

it is difficult to manage these complex and costly drugs, and to anticipate what will be coming out of the pipeline.

*application of appropriate risk adjustment algorithms.*

A critical consideration in the expansion of capitation and its long-term effectiveness in the emerging post-reform environment is the development and application of appropriate risk adjustment algorithms, so that capitation payment amounts reflect the risk characteristics of the populations for which the ACOs are accountable.

medical risk vs financial risk vs allocation of financial recourses vs profit

### LEVEL OF PAYMENT VERSUS STRUCTURE OF PAYMENT

It is important to distinguish the structure of physician payment (e.g., capitation versus fee-for-service) from the level of physician payment (e.g., high versus low payment rates). Originally, ACOs in California had a price advantage over small fee-for-service practices, as they had lower costs due to effective management of specialty services, hospital admissions, and length of stay, but as that utilization advantage has eroded, the cost advantage shrunk. Also fueling this narrowing cost advantage is the fact that some ACOs have consolidated and gained bargaining leverage, either in collaboration with hospitals or on their own, leading to higher levels of physician payment (and insurer costs) compared to the fragmented cottage industry, which has little bargaining power.

It is very difficult to obtain apples-to-apples comparisons of costs between ACOs and cottage industry physician practices, due to both the differences in