CONTRACT NEGOTIATING TOOL:
Information on Contracts with Pharmacy Benefit Managers

Executive Summary

This negotiating tool summarizes the various issues that arise when contracting with Pharmacy Benefit Managers for prescription benefits. The purpose of this negotiating tool is to provide information and is not legal advice.

This document was prepared with the assistance of Georgetown University's Harrison Institute for Public Law, which has more than 40 years of experience working for nonprofit clients on various local and national needs. The document represents the views of the contributors and does not represent the views of Georgetown University.

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EXECUTIVE SUMMARY

INTRODUCTION: Pharmacy Benefit Managers are third-party administrators who manage prescription drug plans for employers (hereinafter called "plan sponsors"). There are approximately 76 PBMs administering prescription drug plans for more than 215 million Americans. Two large companies (Express Scripts-Medco and CVS-Caremark) account for 70% of the market for prescription processing. The prescription drug industry is complex and highly technical — with PBMs connecting plan sponsors, pharmaceutical manufacturers, and pharmacists. While PBMs can provide industry knowledge to plan sponsors, how they operate is often unclear. For example, PBMs negotiate with pharmaceutical manufacturers to set prices for drugs; they also may negotiate rebates for using certain drugs — information that is not publicly available. Due to the lack of transparency, PBMs practices have been the subject of investigations and lawsuits.

Considering the leverage that PBMs have in the market, plan sponsors may not have the knowledge to effectively negotiate a contract that can provide a prescription drug plan at the best cost. In addition, many plan sponsors do not use the current contracting process (referred to as the "request-for-proposal") to effectively outline contract terms or verify the projections that the PBM provides. This Contract Negotiating Tool is a resource for plan sponsors to understand the language and mechanics of a PBM contract. This tool is provided by Pharmacists United for Truth and Transparency (PUTT), a not-for-profit organization comprised of pharmacists and pharmacy owners who want to inform the public about the practices of PBMs.

The Tool lists topics in PBM contracts that can be vague and if left undefined, may raise costs for the plan sponsor. Each contains background information explaining why this topic can be problematic and includes tips to consider when drafting contract language.

TOPICS IN PBM CONTRACTS

Definitions: Many PBM-employer contracts contain language that is ambiguous, vague, or undefined. Undefined terms can lead to the plan operating differently than expected and could lead to increased costs. For instance, PBMs and plan sponsors may define brand and generic drugs differently, which could result in differing pricing terms for the same drug product. Additionally, if the pricing methodologies for drugs are not carefully defined, some pricing definitions may give the PBM too much authority to adjust pricing that is favorable to the PBM or structure plans in a way that the plan sponsor is not getting the lowest possible cost. These are just a few of many contract terms that may not be clearly outlined in PBM-plan sponsor contracts.

Drug Pricing: PBM contracts use a variety of pricing methods for drugs under a prescription plan. Many are not realistic indicators of actual market prices because they are either set by a manufacturer or the PBM, not the market. This makes it difficult for the plan sponsor to know the actual cost of drugs. As a result, many PBM contracts currently allow for "spread pricing," which enables PBMs to charge plan sponsors more than they reimburse pharmacies, so the PBM can profit on the plan's utilization — in addition to its fee for service. This makes it important for the PBM contract to clearly specify the pricing formula used for each drug category and allow the plan sponsor to verify how the PBM is pricing its drugs.

Rebates: PBMs negotiate with third parties, such as pharmaceutical manufacturers, to receive better deals or discounts for drugs. PBMs are incentivized to negotiate with these third parties due to the cost savings for plan sponsors, but also for the receipt of significant rebates. If the plan sponsor does not claim this revenue in the contract, the PBM can keep these rebates rather than forward them to the plan sponsor.

Plan Services: Plan services govern how a PBM will administer a prescription and how the PBM will assist plan members, promote better outcomes, and decrease overall costs. If these services are not addressed in the contract, it leaves the PBM with full authority to change or omit the services. For example, PBM contracts vary as to how fees are structured for the administration of plan services. Listing each service protects the plan sponsor from being charged for the same service under a different fee category while also confirming what services the PBM is expected to provide. While most of these services are beneficial to the plan sponsor, some services could potentially lead to increased costs and decreased member satisfaction.
PBMs are third party administrators of prescription drug programs who contract with employers (referred to as “plan sponsors”) to provide prescription drug benefits to employees (referred to as “members”) of the plan sponsor. PBMs manage prescription drug benefits for approximately two-thirds of all Americans (Atlantic Information Services 2004, p. 329) and control the vast majority of prescription processing. There are an estimated 76 PBMs in the United States (FDA 2011, website). In this concentrated field, two of the largest PBMs, Express Scripts and Medco, merged in 2012. With this merger, Express Scripts-Medco now accounts for approximately 45% of the market. Together with CVS Caremark, these two companies account for approximately 73% of the prescription processing in the United States (Abelson 2012, B3).

PBMs provide an array of services to administer and manage prescription drug plans such as creating a formulary (a list of preferred drugs that will be covered under a plan) and negotiating drug prices with pharmaceutical manufacturers (Congressional Budget Office 2007, p. 10). PBMs also contract with pharmacies, where they reimburse pharmacies at an agreed price for the members’ prescriptions (FTC 2005, p.4). In addition to processing claims between pharmacies and plan members, PBMs review the medications members fill at all pharmacies under the plan (referred to as “drug utilization”). This data assists pharmacists to identify drug interactions and duplicate drugs, and can promote clinical interventions to improve the medication management of plan members (Cook, Kornfield, & Gold 2000, p. 13-14).

PBMs generate revenue by three main methods (Garrett & Garis 2007, 37):

- **Pricing drugs**
  Many PBMs further retain profits based on the drug prices they negotiate between a plan sponsor and a pharmacy. A common practice among PBMs, “price spreading,” allows PBMs to charge a plan sponsor for a drug, but pay a lower amount to the pharmacy that dispenses the drug and keep the difference (Garrett & Garis 2007, 36; Garis & Clark 2004, 20). PBMs also negotiate drug prices with pharmaceutical manufacturers independently of plan sponsors, which can influence what types of drugs are covered under a plan’s formulary (Kaiser Family Foundation, Health Strategies Consultancy 2005, p. 16, 24; FTC 2005, 44-45).

- **Negotiating rebates from drug manufacturers**
  PBMs place brand drugs on a formulary because pharmaceutical manufacturers often provide rebates for using these drugs (FTC 2005, viii). Rebates are also the third main method for how PBMs generate revenue (Garrett & Garis 2007, 44). In a 2005 study, the Federal Trade Commission (FTC) estimated that the top 25 brand drugs accounted for 70 percent of the rebate payments that pharmaceutical manufacturers made to PBMs (FTC 2005, 48). Depending on the contract some PBMs retain a portion of a plan sponsor’s rebate dollars (Anderson, Samuels, & Sarraillie 2012, webinar).

- **Charging a fee to manage drug plans (“plan services”)**
  The types of plan services and related charges depend on the contract between a PBM and plan sponsor. Some PBMs charge a monthly fee per member while other PBMs charge a per transaction fee (Anderson, Samuels, & Sarraillie 2012, webinar).

PBMs evolved as a means to lower overall drug prices and simplify the prescription services process by automating administrative services, obtaining discounts on drugs (ingredient cost), and managing drug utilization. However, PBMs have been under increasing scrutiny, including the subject of numerous claims and litigation, concerning whether their practices actually contribute to decreased costs. Exactly how PBMs generate revenue has been the subject of numerous claims and litigation involving the allegations of increased costs to the plan sponsor and the wrongful retention of profits (See U.S. v. Merck-Medco Managed Care, L.L.C., et al, 2004 WL 5018758 and In Re Express Scripts 2007). For example, in 2006, Medco settled a case with the Department of Justice over allegations of false claims (U.S. Dept. of Justice 2006, Press Release Oct. 23). Included in the lawsuit were allegations that the company did not fulfill its contract obligations, for example, failing to track drug utilization and filling prescriptions with drugs to earn undisclosed rebates with drug manufacturers (See U.S. v. Merck-Medco Managed Care, L.L.C., et al, 2004 WL 5018758). Other lawsuits have alleged that PBMs engaged in practices so that physicians would prescribe brand drugs in order to receive higher rebates undisclosed to the plan sponsor (See In Re Express Scripts 2007; California Office of the Attorney General 2004, Press Release).

Even with the increased legal scrutiny, it is difficult to assess the actual prices in PBM contracts because this information is undisclosed (Freudenheim 2007). The overall lack of transparency in the PBM industry often makes it difficult for plan sponsors to assess the benefits of a prescription drug plan against the cost of the plan (Balto 2006, p. 3; Calabrese 2008, 12-13). Given the highly technical nature of prescription processing, many plan sponsors are unable to effectively identify language requiring a definition so that both parties understand contract terms (Anderson & Cosway 2010, p. 23). PBM contracts often have language that is ambiguous, vague, or undefined (Keel 2008, p. 16). Many plan sponsors may be unaware that important
terms are not adequately defined (Keel 2008, p. 17; Anderson & Cosway 2010, p. 23), potentially adding to the cost of a prescription drug plan (Keel 2008, p. 17; Anderson & Cosway 2010, p. 23). For example, in order to ascertain how a PBM receives rebates and to ensure rebates are passed through, plan sponsors can include contract terms addressing these issues. Alternatively, a plan sponsor can ensure that contracts include cost saving measures through adjusted administrative fees and copayments. These examples reiterate the importance of a carefully drafted contract to allow for agreements that meet the interests of both the PBM and plan sponsor.

These contracting concerns may be heightened by the current method of contracting with PBMs, the request-for-proposal (RFP) process, where plan sponsors or their consultants solicit PBMs to respond to the plan sponsor’s request for a prescription plan (FTC 2005, p. 8). Many RFPs are structured with the plan sponsor or consulting firm sending a questionnaire to PBMs and asking the PBM to project costs for the plan sponsor (Pricewaterhouse Coopers 2001, p. 106). However, the PBMs’ projections may not materialize in the final contract (Anderson, Samuels, & Sarraille 2012, webinar) as many plan sponsors do not use the RFP process to review actual contracts, outline contract terms, and verify that the actual prescription plan reflects the PBMs’ projections (Anderson & Cosway 2010, p. 23; Stern 2005, Issue 4). Moreover, PBMs draft the contracts they negotiate with plan sponsors, often using templates that PBMs have developed (Keel 2008, p. 16; Stern 2005, Issue 4).

There are several aspects of a PBM contract that plan sponsors may want to change (J.P. Morgan 2012, p. 18), but they may not have the knowledge to ensure these changes take place. As such, Pharmacists United for Truth and Transparency (PUTT) is providing a Contract Negotiating Tool to provide information so that plan sponsors can understand common contract terms and their implications. PUTT is a nonprofit organization of pharmacists and pharmacy owners with industry-specific knowledge about PBMs. Like plan sponsors, pharmacies must contract with PBMs; however, pharmacists’ knowledge of prescription processing and pricing has allowed pharmacists to become familiar with PBMs’ practices. PUTT believes some of these practices may not only increase costs for plan sponsors, but also harm local pharmacies and their communities. For example, when PBMs require patients to leave local pharmacies to use PBM-owned mail order pharmacies, local pharmacies and the communities both lose. The pharmacy loses business and relationships with those they serve, and the community loses the ability to discuss prescriptions with a local pharmacist. PUTT hopes that by informing the public about the cost of prescription drugs associated with PBMs, PBM practices may change to the benefit of plan sponsors, members, local pharmacists, and their communities.

With this tool, PUTT hopes to ensure that plan sponsors fully understand the various terms in a PBM contract so that the contract can fully represent their interests. The tool lists topics common in PBM contracts that are vague if the contract does not fully define them. Each contains background information explaining why this topic can be problematic, and includes tips to consider when drafting contract language. The tool also provides suggestions to safeguard a plan sponsor’s interest when negotiating terms with a PBM. The topics are presented as a checklist to assist plan sponsors in identifying and addressing the most common issues related to PBM-plan sponsor contracts. This tool was drafted after conducting a literature review of issues with current PBM-plan sponsor contracts.

Please email info@truth.org for the complete contract negotiating tool.