

Pharmacists Must Lead The Way To Fixing America's Health Care Crisis



By: *Dan Benamoz, RPh, CEO*
Pharmacy Development Services, Inc
.info@pharmacy-owners.com

Introduction - The PBMs are coming! The PBMs are coming!

“The PBMs are coming! The PBMs are coming!” may well be the alarm that must be shouted out to America. Paul Revere, a previously little-known Massachusetts silversmith became legendary for awakening people to “an hour of darkness and peril and need”. So may the independent pharmacy industry become legend by preserving pharmacy and America, through awakening America to how it is being abused by the Pharmacy Benefit Manager industry (PBM), an industry America scarcely knows exists.

America is being encouraged, and in many cases, forced to abandon their local community pharmacies. They are being told: “money grubbing community pharmacies are overcharging.” Little does the typical American know that this argument is a classic ruse, a method to distract them so that they don't feel the slick fingered PBMs picking their pockets clean.

The PBM industry model is challenged by most pharmacists as “lacking transparency”. Few employers and fewer consumers understand what this means and how PBMs are inflating health care costs in their quest for obscene profits. Most people think that doctors and pharmacists are the beneficiaries of the double-digit increases in insurance policy costs each year. Most would be surprised to know that the annual increases pay for the fat profits directed to the new middlemen in health care, the PBMs.

America would be even more surprised to know that many of the largest mail order pharmacies are owned by the PBMs and used as a way to increase their profits. In 2006, the US Government launched a single legal proceeding against a single PBM in an effort to recover \$155 million for behavior involving false claims and kickbacks.

In this “white paper”, we will outline an alternative to the legislative strategy that has been largely unsuccessful in constraining the abuses of PBMs. We will show why America needs to know this is not just a pharmacy problem, but one that touches every single American. We will suggest why we need to enlist the support of America's biggest employers, who are the customers of the PBMs and their parent insurance companies. Finally we will ask for your support in sounding the alarm. “Run for your lives...The PBMs are coming! The PBMs are coming!”

1. Understanding The Problem

Why Prescription Drug Costs Are Soaring

A Pharmacy Benefit Manager (PBM) is a third party manager of prescription drug programs. They are primarily responsible for processing and paying prescription drug claims. They also are responsible for developing and maintaining the formulary, contracting with pharmacies, and negotiating discounts and rebates with drug manufacturers.

Over the last decade, retail pharmacists have spent millions of dollars on Capitol Hill lobbying Congress unsuccessfully to classify Pharmacy Benefit Managers as fiduciaries (a person to whom property or power is entrusted for the benefit of another) or at a minimum, for government regulation of this industry.

Under the “watchful eye” of these unregulated guardians of the United States Health Care System, prescription drug costs have escalated over the last 15 years at such an unprecedented rate that basic healthcare is rapidly becoming less and less affordable for individuals and corporations alike. Studies done by the Federal Reserve Bank of San Francisco point out that the number of employers offering health care insurance as a benefit is decreasing. Further, the employee share of those costs is increasing at such a rate that people are declining insurance even when it is available.

Left unchecked for one more generation we may be working for our healthcare and little more. Americans must understand this is a national issue, not just a special interest issue. In my opinion, Pharmacy Benefit Managers are the internal cancer that is undermining our profession, weakening our healthcare system, and raising havoc with the national economy in the process.

Pharmacy is limited by antitrust law in ways it can address this problem. The basic aim of the antitrust law is to promote competition in the commercial marketplace. The intended consequence of competition is to keep prices low and improve efficiency in production, distribution and marketing. In theory, the consumer and the economy are the ultimate beneficiaries. These aims are achieved through the Sherman Act of 1890 and its amendments which prohibit a number of activities.

As a result of being able to control or move market share, many of the PBMs discovered strategic byproducts to enhance their own profitability. One of these strategic byproducts has been the creation of PBM owned mail order pharmacies. If there is money to be made and you control the flow of money, it was only a matter of time before the PBMs discovered an opportunity by going into direct competition with the network of providers it relied upon to provide the products and services they were charged to manage. Because pharmacists are restricted by antitrust laws from collectively negotiating, the PBMs successfully circumvented and exploited antitrust laws and the intent behind them, to manipulate competitive forces to their advantage and seize control of America’s health care system in the process.

Leveraging the antitrust laws that prohibit the network of providers from collectively bargaining and contractual stipulations that threaten expulsion from the network, the PBMs put themselves in a position unlike any other industry, in which they became the primary payers to their network of pharmacies and also a direct competitor with that same network of providers.

Show Me The Money!

In order to fully understand the proposed new strategy, it is necessary to review certain profit centers in the PBM business model that are common knowledge to insiders within the pharmacy industry and that are irrefutable and indefensible.

PBMs operate on different "business models". A few PBMs implement "pass through pricing". These PBMs execute contracts with their clients that require the PBMs to "pass through" to their clients the PBMs precise purchase or reimbursement drug cost. These PBMs generate their profits by charging a flat, per claim, or per member, administrative fee.

The largest PBMs in the industry charge a much smaller administrative fee and generate additional revenues from alternative sources. Some of these alternative sources include but are not limited to manufacturer rebates, and practices known as re-packaging and spread pricing.

I. Manufacturer Rebates. Previously, pharmaceutical manufacturers primarily earned market share through direct marketing to prescribers. When The Stark Law was enacted it limited manufacturers' marketing methods to prescribers because of the inherent conflict of interest. At the same time, PBMs negotiated rebates and discounts with the manufacturers due to their ability to impact market share of products. Because of significant growth and consolidation in the PBM industry in recent years, their leverage position has increased profoundly. Now a manufacturer may simply purchase market share by obtaining preferred drug status on insurance plan formularies which the PBMs themselves control.

However, in recent years, lawsuits filed by federal and state governments and by PBM clients have alleged that PBMs have been operating against their clients' interests -- and breaching their fiduciary duties to their clients -- by secretly retaining rebates and discounts that the PBMs were obligated to pass through to their clients.

Rebates have been very difficult to fully quantify because a large portion of monies received from manufacturers are not officially classified as rebates. Some of these monies may be appropriated as reimbursements for marketing, general and administrative expenses. This practice enables the PBMs to retain a significant portion of monies received and share a substantially smaller percentage with the self-insured employers to meet its contractual obligations. For example, a large employer may negotiate that 80 dollars of each 100 "rebate dollars" from manufacturers be returned to the employer. But if the PBMs classify only 5 dollars as "rebate dollars", that means the employer gets back only 4 dollars out of the 100 dollars from the manufacturer. The PBMs classify the additional 95 dollars they retain as marketing, general and administrative expenses and of course profit.

From the perspective of a drug manufacturer, obtaining preferred drug (formulary) status is carte blanche in effect to raise prices (within limitations) with little concern of significant market share loss. Imagine a drug company paying a high six or seven figure fee just for an "appointment" to appear before the Pharmacy and Therapeutics (P & T) Committee of the PBM which determines which drugs are to be included and available to the patient. The "appointment fee" would not be classified as "rebate dollars", hence no money would go back to the employer.

From the PBMs perspective, many expenses associated with marketing and operations have to be recouped for the business to remain viable. NOT classifying a large amount of funds received from manufacturers as “rebate dollars” allows PBMs to keep dollars they feel they are entitled to in order to cover “reasonable expenses”. However, in an industry in which the primary commodity is market share, it is extremely difficult to determine how much each component part is entitled to relative to the whole.

II. Spread Pricing. Most PBMs implement "spread pricing", meaning PBMs execute contracts with their clients that enable the PBMs to reimburse network pharmacy providers at a deep discount while invoicing their clients (the employers) at a premium thereby profiting from the difference or "the spread" in pricing. The self insured employers never see on their monthly itemized statement how much was actually paid to the provider but only what they were charged for the product or service by the PBMs. Participating network pharmacies are contractually prohibited from directly contacting the clients (the employers) of the PBM's and disclosing the compensation that they receive directly from the PBMs thereby eliminating a vital component of the free market system necessary to maintain competitive forces in the marketplace.

In one instance, a self-insured employer was charged by their PBM over \$60 for a prescription for 30 generic Prozac 20 mg. It is estimated that the providing pharmacy was compensated less than ten dollars for filling that prescription with the difference, “the spread”, retained as profit by the PBM. It has been estimated that the average dollar amount of the spread nationally is approximately \$22.00. That means that self-insured companies pay a premium over retail prices of approximately \$22.00 per prescription.

GENERIC PRICING. Another area responsible for soaring drug costs is ironically generic drugs. It is true that generic drugs cost less than their brand name counterparts but a significant proportion of the potential savings is not being realized by the self-insured companies. Certainly the employer realizes some of the savings and therefore is motivated to incentivize its employees to accept less costly generic equivalent medication. The most common incentive is the elimination of an entire month's co-pay when three months of supply are ordered by the employee through the mail-order arm of the PBM.

Overall, the employer ends up incurring a greater burden and larger expense compared with retail costs. This is a perfect example of how costs are being driven higher because of the elimination of natural competitive factors. The myth that mail order saves money compared to retail is spread by outside consultants retained by employers but who receive referral and residual commissions from the mail order companies. This is a flagrant conflict of interest.

III. Repackaging. Drugs may be repackaged by licensed repackagers. It is a common practice to purchase products from a manufacturer and repack them into smaller quantities. This is not an uncommon practice in many industries and in a free market system you are free to charge whatever the market will bear. The FDA requires all repackaged products be assigned a national drug code (NDC) with a corresponding average wholesale price (AWP) for that particular NDC. What are the rules for determining AWP? There are none and there really cannot be without undermining our entire free market system. You are free to charge whatever you want.

The problem is people outside this industry are unaware of this practice. When a self insured company receives a monthly billing statement, their negotiated discount is based upon the AWP of the NDC of the product dispensed. Self-insured companies are negotiating contracts based upon discounts off of AWP not realizing that AWP is not a fixed cost. Although percentage discounts offered by mail order are substantially greater than what retail pharmacies can offer, their cost basis is significantly inflated because they are able to manipulate costs to increase their profits. Because the PBMs control the flow of money and create the contracts with their participating network of pharmacies, they are able to preclude anyone else from engaging in similar practices therefore creating the illusion of greater cost savings.

Does this practice occur with all medications dispensed? Absolutely not. It is a common rule of thumb in business: "80 percent of your sales come from 20 percent of your customers." Mail order only needs to apply this principle to the right 20 percent of medications dispensed to maximize profits while maintaining the illusion of lower costs.

2. Understanding Why We Need A New Strategy ***Is Government Intervention Necessary?***

All the best efforts for government regulation of the PBM industry have been thwarted by the wealthier and better politically connected PBM lobby. In retrospect, it really is not the role of the government to protect companies in the private sector from their own ignorance. If the government intervened with regulatory action at every request by industries unable to adapt to changing economic times, we would be living in a virtually socialistic society by now.

What makes our economic system so great is that it promotes and rewards innovation. Those who refuse to adapt become dinosaurs and face a similar fate. The retail pharmacy industry faces a similar fate due to passive indifference and the lack of innovative thinking. A disproportionate amount of attention and effort has been made in the area of clinical innovation at the expense of understanding basic business management principles. Basic business management principles applied properly, can effectively combat the negative impact that mandatory mail order programs have created. This in essence, is the origin of the new strategy I am proposing to the industry for consideration.

What History Has Taught Us

To better understand the strategy, it is necessary to understand some fundamental financial concepts. Ten months before Enron declared bankruptcy, when their stock was above \$63.00 a share, Enron began telling the world it was in big trouble. The major brokerage houses on Wall Street were issuing "Buy" recommendations almost until the very end when Enron finally filed for bankruptcy protection. The warnings from Enron were all in the quarterly financial statements if anyone had taken the time to read them carefully enough.

The language of business is accounting and if history has taught us anything, it has taught us that the financial statements are the ultimate equalizer of publicly traded companies. I believe that if a company like Enron can fall from grace as rapidly as it did, any company can — including the PBMs. This is where the battle must be waged and where I believe it can be won.

Understanding How To Read The Real Scoreboard

It would not make much sense to go to a professional sporting event if no score was being kept. We wouldn't know who the winner and loser was. For any business, it is the financial statements which are the scorecards that tell us if a particular business is successful or not. In a publicly traded company, it is the financial statements which are required by law to be made public on a quarterly basis which are the report cards of how well the business is doing and how well the management team is doing running the business.

It recently dawned on me that if accounting and the requisite of accountability can bring the largest conglomerates to their knees, then the answer for how we regain our long-term viability as an industry can be found within the very same financial statements of a publicly traded company which also happens to be a medically self-insured company.

Financial statements are comprised of three primary documents:

1. Balance Sheet
2. Profit and Loss Statement (a/k/a The P&L Statement, The Statement of Income or, The Income Summary)
3. Cash Flow Statement

The new strategy for saving retail pharmacy originates specifically from within the profit and loss statement. A standard profit and loss statement typically would appear as follows:

	Example A	Example B
Sales (Revenues).....	100	100
Cost of Goods.....	-80	- 80
Gross Profit.....	20	20
Expenses.....	-16	- 15
Net Profit (a/k/a the bottom line).....	4	5

For the purposes of this article, it is unnecessary to include E.B.I.T.D.A. (Earnings before interest, taxes, depreciation and amortization which also appear on profit and loss statements.) The numbers included in the above examples appear only for the purpose of illustrating a concept and have no other significant meaning associated with them.

The profit and loss statement is really the report card of how well management is doing turning revenues into profits. As illustrated in Example A above, \$100 dollars in additional revenues yields only an additional \$4.00 in net profit. However, as illustrated in Example B, a reduction of expenses by only a single dollar adds an additional \$1.00 to the bottom line which also represents a 25 percent improvement of profits. The two main points being:

1. Every dollar overspent on expenses has a direct dollar for dollar impact on the bottom line. In the example above, it is easier to improve the bottom line by reducing

expenses 6.25 percent (\$1.00) than it is to increase sales 25 percent to achieve the same bottom line result.

For many self-insured companies, the rising cost of providing healthcare coverage for its employees is a major concern not to mention a substantial expense. Of greatest concern is the rising cost of prescription drug coverage which for many companies now almost equals the cost for physician and hospitalization coverage combined.

2. Management can control many expenses. How well they do their job controlling expenses will determine how profitable the business ultimately is. The more profitable a company is, the more money that is available for distribution to shareholders or for reinvestment into the business to further grow the company.

An understanding of these two fundamental concepts is a prerequisite for grasping the potential magnitude of the proposed new strategy and recognizing how tenuous mail order programs truly are.

3. Understanding the New Strategy ***The Fatal Faux Pas***

The single biggest mistake that the PBMs made in recent years was going into direct competition with retail pharmacies with their own mail order programs. The logic in theory made sense. Economies of scale, greater buying power and improved safety and efficiency were the key benefits promoted. The actual result realized was the escalation of healthcare costs at an ever alarming annual rate.

As good an idea as mail order seemed as a new revenue stream for the PBMs, it can ultimately be the cause of their demise as healthcare power brokers in this country with the application of some very basic business principles.

We're Off Target By 225 Miles!
(No wonder we're getting our butts kicked)

One explanation perhaps for our current predicament is that we have been fighting Goliath (the PBMs) in a town where Goliath is too formidable. They are wealthier, politically more influential and less restricted by laws, regulations and statutes than we are. We obviously have not fared particularly well in Washington, D.C. and perhaps a change of venue at this eleventh hour against a less formidable opponent might provide pharmacy with a significantly greater likelihood of success. My contention is that this battle should not be waged politically in Washington but rather financially on Wall Street and not directly against the PBMs themselves.

The New Strategy

The Sarbanes-Oxley Act of 2002 was enacted to improve corporate governance, quality of financial reports, and credibility of audit functions. The Act creates more accountability for public companies and their executives, and increases criminal penalties for violations of securities and other applicable laws and regulations. The PBMs are only accountable to their own shareholders, not to the shareholders of the companies whose benefits program they

manage. In every publicly traded company, the board works for the shareholders and the CEO works for the board.

The new strategy I am suggesting is quite simple. Instead of going directly after the PBMs, let us target their customers, more specifically, publicly traded companies that have mandatory mail order programs in place. We need to target one such company because this battle can be won not in a court of law, but in the court of public opinion.

The board of directors of the company are accountable to the shareholders and do have a fiduciary responsibility to maximize shareholder value. Every dollar overspent needlessly directly reduces earnings dollar for dollar which makes that much less available for distribution to shareholders or for reinvestment into growing the company.

Those within the industry know that mail order is more costly than retail. Companies with mandatory mail order companies do not understand the nuances of the pharmacy industry. They likely believe it is more regulated than it is by the government to protect against such abuses. If they understood how much PBMs are contributing to the escalating costs of healthcare, they would cease using mail order immediately.

Executing The Strategy

The first step in the process is making certain that self-insured companies are educated about how PBMs and mail order make their money. The next step is buying a single share of stock of a targeted company and showing up at their annual shareholder meeting. The objective is to put management in the position of having to explain and defend their decision to continue with a mandatory mail order program. For unexplainable reasons, pharmacy to date has largely been unsuccessful communicating this message effectively. Considering the fact this is an indefensible position, if management maintains the mail order program after re-education, shareholders should commence a class action lawsuit against the board for obviously conspiring to defraud shareholders.

The pharmacy industry at this point needs to hire the best public relations firm available as well as Joel Roberts out of L.A., the top media consultant in the country. They will make sure the lawsuit gets covered by the Wall Street Journal, the financial channels and coverage by CNN's 360 with Anderson Cooper, Bill O'Reilly and Larry King. With 2008 being a presidential election year, I believe that this is the type of issue that could propel a candidate right into the White House.

Conclusion - What can you do?

Few people know that Paul Revere was not alone on his famous midnight ride. In reality, dozens of riders shot through the countryside shouting the alarm. Shouting out the alarm about the PBMs needs supporters too. We need a large number of pharmacy owners on board. If we are going to make headway in this battle, we need a unified industry working together towards a common goal. We need to make a statement to our industry leaders that this is a strategy worth pursuing and that we DO have a network of support both industry and nationwide behind it.

If you support this effort please do the following:

1. Forward this “white paper” to every pharmacist that you know and ask them to do the same as well.
2. Go to <http://www.preservepharmacy.com> and register your support by joining the mailing list for updates.

One of the updates will be information about a special DVD we will be making available. The presentation will be by the leading expert on PBM abuses who will be outlining the full array of deceptive tactics used by PBMs to defraud America. We will be recording this presentation so that you may fully arm yourself to repulse the attack of the PBMs, as well as arm your neighbors. You can share copies of the DVD with local employers and your customers. Let the country’s leading expert explain the case for you. The only way to assure that you will be notified when the DVD is available is by registering at the website and verifying your registration in the confirmation e-mail you will receive.

3. Share your thoughts. We want to hear any comments and suggestions you might have so we can put our best foot forward. To share your thoughts, go to the Preserve Pharmacy Blog at <http://preservepharmacy.blogspot.com>.

My friend, if it is to be done, it is up to us.

Sound the alarm. Be armed. Make a difference.