



TRICAST White Paper: August 11, 2009

Average Wholesale Price & How the Court Mandated Settlement Impacts Your Pharmacy Program

Earlier this year the US District Court for the District of Massachusetts granted final approval to the amended settlement involving a class action settlement involving drug data publishers First Data Bank and Medispan. The outcome of this settlement impacts pharmacy benefit programs in the immediate short term and long term.

Questions on the Settlement:

- What does the settlement mean to how drugs will be priced in the short term and what is the financial impact to an organization and its pharmacy benefits program?
- How does the pending elimination of AWP impact a current PBM contract and a payor's ability to negotiate an equitable alternative service agreement?
- Are there specific preemptive actions an organization should take to best position its oversight of this industry change?

AWP Pricing Background

Average Wholesale Price (AWP) is the pharmacy industry basis for pharmaceutical reimbursement of drugs dispensed on behalf of third party payors. Pharmacies typically purchase drugs and negotiate payment from PBMs using a different basis known as Wholesale Acquisition Cost (WAC). AWP pricing represents a markup of WAC and is typically 20%. The differential between the WAC and AWP values factor into pricing algorithms that deliver spread pricing margins to drugstores and many Pharmacy Benefit Managers (PBMs).

Almost two years ago, a class action lawsuit was brought against McKesson Corporation, a national drug wholesaler, alleging collusion between McKesson and First Data Bank, a major drug pricing publisher. The activities between the two entities resulted in an increase of the published AWP as a markup of WAC on more than 400 brand drugs from 20% to 25%, starting around 2001. This secretly raised drug prices and generated excess profits for the primary purchasers (pharmacies) since they were acquiring the drugs via WAC pricing which remained consistent, but receiving an additional 5% reimbursement from the third party payors.

AWP Settlement

The AWP class action settlement was approved by the U.S. District Court for the District of Massachusetts on March 30, 2009. The drug pricing publishers involved have agreed to change the AWP on the affected brand drugs back to 20%, essentially rolling back the prices to pre-collusion levels. The date to roll back the fraudulent increase is September 26, 2009.



Outside of the settlement, the publishers have stated they will apply the same 20% mark-up to all other National Drug Codes (NDCs) which currently have a factor greater than 20%. In addition, the publishers will discontinue publishing AWP information within two years of the rollback date.

It should be noted, however, that the National Association of Chain Drugstores (NACD) does not agree with the settlement and it is widely anticipated that they will challenge the finding which has a negative impact on their reimbursement. {Editor's Note: As of the publication date of this White Paper, the NACD has yet to challenge the court's finding.}

Third Party Payor Impact

The impact on payors is two fold:

1. *Retrospective:* Payors are questioning whether they will be getting back the money they have been overcharged.

McKesson will pay \$350 million to settle this lawsuit, \$288 million of which is to be shared by impacted third party payors who reimbursed for the affected drugs between 8/1/01 and 3/15/05. Claims were to have be postmarked to McKesson no later than July 9, 2009. Additional information about the claim requirements and necessary forms can be found at <http://www.mckessonawpsettlement.com/TPPClass.htm>.

2. *Prospective:* With the new AWP roll back on certain NDCs what does the pricing adjustment mean to the bottom line?

Pharmacy reimbursement rates in the contracts between PBMs and their clients are typically negotiated at a discount off of AWP. The AWP rollback of 5% or greater on the impacted pharmaceuticals can potentially result in increased savings to plan sponsors. Within the two years between initiation and resolution of the lawsuit, however, PBMs have been revising their contract language to include provisions for financial adjustments in light of this situation. Unless third party payors were aware of, and responded to these PBMs strategies, those payors with contracts executed prior to the suit are more likely to realize savings from the settlement.

PBMs have created "financial equivalency" language and other protective language that allows them to reduce the discounts they offer to payors via re-negotiated terms. These new terms fall into three basic categories:

- Pricing offers that revert to much lower drug discounts than currently administered.
- Offers that ignore the current pricing roll back, maintain the current drug discounts and continue to utilize the prior pre settlement AWP mark-up of 20% to 25%.
- Introduction of WAC "plus" pricing as a new alternative to "AWP" terminology.



TRICAST Response

With our extensive pharmacy background and focus on the informatics underlying the industry, TRICAST was well equipped to anticipate the AWP pricing changes.

1. As a preemptive measure we have been assessing WAC mark-up instead of AWP as a standard protocol in our pricing algorithms. This has enabled us to create a history of tracking any relative pricing divergence between WAC and AWP.
2. We are currently completing an evaluation of our book of business to determine the relative impact of the AWP adjustments on drug spend. The analysis serves to assess the net percent of drug spend impacted by the settlement and actions by and determine the equivalent AWP.
3. TRICAST is measuring the effect of the above referenced AWP changes to determine the ultimate impact the new pricing has on our clients. Our review encompasses assessment of all affected claims and not a sample. On behalf of our clients we contrast these claims with the list of NDCs impacted by this settlement, evaluate the ingredient cost in the PBM contract by individual NDC, both historically and prospectively, and assess the financial outcome specific to that client.
4. TRICAST is summarizing the type of drugs affected, including their therapeutic and brand generic mix, to provide our clients an understanding of the type of drugs and associated diseases impacted.

TRICAST's PBM Contracting Support

This settlement does hold broader implications for the market that also deserve attention. By following the money flow, it is apparent that the primary beneficiaries of pre-settlement situation were the PBMs (those with spread based pricing) and the pharmacies. As we watch the future, TRICAST will keep a close eye on these entities to see how they contract together and interact financially with each other and assess how it impacts our clients.

While TRICAST's ingredient cost evaluations can determine the immediate impact of these changes to our clients, we also have the tools to protect them from the future implications. Contracting with PBMs in the current marketplace has become increasingly complex. PBMs strive for "economic equivalency" with pre-settlement pricing. Critical issues arise including:

1. Who determines this equivalency in the PBM's contract?
2. Is the ingredient cost paid by the payor the same?
3. Are the contract terms guaranteed or passed thru?

Plan sponsors must be aware of the intent of the PBM to preserve their own financial equality and take action to guard against losing the advantage provided by the settlement outcome. The sophistication and complexity of PBM contracting requires an equally savvy partner to ensure protection of plan sponsors best interests.



TRICAST is capable of ensuring an equitable contract with your PBM. We capture 100% of claims; therefore any proposed PBM pricing offer will be ‘re-adjudicated’ to validate pricing equity between plan sponsors and the PBM.

TRICAST’s Immediate Recommendation to Plan Sponsors

TRICAST recommends a 100% pharmacy claims capture to:

1. Audit current PBM pricing in order to establish benchmarks.
2. AWP rollback analysis to measure any short term savings potential.
3. AWP and WAC measurement including pricing sensitivity analysis, for example, AWP +/- 20%.
4. Review against any PBM pricing proposals.

TRICAST would welcome any inquiries from pharmacy plan sponsors about how we can assist with evaluating the impact of this situation and protecting your best interests in the future.

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About TRICAST, Inc.

TRICAST, Inc., founded in Milwaukee in 1997, uses pharmaceutical and medical claims analysis for benchmarking, audits and risk analysis for health benefit plan sponsors. The company also provides timely reporting on vendor performance, allowing opportunities for decisive responses. The net result is better program oversight, lowered plan costs and risk exposure.

TRICAST delivers data-driven cost control solutions every day. As a leading next-generation health information business, TRICAST offers programs, products and applications for the healthcare industry that assist risk entities controlling overall healthcare costs, with a specific focus on pharmaceutical benefits. Please visit www.tricast.com to learn more.

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