Testimony of David A. Balto

House Bill 5384

Before the Connecticut House Committee on Insurance and Real Estate

March 6, 2018

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Chairmen Kelly, Larson, and Scanlon, and other members of the House Committee on Insurance and Real Estate, thank you for the opportunity to present this testimony on the concerns and regulatory opportunity of high prescription drug costs as presented in House Bill 5384. My testimony documents the tremendous competitive and consumer protection problems in the pharmacy benefit management ("PBM") market, which significantly contribute to the rising drug costs, and the need for strong enforcement and legislation.

My comments in this testimony are based on my 30 plus years of experience as a public interest advocate, private sector antitrust attorney and an antitrust enforcer for both the Department of Justice and the Federal Trade Commission ("FTC"). From 1995 to 2001, I served as the Policy Director for the FTC's Bureau of Competition and the attorney advisor to Chairman Robert Pitofsky. Currently, I work as a public interest antitrust attorney in Washington, DC. I have represented consumer groups, health plans, unions, employers, and even PBMs on PBM regulatory and competitive issues, as well as issues concerning the high costs of prescription drugs that have been surrounding much of the recent debate in health care. I have testified before Congress and well over a dozen state legislatures on PBM regulation, drug costs, and health care competition matters, and was an expert witness for the State of Maine on its PBM reform legislation.[1]

While, there are other concerns with respect to the issues of increasing costs for prescription drugs, my testimony focuses on the role that PBMs play in contributing to the high costs, and makes the following points:

- PBMs are one of the least regulated sectors of the health care system.
- The PBM market lacks the essential elements for a competitive market: (1) transparency, (2) choice, and (3) lack of conflicts of interest.
- The lack of enforcement, regulation, and competition has created a unhealthy marketplace in which PBMs reign free to engage in anticompetitive, deceptive

[1] Much of my testimony can be found at my firm website www.dcantitrustlaw.com. I also operate a website on the problematic conduct of PBMs – www.pbmwatch.com.

and fraudulent conduct that harms consumers, employers and unions. The profits of the major PBMs are increasing at a rapid pace, at the same time that the list price for prescription medication is on a rapid assent. As drug prices increase, PBMs are not adequately fulfilling their function in controlling costs – indeed PBM profits are increasing at the same time drug costs increase because they secure higher rebates from these cost increases.

I welcome this hearing as a good starting point for the discussion of controlling drug costs to Connecticut consumers. For the market to function properly for Connecticut residents there needs to be sound oversight, regulation and great consumer protection enforcement.

Background

PBMs increasingly engage in anticompetitive, deceptive or egregious conduct that harms consumers. Consumers and their health plans suffer when health plans are denied the benefits of the PBMs' services as an honest broker, which drives up drug costs, and ultimately leaves consumers footing the bill for higher premiums.

This Committee's attention to PBM regulation as a contributing factor to escalating drug costs is extremely timely. PBMs are one of the least regulated sectors of the healthcare system. Because there is very limited federal regulation, state regulation has increased, but both increased state and federal regulation are necessary to reign in these practices.

Undoubtedly, and one of the major reasons this hearing is occurring today, consumers care about rising health care costs, which are all too common these days, including out-of-pocket costs for prescription drugs. **PBMs have a profound impact upon drug costs.** If PBMs are unregulated they can continue to engage in conduct that is deceptive, anticompetitive, and egregious. For this system to work effectively PBMs must be free of conflicts of interest including, incentives to PBMs in the form of high rebates in exchange for formulary promotion of high cost drugs.

What health plans and employers are fundamentally purchasing from the PBM is the services of an "honest broker" to secure the lowest prices and best services from both pharmaceutical manufacturers and from pharmacies. When the PBM is owned by the entity it is supposed to bargain with or has its own mail order operations there is an inherent conflict of interest, which can lead to fraud, deception, anticompetitive conduct, and higher prices.

Problems in the PBM Market

PBMs are like other healthcare intermediaries that manage transactions by forming networks and transferring information and money. As a former antitrust enforcer I know that there are three essential elements for a competitive market: (1) transparency, (2) choice and (3) a lack of conflicts of interest. This is especially true when dealing with health care intermediaries such as PBMs and health insurers where information may be difficult to access, arrangements are complex and clouded in obscurity, and there may be principal-agency problems. As I explain below on all three of these elements the PBM market receives a failing grade.

Why are choice, transparency, and a lack of conflicts of interest important? It should seem obvious. Consumers need meaningful alternatives to force competitors to vie for their loyalty by

offering fair prices and better services. Transparency is necessary for consumers to evaluate products carefully, to make informed choices, and to secure the full range of services they desire. In both of these respects the PBM market is fragile at best. There is certainly a lack of choice especially for those plans that are dependent on the top tier big three PBMs – CVS Caremark, Express Scripts and OptumRx – which have an approximate 80% share of the market. And PBM operations are very obscure and a lack of transparency makes it difficult for plans, including government buyers, to make sure they are getting the benefits they deserve.

When dealing with intermediaries, it is particularly critical that there are no conflicts of interest. The service a PBM provides is that of being an "honest broker" bargaining to secure the lowest price for drugs and drug dispensing services. When a PBM has an ownership interest in a drug company, a health insurer, or has its own mail order or specialty pharmacy dispensing operations, it is effectively serving two masters and may no longer be an "honest broker." And when this happens, ultimately consumers lose through less choice and higher prices.

As I detail below, the rapidly increasing drug costs which effectively lead to higher drug rebates for the PBMs leads one to question which master the PBM is serving. It increasingly appears that PBMs profit from higher drug prices, because they lead to higher rebates.

Finally, where these factors – choice, transparency and lack of conflicts of interest – are absent, regulation is often necessary to fill the gap.

A Broken Market Leads to Escalating Drug Costs and Rapidly Increasing PBM Profits

What is the result of this dysfunctional market? PBMs entered the health care market as "honest brokers" or intermediaries between heath care entities. However, the role of the PBM has evolved over time and increasingly PBMs are able to "play the spread" by not fully sharing the savings they purportedly secure from drug manufacturers. As a result PBM profits have skyrocketed over the past dozen years. The two largest PBMs—Express Scripts and CVS Caremark— have seen their profits increase by almost 800% from $900 million to approximately $8 billion.[2]

If the market was competitive one would expect profits and margins would be driven down. But as concentration has increased the exact opposite has occurred. That is why regulation is so necessary.

The rapidly increasing drug prices threaten our nation's ability to control the cost of health care. While PBMs suggest that they are there to control these costs these claims must be carefully scrutinized. The concern of a PBM is to maximize profits and that means maximizing the amount of rebates they receive. Since rebates are not disclosed this is an incredibly attractive source of revenue. PBMs can actually profit from higher drug prices, since this will lead to higher rebates.[3] While PBMs tout their ability to lower drug costs, the gross profit the major PBMs reap on each prescription covered is increasing year after year. For example, Express Scripts' gross profit on an adjusted prescription increased from an average of $4.16 in 2012 to approximately $7.00 in

[2] Express Scripts Holding Co. and CVS Health, Fortune 500, Fortune.com (2017).
[3] *See, e.g.*, David Balto, How PBMs Make the Drug Price Problem Worse, The Hill (August 31, 2016), available at http://thehill.com/blogs/pundits-blog/healthcare/294025-how-pbms-make-the-drug-price-problem-worse.

2017. In other words, the gross profits have increased by almost 70% since Express Scripts acquired its biggest rival Medco. Moreover, IMS data reveals that the list of price of medications is growing at a far greater rate than the net price, which leads to the conclusion that most of the increase in drug spending has been from rebates pocketed by PBMs and insures.[4]

Would PBMs withhold their negotiating punch to secure higher rebates? We do not have to guess that this is occurring. PBMs have used similar strategies in the past. Indeed, as noted below state enforcers have attacked PBMs arrangements to force consumers to use higher cost, less efficacious drugs, in order to maximize rebates and secure kickbacks.[5] They held back their negotiating muscle to allow prices to escalate to maximize rebates. For example, PBMs have switched patients from prescribed drugs to an often more expensive drug to take advantage of rebates that the PBM receives from drug manufacturers. PBMs often do not pass through to payors rebates secured from drug manufacturers, and instead are accounted for as a reduction in cost of revenues, allowing the PBMs to hide profits. In fact, Medco was the last PBM to publicly disclose rebates in 2012.[6] In short, PBMs derive enormous profits at the expense of the health care system from the ability to "play the spread" between pharmaceutical manufacturers, pharmacies and health care plans.

You do not need a Ph.D. in economics to figure out that the market is not competitive and that plans and consumers are paying more than they otherwise would. Case in point was the recent lawsuit brought by Anthem against Express Scripts. Anthem alleged that Express Scripts withheld $15 billion in rebates which should have been passed back to Anthem.[7] This suit, among others, suggests that these rebates are retained by the PBMs instead of passing along to their plan sponsors, leading to higher drug spend by the plans and ultimately consumers.

There are three very important lessons here: (1) the fundamental elements of a well functioning market are absent; (2) plans and consumers have already suffered substantial harm from deception, fraud and other egregious practices; and (3) there is a tremendous need for comprehensive regulation of PBMs and other fixes to decrease drug costs for consumers.

House Bill 5384

I applaud the Committee for hearing H.B. 5384. In particular, Section 1 of H.B. 5384 is critically important. This language requires increased transparency on PBMs and the duty to report the

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[4] *See*, Robert Goldberg. "Most of the Increase in Drug Spending Pocketed By PBMs and Insurers." Drug Wonks (April 15, 2016).

[5] PBMs have been fined by state and federal entities to the tune of over $400 million for such conduct. For a more detailed analysis of the federal and state cases against the PBMs, *see* David A. Balto, Federal and State Litigation Regarding Pharmacy Benefit Managers. http://www.dcantitrustlaw.com/assets/content/documents/PBM/PBM%20Litigation%20Updated%20Outline%20-%201-2011.pdf.

[6] Note, in late 2017, the Securities and Exchange Commission ("SEC") required Express Scripts to report gross rebates received from drug manufacturers. The SEC deemed drug manufacturers are not customers of PBMs, and therefore, required a separate disclosure by Express Scripts rather than allowing Express Scripts to hide such rebate revenue in its general trade receivables. *See*, J. Swichar and B. Wasser, SEC Begins to Knock Down Wall of Secrecy Between PBMs and Drug Manufacturers, The Temple 10-Q (February 2018), available at https://www2.law.temple.edu/10q/temple-law-students-place-finals-national-telecommunications-technology-moot-court-competition/.

[7] *Anthem v. Express Scripts*, Case No. 16-cv-2048 (S.D.N.Y.).

rebates the PBMs receive from drug manufacturers. Such legislation will go a long way in assisting the Insurance Department in its understanding of the all-too opaque profits accruing to the PBMs. Indeed, such increased disclosures by PBMs have resulted in price decreases and significant savings for plan sponsors.[8]

Similarly, I applaud the inclusion of Section 6 in H.B. 5384. This Section requires managed care organizations to pass through a majority of earned rebates to the consumer (whether in the form of lowering premiums, or payments to insureds). This provision is designed to obviously lower costs for consumers. However, the legislation does need to go further in several respects. First, the legislation should require that not just managed care organizations pass along rebates, but that the PBMs pass through rebates to the health plans or employer groups as well. Second, that those rebates be used to lower premiums or direct out-of-pocket costs to consumers. And third, that entities required to pass through rebates to help consumers lower out-of-pocket costs not simply pass along "the majority of any rebate," but rather pass along a substantial majority of the rebate, no less than 75%. Ensuring that rebates are passed through to consumers will eliminate incentives to keep only the highest priced medications on formulary, and will ultimately lower premiums or direct out-of-pocket costs ultimately benefiting Connecticut consumers.

Conclusion

Connecticut consumers need greater protection from the opaque transactions of PBMs and others in the health care arena that drive up their health care costs. The PBMs pocket billions of dollars while failing to pass along such savings to consumers. H.B. 5384 is a starting point to help ensure PBMs act in a more transparent manner and to help ensure cost savings are ultimately used to help lower drug costs to consumers. I strongly encourage the Committee to additionally consider the above suggestions for improving the legislation.

Thank you for your time and consideration. Please let me know if I can advise the Committee further in any future hearings, or if I can provide any additional information.

[8] For example, a recent report revealed that Meridian Health System discovered that its drug benefit increased by 1.3 million within the first month of contracting with Express Scripts for PBM services. Meridian discovered that they were being billed for generic amoxicillin at a rate three times higher than Express Scripts was paying to the pharmacy to fill these same prescriptions. The transparency learned of by Meridian led to a $2 million cost saving in the first year of a new contract with a different PBM. *See* Katherine Eban, *Painful Prescription*, Fortune Magazine (Oct. 10, 2013).