

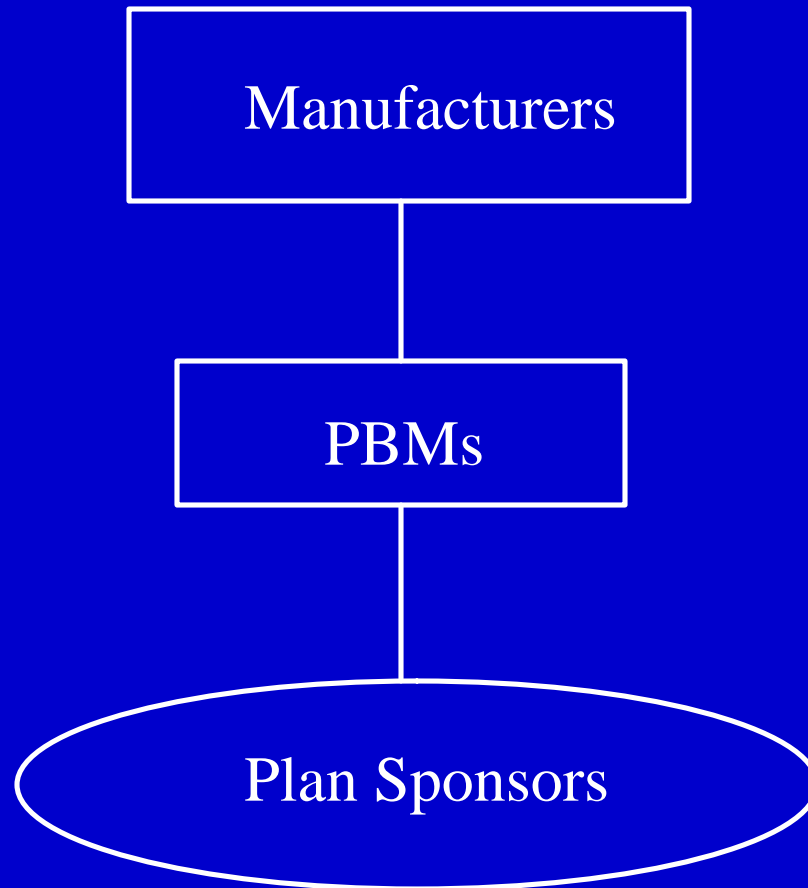
Pharmaceutical Benefit Managers: Competition and Transparency

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FTC Healthcare Hearings

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Pharmaceutical Supply Chain



Antitrust Background: Eli Lilly/PCS

- The FTC issued a complaint and consent order in July, 1995 to Lilly concerning its acquisition of PCS
- The complaint accompanying the consent agreement alleged that the acquisition (a vertical merger) would
 - Harm national PBM market competition
 - Lead to the exclusion of non-Lilly products from PCS formularies
 - Eliminate PCS as an independent negotiator of pharmaceutical prices with manufacturers
 - Facilitate collusion among vertically integrated pharmaceutical companies
 - Limit market entry, increase prices, diminish quality, and reduce R&D incentives of other pharmaceutical companies

Antitrust Background: Eli Lilly/PCS

- The consent order provisions:
 - On transparency:
 - PCS must accept rebates and concessions from any manufacturer and include this information in its open formulary pricing information
 - On potential foreclosure of non-Lilly manufactured drugs:
 - Requires PCS to maintain an open formulary that does not give unwarranted preference to Lilly's products
 - But allows PCS to offer a closed formulary
 - On potential collusion:
 - Creates a firewall preventing communications between Lilly and PCS concerning bids, proposals, prices and other information
 - *See Eli Lilly*, 61 Fed. Reg. 31,117 (June 19, 1996) for final consent order and Commission statement.

Antitrust Background: Merck/Medco

- The FTC issued a complaint and consent order in February, 1999 to Merck concerning its acquisition of Medco
- The complaint accompanying the consent agreement alleged that the acquisition would
 - Harm national PBM market competition
 - Lead to the exclusion of non-Merck products from Medco formularies
 - Eliminate Medco as an independent negotiator of pharmaceutical prices with manufacturers
 - Facilitate collusion among vertically integrated pharmaceutical companies
 - Increase prices, diminish quality, and reduce R&D incentives of other pharmaceutical companies

Antitrust Background: Merck/Medco

- The consent order provisions:
 - On transparency:
 - Medco must accept rebates and concessions from any manufacturer and include this information in its open formulary pricing information
 - Medco must disclose the availability of the open formulary to all of its current and potential customers
 - On potential foreclosure of non-Merck manufactured drugs:
 - Requires Medco to maintain an open formulary that does not give unwarranted preference to Merck's products
 - But allows Medco to offer a closed formulary
 - On potential collusion:
 - Creates a firewall preventing communications between Merck and Medco concerning bids, proposals, prices and other information
 - *See In the Matter of Merck & Co., Inc., and Merck-Medco Managed Care*, 951-0097 (1998) for final consent order and Commission statement.

Antitrust: Lawsuit Filed by AFSCME

- Filed in California Superior Court, Los Angeles on 3/17/2003 under California's Unfair Competition Law
- by AFSCME, the Prescription Access Litigation project, and the AFL-CIO
- Against the nation's four largest PBMs
 - PCS
 - Express Scripts
 - Medco
 - Caremark

Antitrust: Lawsuit Filed by AFSCME

- Allegations:
 - the PBMs force health plans and consumers to pay inflated prices,
 - The companies influenced health plans and consumers to rely on more costly drugs
 - The companies have illegally increased their profits by not passing on rebate savings from drug manufacturers
 - The complaint Seeks to enjoin unfair and unlawful business practices of the PBMs and to disgorge money made by engaging in these practices

Competitive Concerns in the PBM Industry

- Highly concentrated
 - Four largest firms have approximately 70% of the market
 - Market for full-service PBM providers capable of bidding on Medicare contracts is even more concentrated
- Concentration is increasing
 - Substantial concentration increase in the last decade
 - No successful PBM market entry for a long time
 - High costs prevent market entry

Competitive Concerns in the PBM Industry

- Difficulty for consumers to switch PBMs
 - This allows PBMs to opportunistically increase prices or decrease service
 - This is why the FTC has placed the two largest PBMs under regulatory consent orders
 - FTC found that the PBMs had improperly favored the drugs of their manufacturer-owners, resulting in higher prices and less consumer choice

Primary Benefits of Price Transparency: Competition

- Assures competition
 - Gives consumers bargaining power
 - Decreases prices by requiring PBMs to disclose price concessions and rebates from pharmaceutical manufacturers
 - Armed with information about rebates, buyers can encourage PBMs to compete to secure lower prices

Primary Benefits of Price Transparency: Prevents Discrimination

- Prevents discrimination
 - Secret rebates encourage choosing higher priced drugs
 - Enables buyers, such as Medicare, to know when they are receiving the full benefit of price concessions
 - Rebate disclosure allows buyers to monitor and prevent price discrimination

Rebates as Kickbacks

- Congress enacted anti-kickback legislation to prevent conflicts and possible discrimination
- PBMs currently being investigated by a U.S. attorney's office in Pennsylvania for whether rebates from pharmaceutical manufacturers constitute kickbacks
- Disclosure of rebates and price concessions would help discourage kickbacks
 - Congress and HHS require full disclosure as a prerequisite to the application of the “discount safe harbor” to the anti-kickback law

Price Transparency: The Cornerstone to Competition

- Transparency facilitates fully informed choices
- Forces firms to compete more aggressively
- “Firms obtain market power from consumer lack of knowledge about prices and quality . . . Limited information can lead to a monopolistic price in what would otherwise be a competitive market.”
- Dennis Carlton & Jeffrey Perloff, *Modern Industrial Organization* 431(2000).

Price Transparency and Antitrust Laws

- Antitrust laws make clear that transparency is vital to effective market functioning
- *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977)
 - Supreme Court struck down ban on lawyer advertising
 - Disclosure of prices and other dimensions of competition “performs an indispensable role in the allocation of resources in a free enterprise system.” 433 U.S. at 364.
- *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986)
 - Supreme Court declared illegal a dentist association rule that prevented disclosure of x-rays to managed care providers

Lack of Transparency Lead to Less Competition and Higher Prices

- Restrictions on transparency
 - “increase the difficulty of discovering the lowest cost seller of acceptable ability”
 - “reduce the incentive to price competitively”
 - “serv[e] to perpetuate the market position of established [market participants].” *Bates*, 433 U.S. at 377.
- As a result of pricing transparency
 - “where consumers have the benefit of price advertising, retail prices often are dramatically lower than they would be without advertising.” *Bates*, 433 U.S. at 377.

Other Aspects of the Importance of Transparency

- Transparency is important to all material aspects of the transaction
- The Supreme Court has indicated that:
 - “all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost, are favorably affected by the free opportunity to selected among alternative offers.”
United States v. National Society of Professional Engineers, 435 U.S. 679, 695 (1978).

Federal Antitrust Enforcement Agencies: Protection of Transparency

- FTC has required disclosure of the underlying terms of transactions to help consumers make fully informed choices
- Funeral industry rule: FTC requires the industry to provide consumers with detailed pricing information for all products and services they provide. 16 C.F.R. 453 et seq.
- Telemarketing Rule to insure complete price disclosure and consumer choice. 16 C.F.R. 310.

Federal Antitrust Enforcement Agencies: Protection of Transparency

- Disclosure may alleviate potential conflicts of interest for middlemen such as PBMs
- Example of internet search engines
 - Internet search engines often receive payments from companies that advertise on their web site
 - FTC recently informed internet search engine companies that they must disclose the existence of these payments in their website.

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