot of time.

Vendors sometimes try to request a late fee if an invoice isn’t paid within 30 days, but the contract should state that you won’t pay a late fee if the contract is in dispute, he advised.

All implants should be consigned, not owned, he said. Vendors should not be allowed to come in to restock or to impose a medical device tax. For consigned items, you should have a separate agreement that clearly outlines the value of items on the shelf. Transient items are on the shelf for only a short time—make sure the supplier knows you won’t be responsible for transient items, he advised.

“Do you routinely ask your supplier for a sales report for the last quarter or the last month?” he asked. He recommends comparing the sales report on a regular basis against inventory and costs.

Most software systems have a way to track authorized vendors. However, it’s important to state in the contract that the vendor is expected to be compliant with the facility’s vendor policies. In addition, you should have copies of the vendor’s warranty/liability and force majeure documents, and have legal counsel review them.

Your agreement should state that the jurisdiction and venue are for your facility’s location, not your vendor’s, he noted.

“No one should be writing a contract without an out clause, and it should be 30 to 60 days at most. It should be mutual—either party can breach, and with or without cause,” he said. This gives you an out if your hospital is sold or the surgeon leaves.

**Cost control**

You should have a price schedule in an electronic format, and specify a specific year on the price list to ensure price protection. “Get a full catalogue of [the vendor’s] products,” he stressed. This way, you know exactly how much every item costs, and you can compare prices if any items are given new catalogue numbers later. Often times, new catalogue numbers are issued at prices as much as 25% higher than they were previously.

Biologics vendors sometimes sell larger quantities than are actually needed. For example, he said, a 1-mL syringe may be the size that’s actually needed for a given procedure, yet if the vendor has sold a 5-mL syringe for that purpose, the surgeon may use just 1 mL and discard the rest.

“In the contracts we’ve started writing for biologics, we’re now putting in a cap per level amount,” he noted.
As for biologics, he said, price, selection, and dosing are the 3 elements that must be discussed with physicians. He said there are really just 5 classes of biologics:

- Allograft structure (eg, struts, blocks, machine bone pieces, bone chips)
- Bone void filler—allograft (ie, demineralized bone matrix [DBM]); this will go through the standard tissue tracking process
- Bone void filler—synthetic
- Cell-based matrix products
- Amniotic products (eg, membranes, morsilized).

One thing to consider is that there really shouldn’t be a price differential in DBMs, but because some surgeons prefer different types, a decision needs to be made about whether it’s worth paying a premium for certain types and if so, how much.

Another way to avoid creeping costs is to tell the vendor you expect to get 75% off the list price for wasted implants. Examples include opening the wrong packet, pulling out the wrong pedicle screw size, or stripping the pedicle screw.

Ensuring that shipping fees aren’t inadvertently paid and that prompt payment terms are honored will help save money. Senn suggests reviewing a random selection of 15 to 20 POs and comparing them with invoices written to the vendor. The contract may state that no shipping fees will be paid, but if a price is within 2% of the price on the purchase order, AP may elect to pay that amount. The discrepancy, however, could be as much as $500 per PO, he noted. In addition, vendors will often agree to a 2% discount on the entire purchase price if the invoice is paid within 15 days, so you should work with your AP department to keep costs down.

**Best practices**

- Try to make vendor contracts consistent in terms of start and end dates, he advised. For example, if a vendor drags out negotiations, you may need to shorten the term from, say, 2 years to 18 months so that all of your contracts are on the same schedule.
- Do audits periodically to recoup costs in the event you overpaid for anything.
- Ask the distributor to verify their distribution channel, so you’ll know if there’s a physician-owned distributorship (POD). Ask if there’s one already in place and tell them that if they develop one in the future, they should let you know. It’s a way of mandating disclosure if a POD occurs after the contract was made, he explained.

**Q&A**

One attendee commented that it’s important to make sure that the parent company signs any pricing agreement so that the price will be guaranteed if the distributor should leave. Senn agreed that’s a good practice.

“Are the distributors just a channel for the company, or do you have to have some kind of contract with them that they’ll agree to abide by the terms?” asked another attendee.

“It depends,” he replied. “If you write the agreement with the manufacturer, all the terms now apply to the distributor. If you write the agreement with the distributor, who may represent several companies, you must have some kind of notification to the various suppliers.”

Another attendee asked Senn whether he writes a clause about worn-out instruments or broken instruments and who’s responsible.

“I write very specifically that you will only pay for replacement if there’s evidence of abuse or if it’s lost. If it’s worn out, it’s the vendor’s responsibility,” he said.

“Do you suggest any provisions around service, for example, replenishing sets or timeliness?” another attendee asked.
“We will say instrumentation must be in our hands 24 hours before the case to allow time for sterilization,” Senn said.

The bottom line, he said, is that contracts require constant vigilance. “If you are not actively managing the contracts, neither is the vendor; you will see the expense increase and the savings evaporate,” he noted.

—Elizabeth Wood