



PHARMACEUTICAL
STRATEGIES GROUP



2009 Pharmacy Benefit/Drug Pricing Survey Summary and Report of Results

July 2009

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Introduction and Background

On March 30, 2009, the United States District Court in Massachusetts entered the “Final Order and Judgment” approving the class action settlement for the First DataBank (FDB) and Medi-Span Average Wholesale Price (AWP) litigation. The suits contended that the defendants had “engaged in a racketeering enterprise to fraudulently increase the published ‘average wholesale price’ (AWP) of over four hundred branded drugs from late 2001 to 2005...”¹

The Final Order and Judgment included the following stipulations:

- FDB and Medi-Span will pay approximately \$2.7 million into a settlement fund for the benefit of the settlement class.
- FDB and Medi-Span will adjust their AWP index to rollback the markup over Wholesale Acquisition Cost (WAC) from 1.25 to 1.20 on approximately 1,400 national drug codes (NDCs). These adjustments are to be made 180 days from the Final Order and Judgment (i.e., on September 26, 2009).

Separately, FDB and Medi-Span plan to discontinue publishing their AWP index within two years. They will continue to publish other drug pricing indices including WAC, Direct Price, Suggested Wholesale

Price, and Federal Financing Participation Upper Limits (FFPUL).

The rollback and subsequent discontinuance of AWP and the switch to an alternative basis for drug pricing is a massive paradigm shift with industry-wide consequences. Current drug pricing, although based on a flawed index (AWP), is uniform. Rollback and discontinuance of AWP will likely result in a fragmented approach to drug pricing, greatly increasing complexity and financial risk for payers. This fragmented approach will make it more difficult to compare pricing arrangements between PBMs and auditing for contract compliance.

Contract language and pricing scenarios for all entities utilizing the services of a pharmacy benefit manager (PBM) including employers, health plans, hospitals, government agencies, unions, third parties, etc., will need to be altered. While PBMs have a responsibility to inform their clients of planned changes to their pricing practices, the clients of PBMs will need to take measures to ensure their financial interests are protected.

¹ U.S. District Court of Massachusetts, Case 1:05-cv-11148-PBS, March, 17, 2009.

Purpose, Scope, and Methodology

Pharmaceutical Strategies Group, LP (PSG) conducted a survey of organizations that currently use the services of a PBM for the purpose of gauging marketplace-readiness for the sweeping changes now on the horizon to drug pricing practices.

PSG collected responses from 157 survey participants, constituted primarily of employers (70%) and health plans (21%), though also including government agencies (7%), unions (2%), and other entities.

The survey consisted of 13 questions, focused primarily on:

- Current PBM pricing arrangements.
- Familiarity with drug pricing practices and the issues surrounding AWP.
- Level of concern regarding changes to drug pricing practices.
- Readiness for drug pricing practices, including contractual provisions.

- Level of communication from PBMs
- Proposed methodologies by PBMs when the AWP adjustment occurs.
- Plans for validating proposed pricing changes to ensure economic neutrality.
- Expected level of disruption.
- Whether aspects of the AWP litigation will have value to various organizations.

The survey was active during the period of June 12-26, 2009.

Summary of Key Findings

General

88% of respondents indicated that they currently use AWP as the contractual basis on which their drug pricing is based (3% indicated current use of WAC; while 9% did not know which pricing base they used). 79% of respondents noted that they are either “somewhat familiar” or “very familiar” with the court order forcing a change to the AWP index. Significant among the findings are that 69% indicated they are either “somewhat concerned” or “very concerned” that the change in the AWP index will increase the cost of their pharmacy benefit. There is also a general perception that contracted PBMs have not sufficiently or effectively communicated the issues surrounding the AWP issue and planned future changes to drug pricing practices. Only 15% indicated that their PBM has contacted them with specific information about a proposed adjustment method. 35% acknowledged receiving general information, while nearly half (45%) have indicated they have not received any communication whatsoever from their PBMs.

Only 3% of respondents indicated their intention to trust their PBM’s changes to drug pricing methodology without some form of validation. The majority (67%) plan to use some form of validation, whether internal or external, to ensure that their PBM maintains economic neutrality. Fewer than 4% of respondents indicated that they would accept their PBM’s new pricing methodology without implementing a validation process. This suggests respondents are not ready to accept PBM claims of “economic neutrality” at face value. 22% do not yet know how they will address the issues.

Based on PSG’s industry experience, we believe that the credibility problem suggested by survey results is attributable to several key factors, including:

- The complexity of industry-wide drug prices practices.
- Difficulty on the part of payers to understand the true economic impact of impending changes.
- Confusion over the true definition of “economic neutrality”.
- Ongoing issues around financial transparency and an industry track record of non-disclosure to payers.

The impact of this change is broader than pure financial considerations. 63% of survey respondents expressed concern over the possibility of disruption to their organization due to the near-term AWP adjustment and/or future pricing indicator changes. 40% expressed concern about disruption in terms of the expected time needed to analyze and assess proposed changes. 10% had concerns over the impact on downstream contracts (with additional pricing changes required). 8% were concerned over the possibility of additional administrative burden and 5% were concerned about added legal review time.

Health Plan vs. Non-Health Plan Respondents

Health Plans/Managed Care Organizations indicated a broader understanding of the key issues involving both the AWP litigation and impending changes to drug pricing methodologies. 59% of health plans indicated that they were “very familiar” with the issues, compared to 25% of non-health plan entities.

When asked whether they had been contacted by their PBMs about possible changes to the AWP index, 22% of health plans versus 51% on non-health plans indicated “No.” 31% of health plans indicated receiving *specific information* about a proposed adjustment method compared to 11% of non-health plans. The provision of general information was closer but still disparate with 41% of health plans receiving basic information compared to 33% among non-health plans.

There appears to be a correlation between knowledge levels of the issues with concern over impending changes. While health plans exhibited a greater knowledge than non-health plans of the key issues, they also had a higher rate of concern. 25% of health plans indicated they were “very concerned” with 44% being “somewhat concerned”. This contrasts with non-health plans which indicated a “very concerned” level of 14% and a “somewhat concerned” level of 55%. This disparity and correlation suggests that the more an organization knows about the issues involved, the greater level of concern and the lower the level of willingness to accept at face value any changes promulgated by the contracted PBM.

Future Implications and Recommendations

Health plans and plan sponsors alike are rightly concerned about costs. Payers who were damaged by the artificial increase in AWP are now being further damaged by additional costs incurred to defend their current position and to maintain economic neutrality. In essence, they are being damaged twice.

Payers have a short-term and long-term challenge. The short-term challenge is in addressing the immediate need created by the courts to adjust AWP for a large subset of drugs. The longer-term challenge is the eventual replacement of the AWP index altogether. Further complicating matters is that proposed PBM drug pricing solutions are far from monolithic.

The strength of AWP is the simplicity and consistency it provides to the industry. A replacement index will necessarily be more complex and less consistent. Payers are going to be forced to accept an inadequately tested replacement pricing methodology. The elimination of AWP creates variability that will make achieving economic neutrality difficult. It will inevitably lead to a fragmented approach to drug pricing that will be inherently more complex, resulting in greater financial risk for payers and increased difficulty in comparing PBM pricing arrangements and auditing results. The survey results indicate payers sense this.

Those knowledgeable of the relevant issues are rightly concerned about the potential for unnecessary cost increases. Those who remain unaware of the issues and are not currently readying themselves are likely putting their organizations at risk.

It should be noted that some vendors have proposed near-term pricing adjustments and other solutions whose methodologies have been reviewed by third party actuarial firms that appear to offer immediate neutrality. Initial testing by PSG of certain of these methodologies has produced greater variability in individual client results than was anticipated based on PBM representations, indicating that additional refinements may be necessary to achieve and maintain economic neutrality. Unfortunately however, not all vendors have outlined their proposed strategies, nor have they had their methodology reviewed for credibility. Further, no solution has been tested over time to ensure neutrality continues for the term of the agreement.

Many PBM contracts already contain language requiring the parties to maintain the “relative economics” of the original PBM pricing arrangement in the event of a change in AWP.

Some agreements do not specifically address this issue. Organizations contracting with a PBM should carefully review their contract for language addressing the AWP pricing change, along with alternative pricing practices down the road. Based on PSG’s experience in reviewing such language, many contracts do not specify key definitions or methods for calculating adjustments or resolving disagreements that might arise during this process, which could leave individual plan sponsors in a less favorable position than before the change in AWP.

In addition, contract language changes should only address the “relative economics” of the PBM relationship. It would not be appropriate for PBMs to use the AWP settlement/judgment as a rationale to make changes elsewhere in the contract, or pricing adjustments that over time would fail to

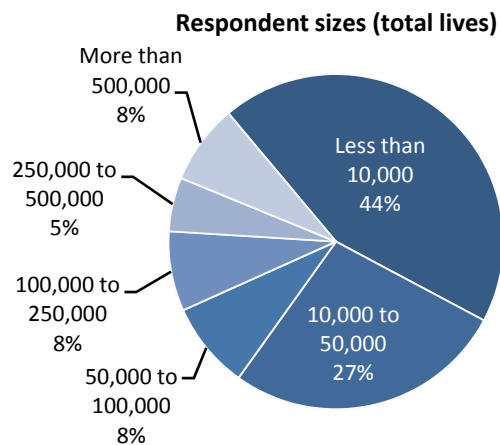
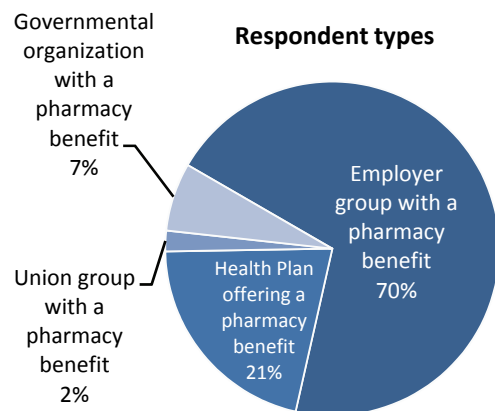
maintain economic neutrality. A detailed evaluation of contract language regarding these issues should be completed right away.

Prior to the effective date of the change to AWP prescribed by the settlement, a validation of implementation of the “relative economics” clause should be completed, including agreement on specific changes to pricing terms (based on individual plan sponsor utilization) and contract language. There are significant differences in how PBMs have proposed defining economic neutrality and in the specific approach they have proposed in dealing with this issue. Failure to understand these issues could result in economic loss or less favorable contract terms.

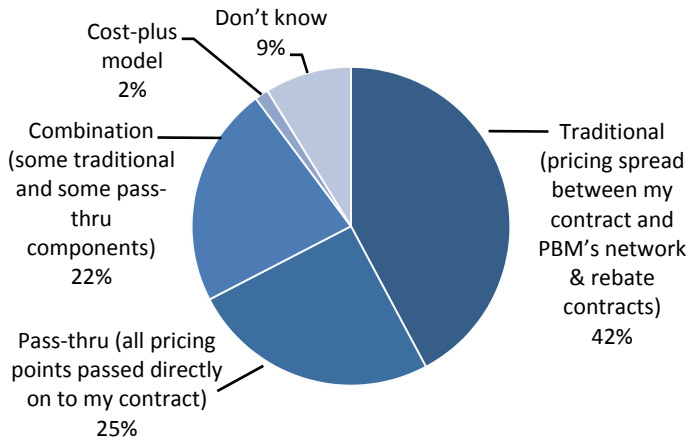
Detailed Findings

Combined Results (Health Plans and Non-Health Plans)

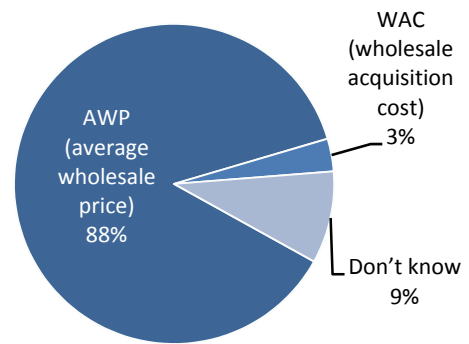
Number of respondents: 157



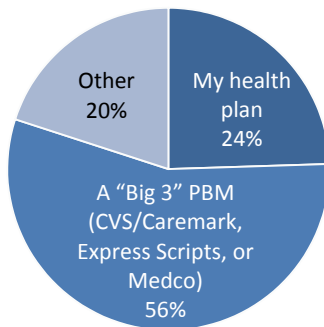
Pricing arrangements with PBMs



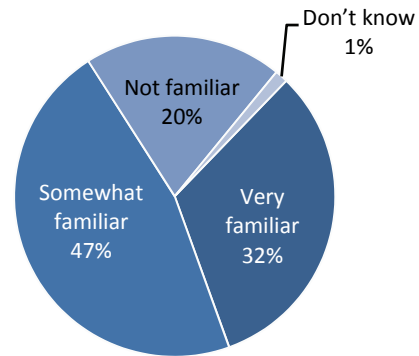
Current drug pricing base



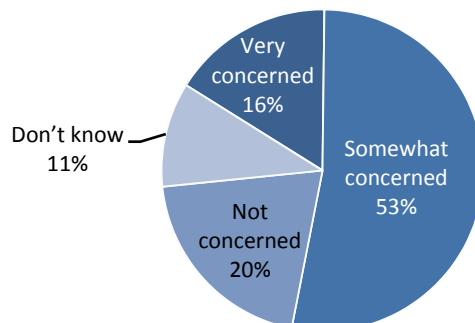
Type of vendor administering PBM/PBA program



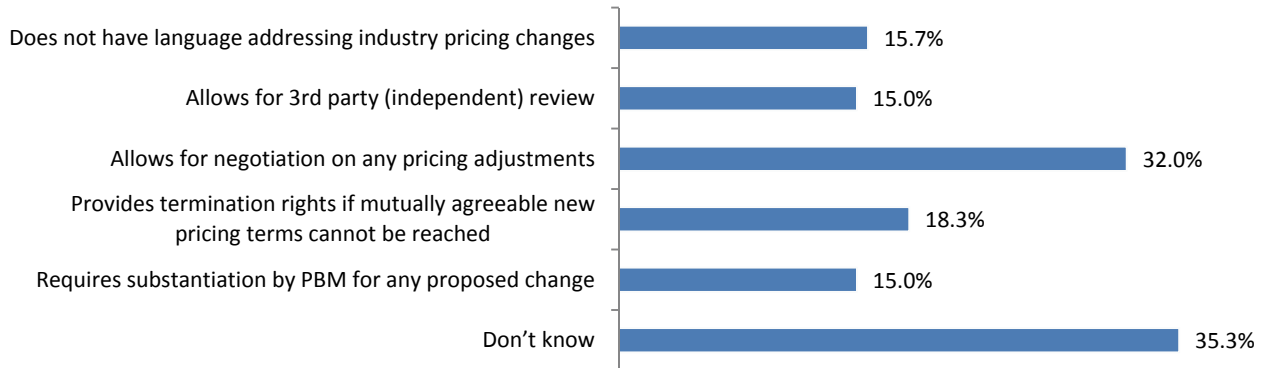
Familiarity with legislation forcing material change to AWP?



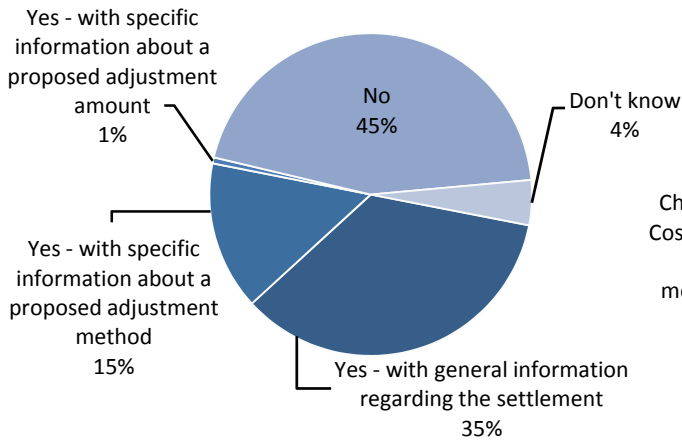
Level of concern that a change in the AWP index will increase the cost of the pharmacy



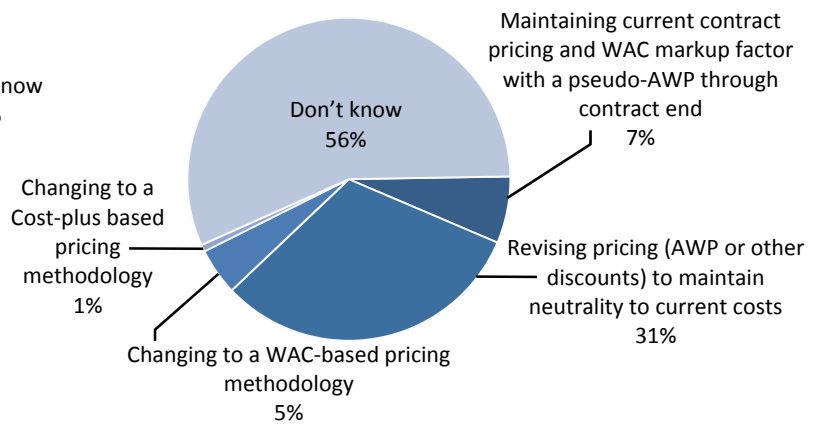
Manner in which current contract with PBM addresses adjustments in AWP or industry pricing indicator changes (multiple answers)



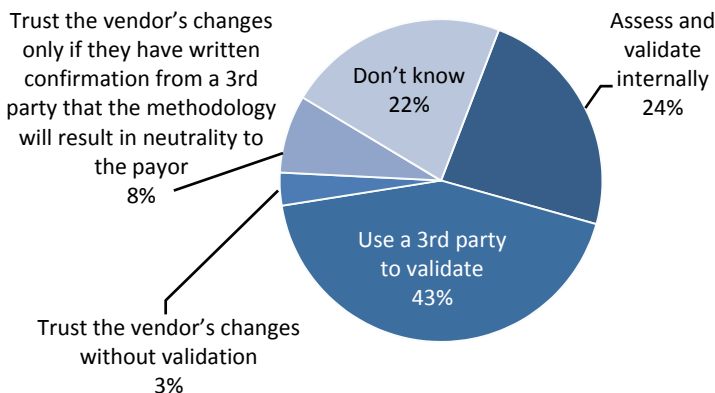
Level of contact from PBMs about possible changes to the AWP index



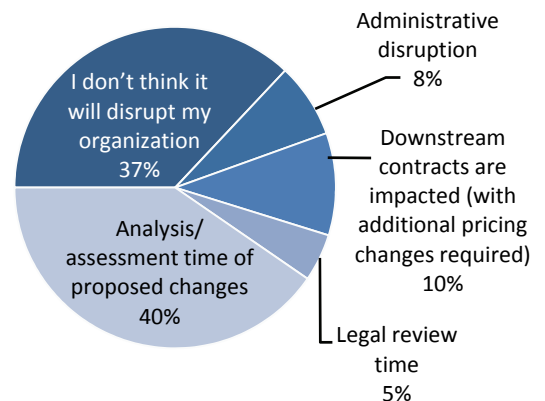
Methodology proposed by PBM when AWP adjustment occurs



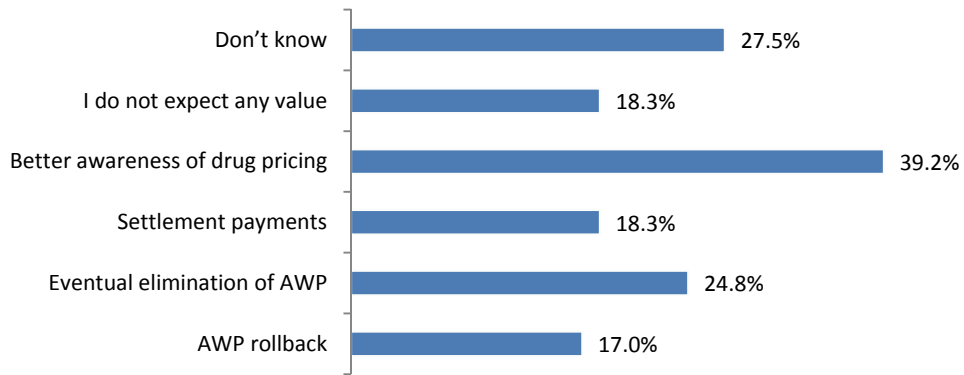
Plans for validation of proposed pricing changes from PBM to ensure economic neutrality



Anticipated disruption from pricing indicator change or AWP adjustment

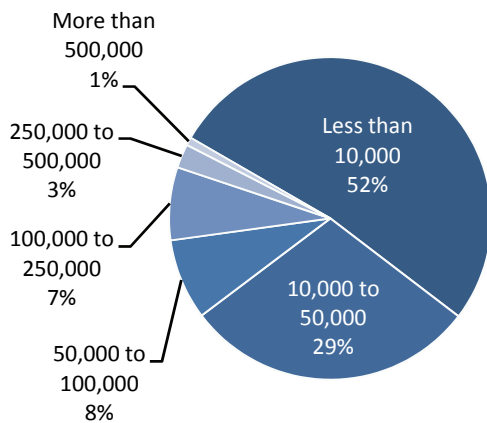


Aspects of AWP litigation expected to have value to organization (multiple answers)

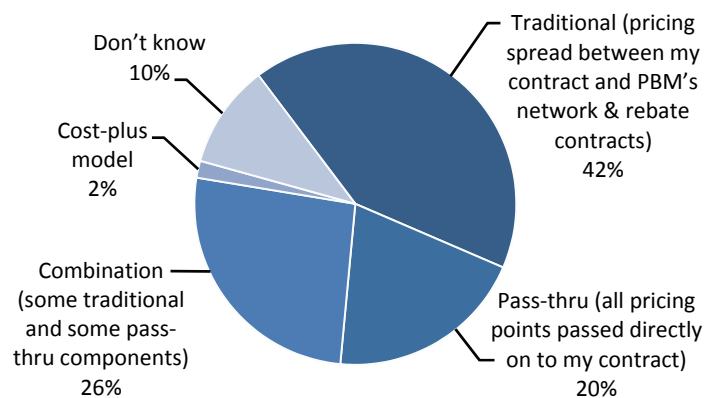


Employers, Government, and Union Results

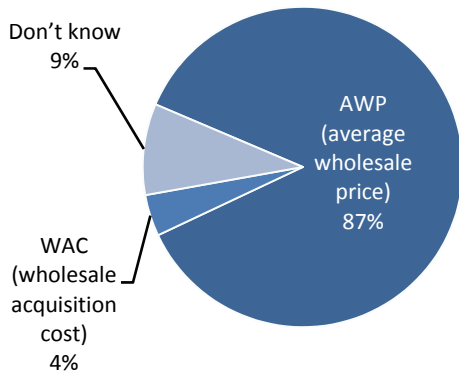
Respondent sizes



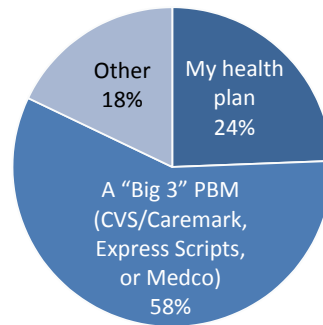
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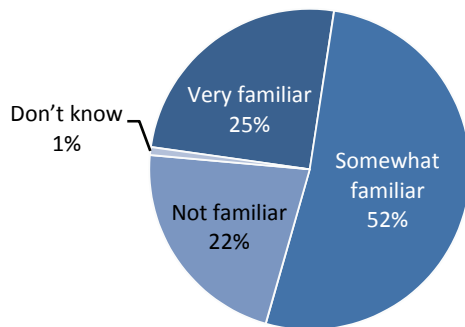
Current drug pricing base



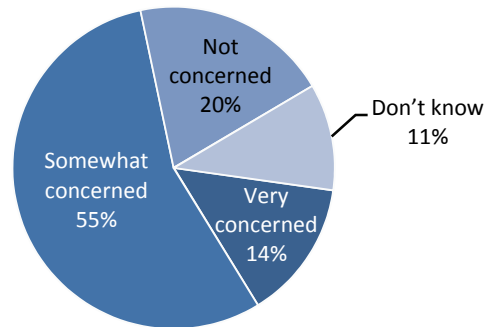
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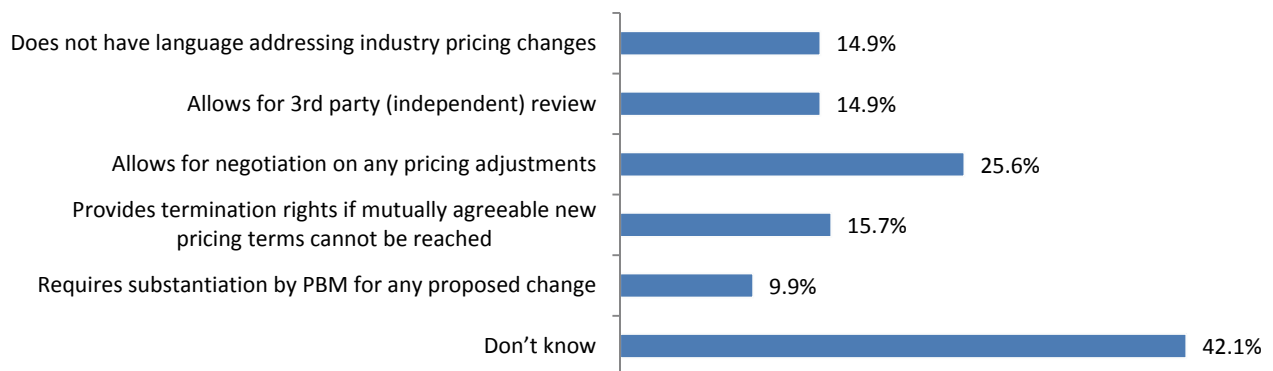
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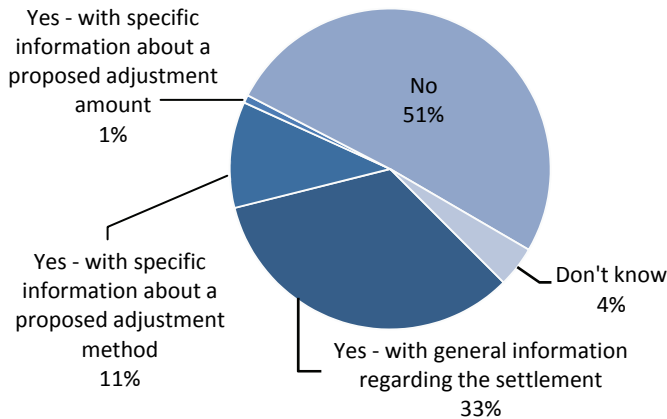
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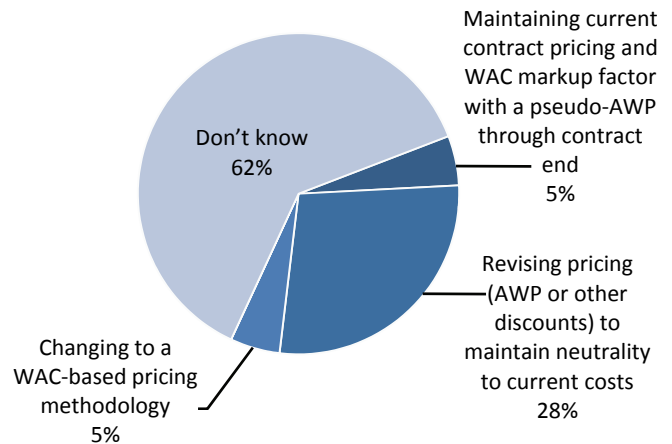
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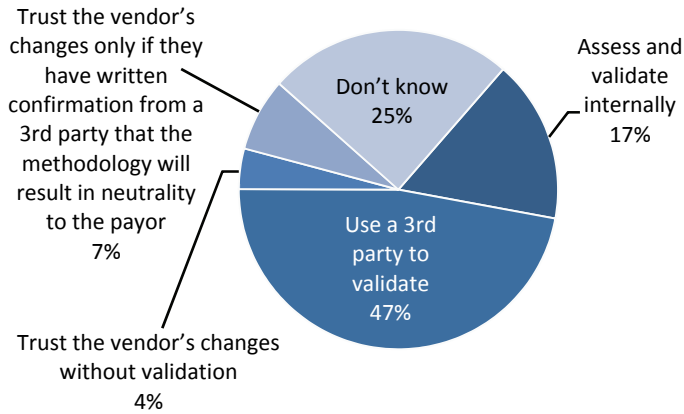
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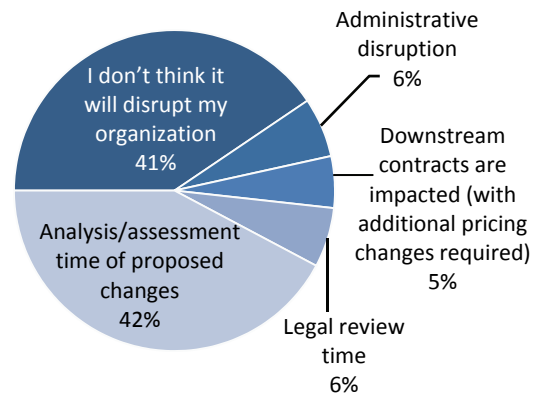
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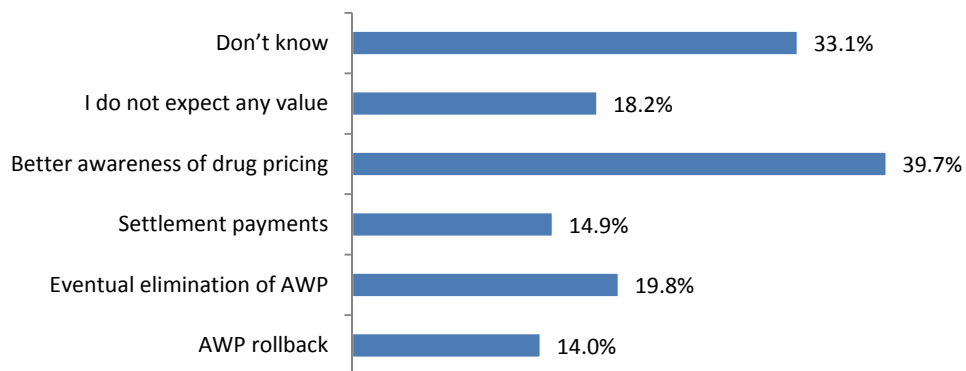
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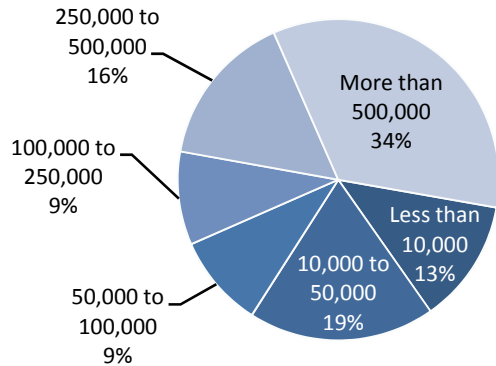


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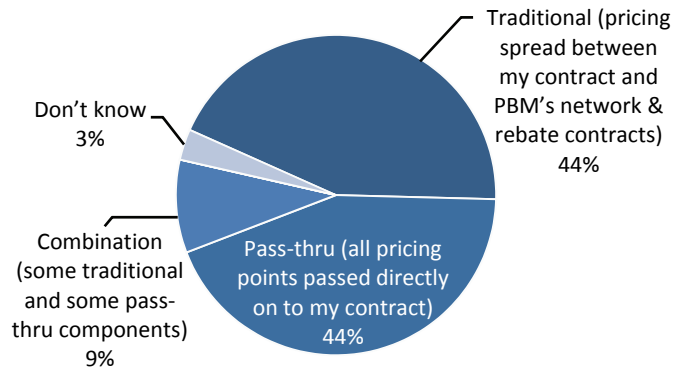


Health Plan Results

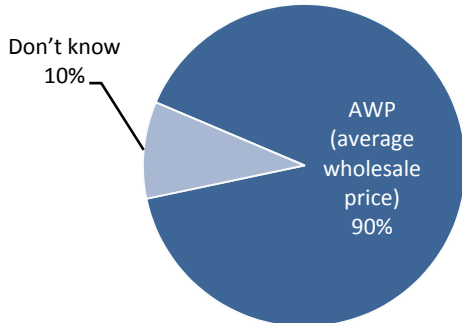
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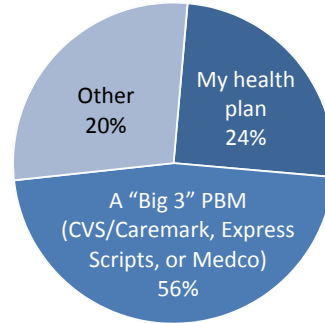
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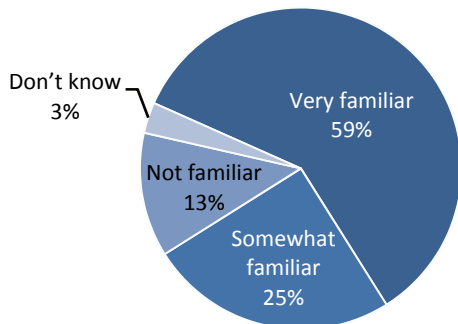
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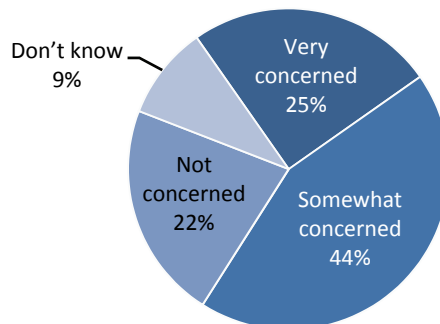
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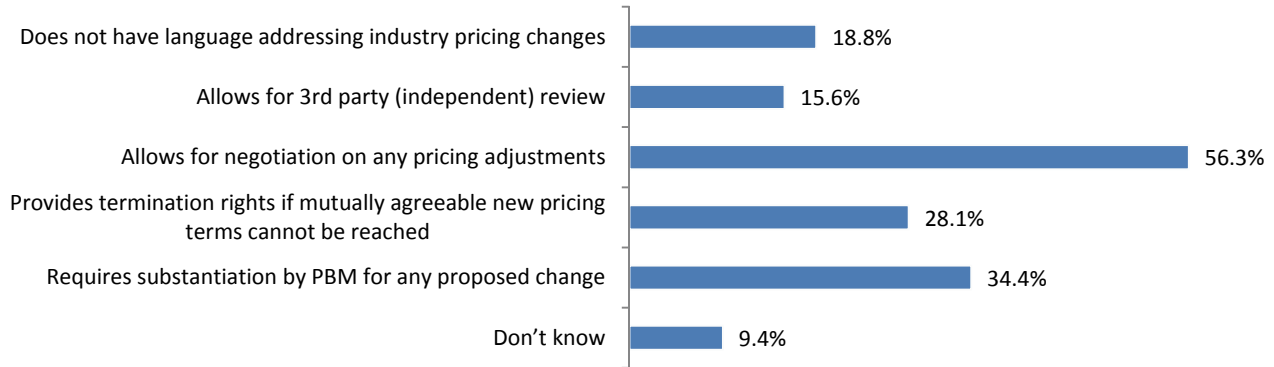
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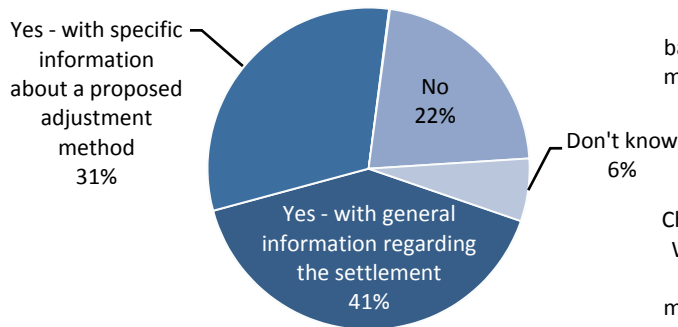
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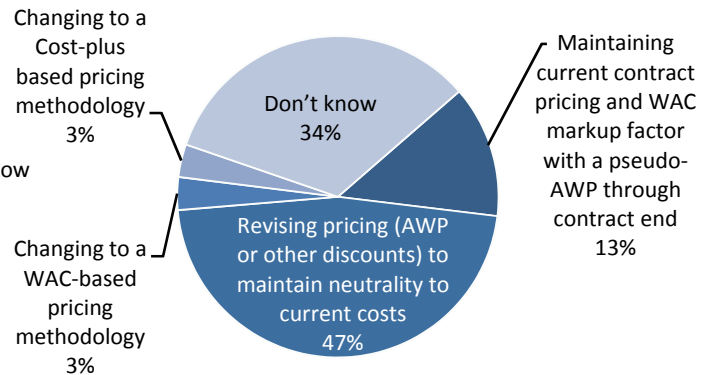
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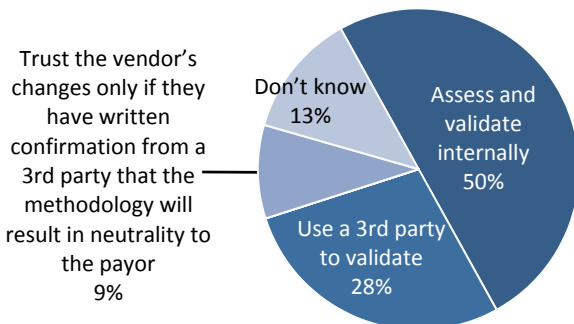
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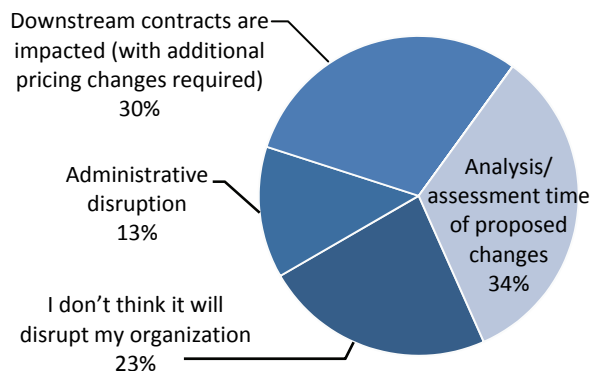
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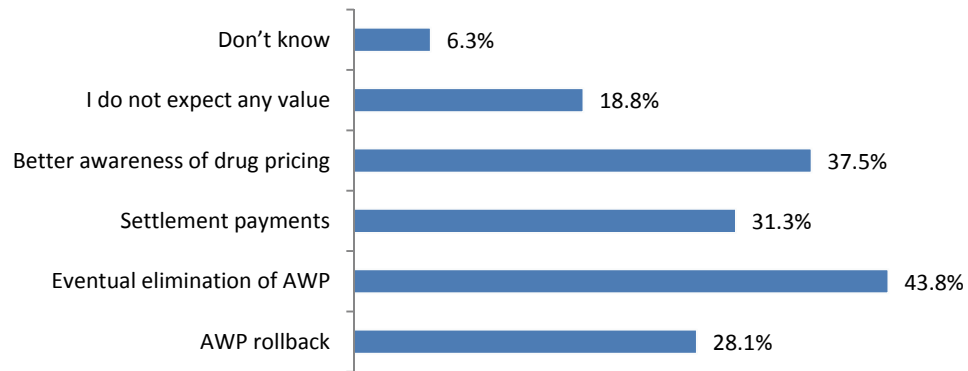
Plans for validation of proposed pricing changes from PBM to ensure economic neutrality



Anticipated disruption from pricing indicator change or AWP adjustment



Aspects of AWP litigation expected to have value to organization (multiple answers)



About Pharmaceutical Strategies Group

PSG assists plan sponsors in designing and managing programs that maximize the value of pharmaceuticals in their population. The strategies employed by PSG allow plan sponsors to gain immediate control over their pharmacy benefit expenditures, while positioning their program to meet future pharmacy benefit challenges.