



State of Delaware
Office of Auditor of Accounts
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Lack of Transparency & Accountability in Drug Pricing Could be Costing Taxpayers Millions



*A Special Report by
State Auditor Kathleen McGuiness*



State of Delaware
Office of Auditor of Accounts
Kathleen K. McGuinness, RPh, CFE
State Auditor



Dear fellow Delawareans,

The rising costs of healthcare are a major concern for many Americans. Co-payments, prescription drug costs, and overall premiums have skyrocketed, leaving many people to put their health concerns on the back burner.

One contributing factor that the public does not see is the role that Pharmacy Benefit Managers, or PBMs, play in setting healthcare costs. PBMs, hired by employers to manage prescription drug plans, are expected to contain drug costs by negotiating rates for prescription drugs with drug makers and pharmacies.

Instead, controversy surrounds the ways PBMs generate revenue. Practices such as claw-backs, gag clauses, rebate pumping and spread pricing have become common in the PBM industry and drive prescription prices to new heights.

As stewards of the funds entrusted to us by Delawareans, elected officials need to be mindful of contracted organizations that value revenue generation as a major organizational priority.

Providing Delawareans healthcare at a reasonable cost should be the goal of our healthcare system. As of July 1, 2021, Delaware will cut ties with PBM provider Express Scripts (ESI) and will contract for PBM services with CVS Caremark. Due to the time involved in examining the contracts and the need for supporting data, this report focuses on the relationship that Delaware had with ESI as the contracted PBM for state employees. My team reviewed the state's contract with ESI, as well as pharmaceutical drug data for fiscal years 2018 to 2020, and surveyed owners of independent pharmacies regarding how PBM practices affect their ability to do business.

Our analysis revealed major concerns regarding transparency, accountability, and contract terms. Altogether, this report contains five observations and five recommendations for improvement. My team and I urge lawmakers to consider our recommendations and review state trends to find the best possible way to handle these questionable PBM practices.

Thank you for the opportunity to serve you.

Sincerely,

Kathy McGuinness, RPh, CFE
State Auditor



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Terminology

Average Wholesale Price (AWP): The published price for prescription drugs based on a nationally recognized list of wholesale drug prices used to determine payments for medications covered by a prescription benefits plan.

Claim: The requested financial amount due for prescription drugs and related health products and services by a plan member or pharmacy.

Direct and Indirect Remuneration (DIR) Fees: A broad term encompassing various charges made by a pharmacy benefit manager to the pharmacy outside administrative fees at the point of sale.

Dispensing Fee: The amount paid to compensate pharmacies for providing pharmaceutical services in addition to reimbursement for a prescription drug.

Formulary: A list of approved prescription drugs a health plan will cover.

Generic Drugs: Prescription drugs that are equivalents or alternatives to brand drugs and share the same active ingredient and provide the same therapeutic effect.

Independent (community) pharmacy: A single pharmacy (store) or sole proprietorship that could consist of more than one store owned by an individual or small group.

Multisource Drugs: Prescription drugs manufactured by more than one company and have both a brand drug and generic drug equivalent.

Pass-Through Pricing Model: Under this pricing model, a pharmacy benefit manager passes through the exact same discounts and dispensing fees charged by a pharmacy to the plan sponsor.

Pharmacy Benefit Manager (PBM): A pharmacy benefit manager is a third-party administrator of prescription drug programs and otherwise known as the “middleman.”

Pharmacy Audit: An examination conducted by a pharmacy benefit manager’s audit team of a limited number of claims for a specified period submitted by a pharmacy.

Rebate: Any discount or price concession from a drug manufacturer for use of a certain prescription drug.

Retail (chain) pharmacy: An organization representing four or more pharmacies.

Single Source Drugs: Prescription drugs manufactured by one company and protected under patent exclusivity.

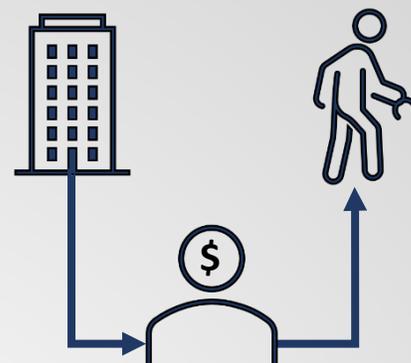
Spread: The difference between what a pharmacy “middleman” (PBM) reimburses a pharmacy and what it charges a health plan for a prescription drug claim.

State Benefits Office (SBO): A division of the Delaware Department of Human Resources with the focus of helping members understand benefits by providing the information, resources, and tools needed when needed, so members can make the most of benefits and healthcare dollars.

Background

What is a PBM?

A pharmacy benefit manager, also known as a PBM, is a third-party administrator hired to manage the prescription drug programs for employer health plans. "PBMs provide programs and services designed to help maximize drug effectiveness and contain drug expenditures by appropriately influencing the behaviors of prescribing physicians, pharmacists, and members."¹ They are considered a "middleman" between the insurance company, pharmacy, and manufacturer of the individual's prescription, and they assist in the negotiation of discounts and rebates, process claims, oversee formularies, and much more. According to PBMs, their mission is based upon the reliance of plan sponsors (employers) to create networking channels that enable pharmaceutical services at the lowest price possible.

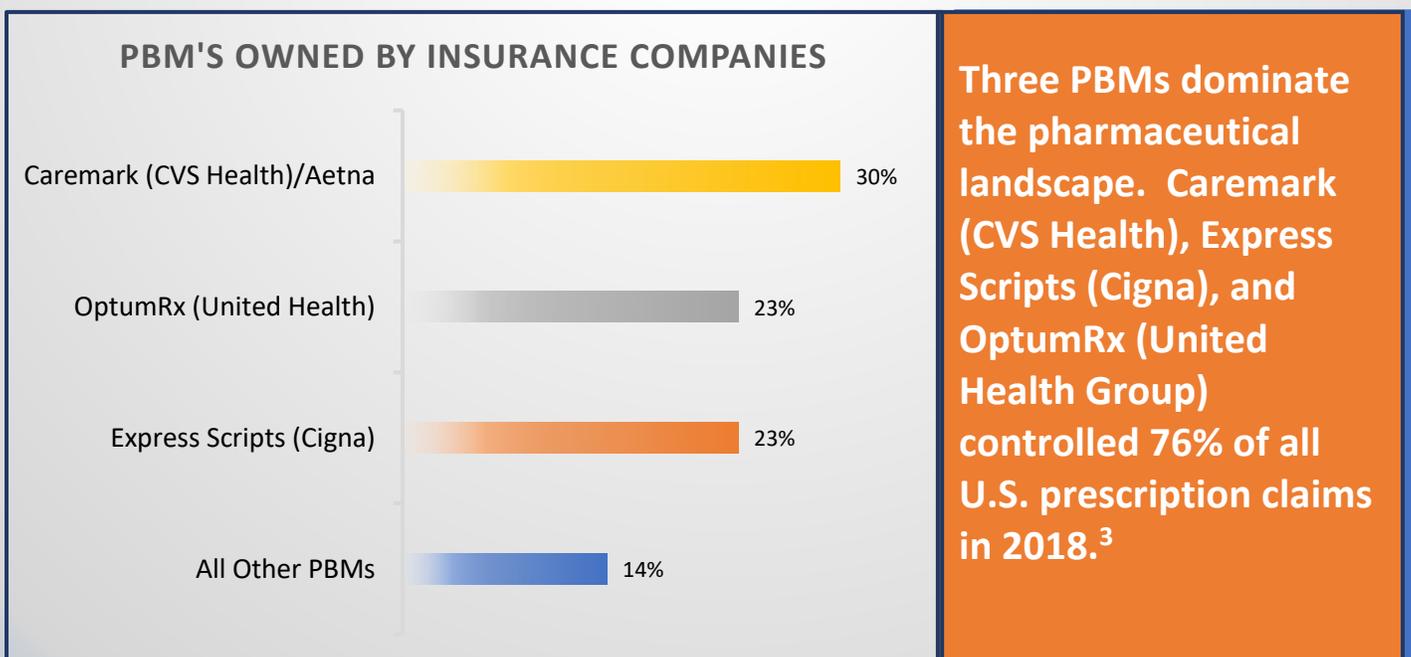


THE PBM SERVES AS THE MIDDLEMAN BETWEEN THE INSURANCE COMPANY, THE PHARMACY AND THE MANUFACTURER OF THE PERSON'S PRESCRIPTION

What is an MCO?

A managed care organization (MCO) is "a health care provider or a group or organization of medical service providers who offers managed care health plans. It is a health organization that contracts with insurers or self-insured employers and finances and delivers health care using a specific provider network and specific services and products."²

Insurance Companies Own PBMs and Contribute Heavily to Their Profits



¹Bihari, M. "What Does a Pharmacy Benefit Manager Do?" Verywell Health. Accessed May 19, 2021. <https://www.verywellhealth.com/pharmacy-benefit-manager-1124201>.

²US Legal, Inc. "Managed Care Organization (MCO) Law and Legal Definition. Accessed May 19, 2021. <https://definitions.uslegal.com/m/managed-care-organization-mco/>.

³Paavola, A. "Top PBMs by Market Share." Becker's Hospital Review, 2019. Accessed May 21, 2021. <https://www.beckershospitalreview.com/pharmacy/top-pbms-by-market-share.html>.

CONTRACT PRICING MODELS

The pricing model between an employer and a PBM is typically contracted in one of three ways: 1) traditional, 2) pass-through or 3) in combination. Each has its own distinct features.

Traditional Pricing Model

A traditional/spread pricing model allows a PBM to charge an employer’s plan an agreed-upon price for medications that may be different than what it reimburses the pharmacy. The medication price may include rebates and discounts to keep drug prices low. The PBM maintains all or most of the difference between what it reimburses the pharmacy and what it charges the plan as profit known as “the spread.”

Pass-through Pricing Model

The most common employer-PBM arrangement is the pass-through pricing model in which the PBM transparently charges insurance plans the same amount for medications that the PBM pays to pharmacies. The PBM then charges the insurance plan higher administrative fees to offset the costs.

ABOUT DELAWARE’S PBM

Express Scripts (ESI) was the vendor hired to manage the pharmacy benefit for the State of Delaware’s (SOD) active and retired employees using the pass-through pricing model from 2018 through 2020. ESI had negotiated to include the traditional spread pricing model. ESI negotiated rebates and discounts with drug manufacturers and had agreed to pass 100 percent of those rebates and discounts to the plan after claims are paid. In return, to help keep drug prices low, the plan agrees to pay ESI administrative fees to manage its prescription benefit.

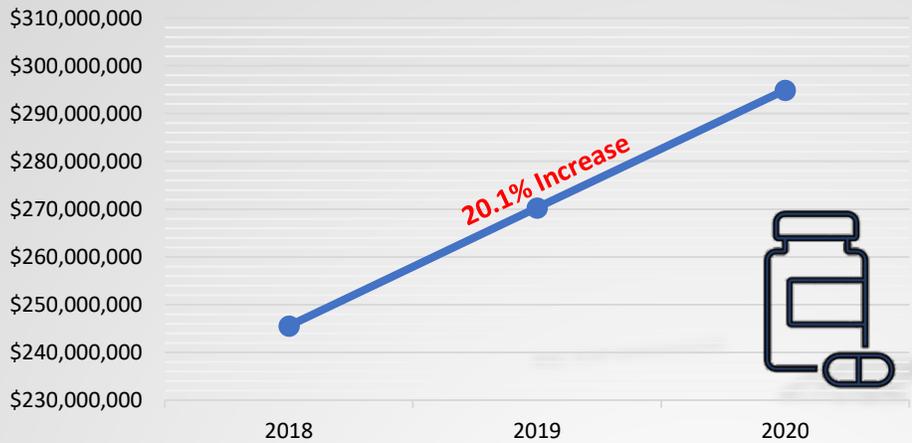
PBM Service Costs Depend Upon the Pricing Model

Traditional/Spread Pricing Model		Transparent Revenue Model	
Admin Fees	\$xx.xx	Flat Fee per Rx	\$xx.xx
Spread	\$xx.xx	<u>Per Member per Month</u>	<u>\$xx.xx</u>
Rebates	\$xx.xx		
Pharmacy Admin Fees	\$xx.xx		
<u>Other Misc Fees</u>	<u>\$xx.xx</u>		
Subtotal	\$8-10/Rx		Subtotal
			\$8-10/Rx

PBMs structure contract fees to ensure profits regardless of which pricing model the plan provider chooses

Questionable PBM Practices

Total Plan Cost for Prescription Medications by Fiscal Year



Increased Spending

We examined data from three fiscal plan years (2018 to 2020) that the state provided to determine how much it spent for prescription drugs. During this three-year period, the state paid more than **\$810 million** in prescription drug claims for all plan members. From 2018 to 2020, the overall spending for prescription medications increased 20.1 percent.

Excessive Inflationary Costs

We calculated the per-claim costs for each of the examined years, and we found that the average prescription cost increased 14.3 percent under ESI's watch. When compared to the national prescription average cost increase from 2018 to 2020, **Delaware's overall drug costs increase was nearly triple that of the overall drug inflation percentage.** We calculated that if the average cost per prescription had matched the inflation rate, Delawareans could have saved \$24.5 million in prescription drug costs.

DELAWARE'S DRUG COSTS INCREASE WAS NEARLY TRIPLE THAT OF THE NATIONAL OVERALL DRUG INFLATION PERCENTAGE. DELAWAREANS COULD HAVE SAVED \$24.5 MILLION IN PRESCRIPTION DRUG COSTS.



NATIONAL AVERAGE DRUG PRICE INFLATION RATES (2018-2020)

Overall Inflation:
4.7%

Brand Inflation:
9.0%

Generic Inflation:
0.3%

Specialty Inflation:
9.4%

Source: <https://confidio.com/drug-price-inflation/>

PBMs Leverage Contracts to Benefit Themselves

How ESI Profited

ESI profited in three main ways under the contract:

- ❖ Administrative and Direct and Indirect Remuneration fees,
- ❖ Spread pricing, and
- ❖ Pharmacy fees.

The OAOA primarily focused on administrative fees and spread pricing in its review to understand how the contract arrangement impacted prescription drug spending by the state and its effects on Delaware pharmacies. Pharmacy fees charged by ESI to its network pharmacies are proprietary. To the extent that we were able to present information on pharmacy fees and their impact on the overall pharmacy market is discussed in a later section.

Administrative Fees

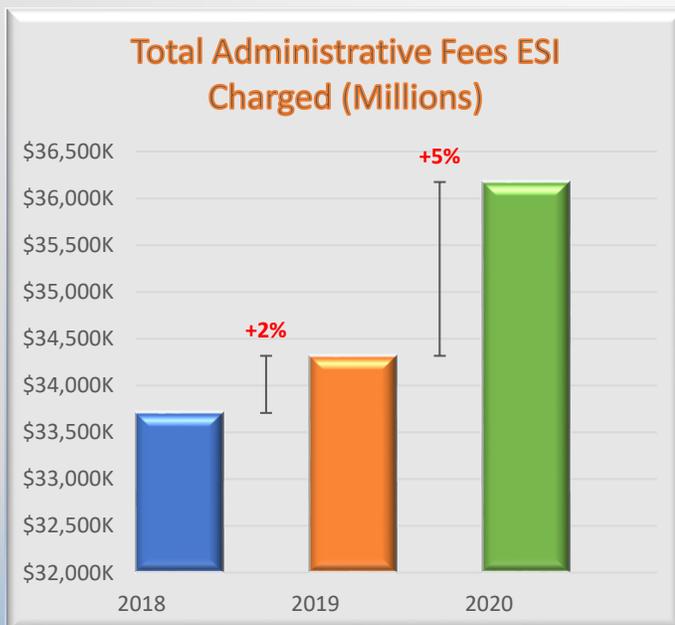
Between FY18 and FY20, ESI charged the plan more than \$104 million in administrative fees, charging an average of \$21.05 in fees per claim. During this period, administrative fees were responsible for almost 13 percent of total claim cost.

Administrative fees increased each year of the contract period. Between FY18 and FY19, fees increased by 1.8 percent, while between FY19 and FY20 they

SUPER-SIZED ADMINISTRATIVE FEES

THE CONTRACT INCLUDES MORE THAN 50 ADMINISTRATIVE SERVICES AND CLINICAL PROGRAM FEES RANGING IN AMOUNTS OF A FEW CENTS TO HUNDREDS OF DOLLARS PER ACTION.

increased by 5.4 percent. During that time, however, that the number of claims generated by active and retired employees remained relatively flat. By all indications, the plan paid \$610K and \$1.8 million more in fees for essentially the same volume of services for fiscal years 2019 and 2020 respectively.

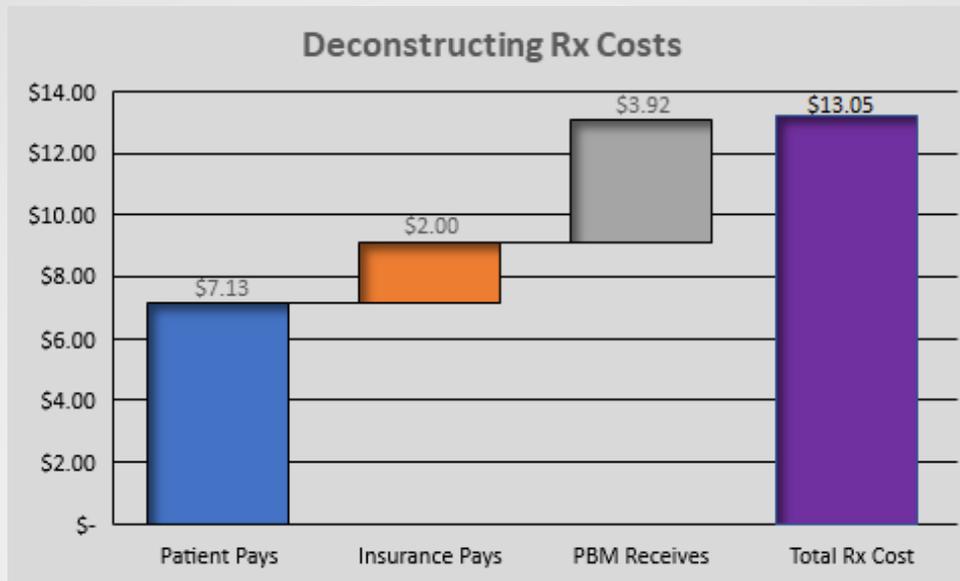


BY ALL INDICATIONS, THE PLAN PAID \$610K AND \$1.8 MILLION MORE IN FEES FOR ESSENTIALLY THE SAME VOLUME OF SERVICES FOR FISCAL YEARS 2019 AND 2020 RESPECTIVELY.

PBMs Pad Their Profit

Spread Pricing

PBMs generally make the most profit from the spread. We found this to be the case with the contract between SBO and ESI. The spread represents the difference between what a PBM reimburses a pharmacy for a prescription drug and what it charges a health plan. The spread price is important because the greater the spread, the greater the costs to the plan and the more the state (and taxpayers) paid.



How it works: A pharmacy submits a claim for a prescription drug costing \$100. The PBM reimburses the pharmacy \$40 and charges the Plan \$100. The difference of \$60 is the spread, or profit to the middleman (PBM).



Local Pharmacies Driven Out of Business

Pharmacy Fees

We listened to the concerns of members of Delaware's pharmaceutical organizations, who contend that PBMs make their own rules with take-it-or-leave-it contracts that benefit large national chains, and unfairly conduct audits on pharmacy claims. We followed up with a survey of Delaware's small independent pharmacies and found that, without exception, the owners of these businesses had experienced cases where PBMs assessed penalties on pharmacies for minor errors that were insignificant to the claim.

Our office evaluated the financial data provided by ESI and contacted plan managers and could not trace back a single plan reimbursement from pharmacy audits conducted by ESI. The lack of data highlights the lack of transparency and suggests that ESI may be keeping the pharmacy audit claim recovery.

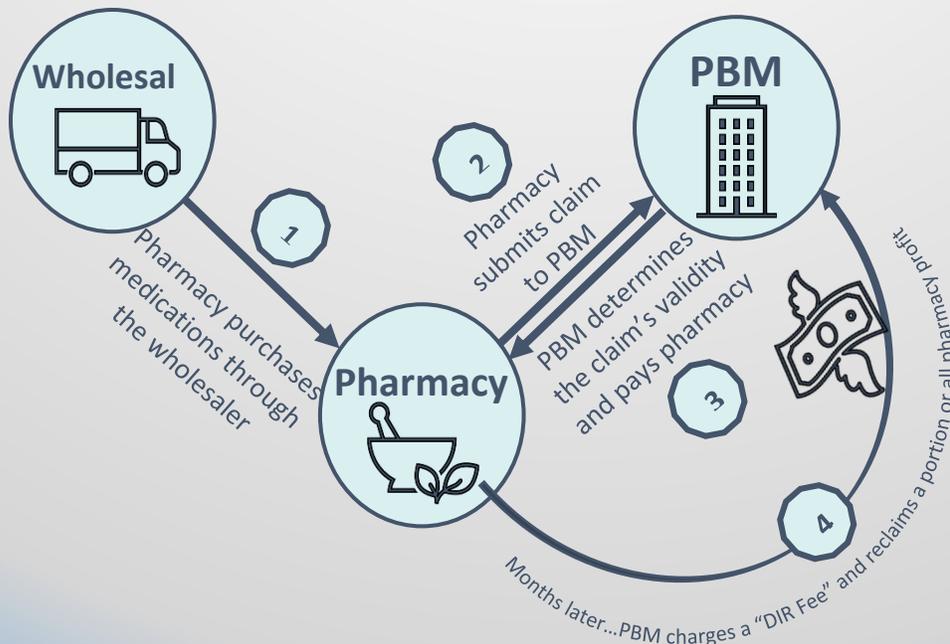
THE PBM WILL CHARGE FEES TO THE PHARMACY THAT CAN DRASTICALLY LOWER THEIR PROFIT AND SOMETIMES WIPE IT OUT ALTOGETHER

According to pharmaceutical organization members, PBMs also make their money by charging direct and indirect remuneration (DIR) fees consisting of various charges made by a PBM to the pharmacy outside administrative fees at the point of sale. Our survey respondents identified these DIR fees as having a "Very High Impact" on the business. To explain how DIR fees work, several months after a drug is dispensed, a PBM will charge fees to the pharmacy that can drastically lower their profit and sometimes wipe it out altogether. These fees are occasionally labeled as performance payments to encourage pharmacies to improve clinical services and enhance patient outcomes, but they also provide another way for PBMs to extract monies from pharmacies and to increase their bottom line. Due to the confidential nature of the financial terms between PBMs and pharmacies, our team was unable to determine how much money ESI made on pharmacy fees.

Pinch on Independent Pharmacies

UNFAIRLY LEVIED PHARMACY FEES HURT INDEPENDENT PHARMACIES MORE DUE TO THEIR SMALL SIZE AND THINNER PROFIT MARGINS

According to pharmaceutical organization members, PBMs also make their money by charging direct and indirect remuneration (DIR)



How PBMs make their money by charging DIR fees



Survey Feedback from Delaware's Small Independent Pharmacies

"The PBMs are trying to get us out of business to fulfill their own pharmacy agenda. It is the most unfair thing [that] ever happened to allow PBMs to have their own pharmacy."

"They are judge, jury and executioner in the retail pharmacy space. Independent pharmacies have no body [that] has any jurisdiction over PBMs to launch complaints."

"PBMs all too often cover a claim, then 8 to 12 months later the PBM charges back the claim for a refill too soon ... the charge back amounts easily can exceed \$500 per claim. ... If the PBM approves a claim at the point of sale, the PBM should not be permitted to charge the claim back to the pharmacy."

"If the tactics that PBMs have been using, coupled with the lack of transparency and uncertainty of fees being given continue, I do not know if I will be in business in the next 3 years. It is unfair that the little guy, the one that actually works hard to care for their patient, has to deal with this."

A New Type of Claw-Back?

Our analysis identified a significant number of noteworthy claims in our sample. These were instances where ESI paid or remitted nothing to the pharmacy yet billed the plan for a claim. We analyzed the data for our sample pharmacy and extracted state employee and retiree claims over a three-year period. From this data, we noted that for 9,255 claims (39 percent), the pharmacy reported receiving no payment from the plan's PBM;

however, the plan was charged costs ranging from \$0.01 to \$840.79. The total amount billed to the plan was \$109,504 from one independent pharmacy in our sample over three years. In other words, for ESI to pay nothing to the pharmacy, it likely determined the employee copayment covered the entire cost of the medication.

1 Delaware Pharmacy

39% of Pharmacy Claims

\$109,504 Billed to DE SBO (3 Yr. Period)

\$0 Paid to Pharmacy by ESI (3 Yr. Period)

100% Profit for ESI PBM

Consider this:



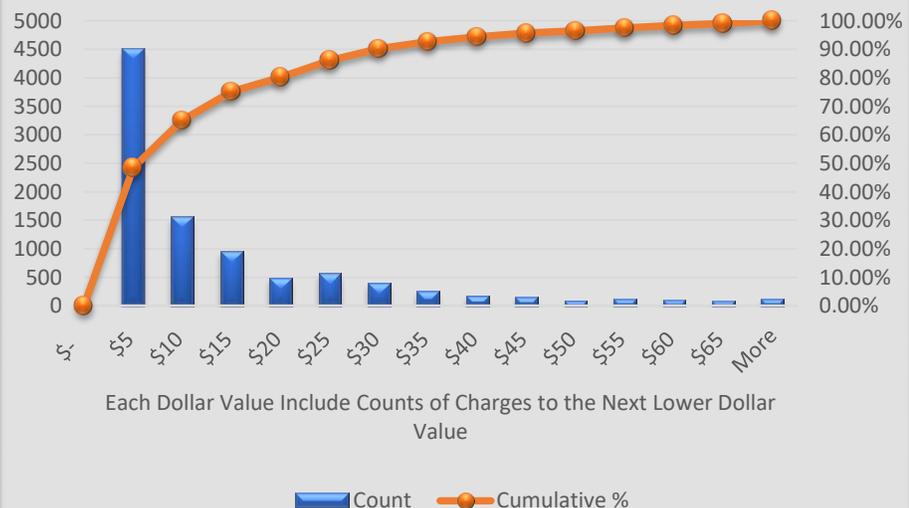
If we assume that this practice occurred across the entire plan and the plan spent more than \$810 million for prescription drugs over three years, then the state could have overpaid a total of \$32 million (more than \$10 million annually) for medications that should have been covered by the copay.

It is not clear why ESI then charged the plan for these medications. These claims represent a 100 percent profit to ESI. Moreover, they account for 4 percent of the Plan's total drug spending in our sample. It is possible for ESI to have billed the plan for claims that the copay may have otherwise covered when the state does not know how much ESI reimbursed the pharmacy.

Zero Remittance

The associated chart shows the number of times the plan was charged without a payment made to the pharmacy. Most of the time, the charges to the plan are \$5 or less. In fact, 90% of the charges were less than \$30. The average charge for all claims is \$11.83 per claim.

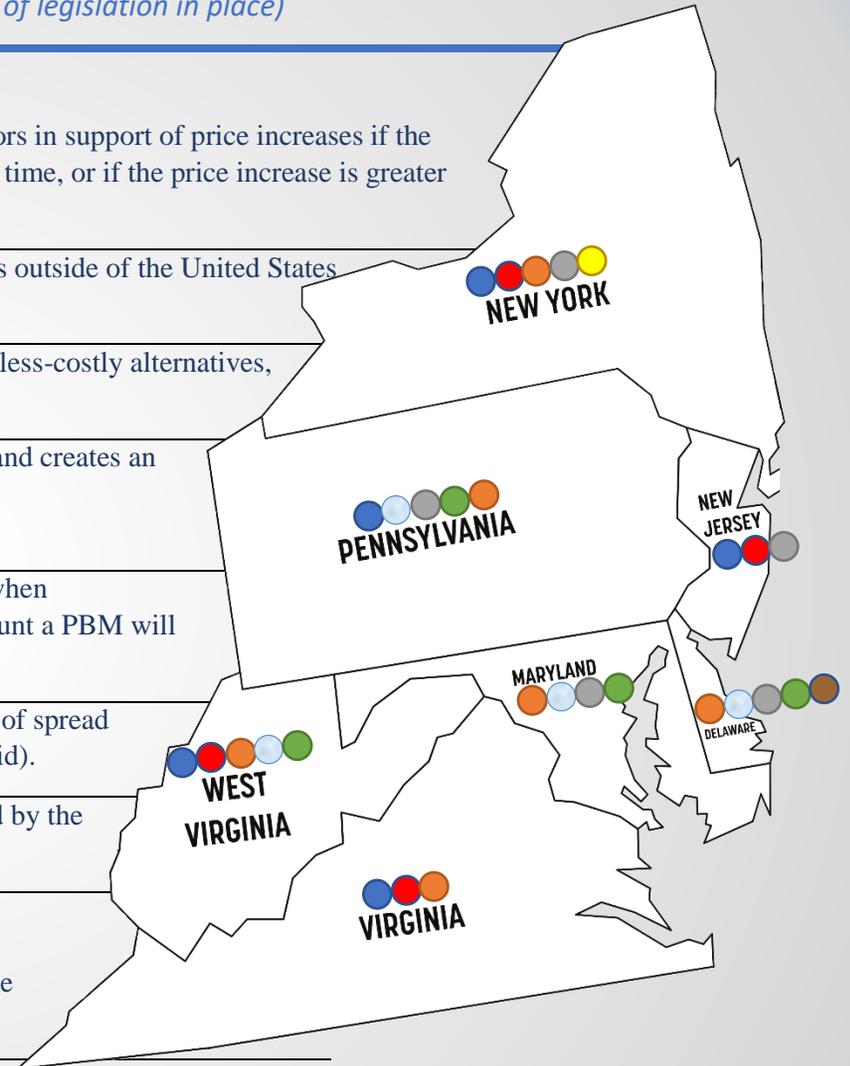
Number of Plan Charges Without Pharmacy Payments



National Trends

*Bordering and Nearby State Legislation Designed to Regulate the PBM Industry^{4,5,6}
(color circles indicate that there is some level of legislation in place)*

	Transparency	Legislation that requires drug companies to report on the factors in support of price increases if the percentage of increase occurs over a relatively short period of time, or if the price increase is greater than a set price point.
	Importation	Legislation that allows the state to purchase prescription drugs outside of the United States in cheaper markets.
	Gag Clause Ban	Legislation that bans preventing pharmacists from discussing less-costly alternatives, including similar drugs.
	PBM/Pharmacy Audit Interactions	Legislation that places restrictions on PBM audit procedures and creates an appeal process for pharmacies in response to audit findings.
	MAC List Requirement	Legislation that requires PBMs to follow certain procedures when developing and using MAC lists. MAC is the maximum amount a PBM will reimburse a pharmacy for the cost of a drug.
	Spread Pricing Ban	Legislation that prevents the PBM from retaining any portion of spread pricing (often only applicable to certain plans such as Medicaid).
	Licensure	Legislation that requires a PBM to register with or be licensed by the state insurance commissioner.
	Clawback Ban	Legislation that bans the practice where the PBM requires a copayment above the prescription price and then charges the pharmacy the difference between the prescription price and the copay amount.



⁴ Antwerp, G., Korba, C., Naaz, B. (2020) "State Drug Pricing Policies." Deloitte Insights. Accessed on May 24, 2021 <https://www2.deloitte.com/us/en/insights/industry/life-sciences/state-drug-pricing-legislation.html>

⁵ pbmwatch.com. (n.d.) "Pharmacy Benefit Manager Legislation." Accessed on May 24, 2021 <http://www.pbmwatch.com/pbm-legislation.html>

⁶ Kaminski, L. (2018). "State Laws Concerning Pharmacy Benefit Managers." Office of Legislative Research, Objective Research for Connecticut's Legislature. Accessed on May 27, 2021 <https://www.cga.ct.gov/2018/rpt/pdf/2018-R-0083.pdf>

OBSERVATIONS



EXCESSIVE PBM COSTS

PBM (ESI) is charged with saving the clients' money at the prescription counter, but Delaware taxpayers are footing the bill for inflationary costs at **3 times** national average

WEAK CONTRACT TERMS

Contract terms allow PBMs to audit and assess penalties on pharmacies for minor errors and keep reclaimed funds concealed from the State plan

PBM LEVERAGE MASKING COSTS TO INCREASE REVENUE

An abundance of various administrative fees creates multiple pathways to mask true costs and ensure PBM profits on the backs of Delaware taxpayers

NO TRANSPARENCY REQUIREMENTS

Lack of transparency allows PBM to operate as an unregulated go-between that charges state taxpayer health plans more than the pharmacy reimbursement

PBM PREDATORY PRACTICES

PBM behaviors have fueled its profits on the backs of community pharmacies, forcing closures and cutting access to healthcare for patients, and losses of jobs in Delaware

RECOMMENDATIONS



1

Transparency

Revise contract to include full audit rights in a clause that enables SBO to review claims paid out to pharmacies, ensuring reclaimed fees are passed through to plan.

2

PBM Masks Costs

Independent pharmaceutical expertise should be included in negotiations to provide the legal team with guidance as to ensure a sensible fee structure within the PBM contract.

3

Excessive PBM Costs

SBO should develop a robust analytics program that reviews prescription drug program data outside of regular periodic audits. This would support oversight and contract reviews, given ESI's questionable business practices.

4

No Transparency

Delaware lawmakers should sponsor stronger laws and regulatory oversight that reform PBM reimbursement, preventing PBMs from reducing claim payments approved at point of sale.

5

Questionable Practices

Legislation should be passed that allows a pharmacy to decline to dispense a prescription drug if the amount reimbursed by a PBM is less than the pharmacy acquisition cost.