

**Written Testimony for the ERISA Advisory Council Hearing on PBM
Compensation and Fee Disclosure.**

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EXECUTIVE SUMMARY

The Department of Labor (“DOL”) is considering a transparency rule under ERISA that would require pharmacy benefit managers (“PBMs”) to provide detailed disclosure of their proprietary cost structures, including pharmacy discounts and drug manufacturer rebates. This testimony will explain that regulations requiring PBMs to disclose competitively-sensitive financial information will foster tacit collusion and reduce PBMs’ ability to negotiate discounts with pharmacies and rebates with drug manufacturers. As a result, drug prices will rise for consumers and employer health plans.

After providing a brief background of the PBM business model and PBM pricing arrangements, this testimony explains why mandatory disclosure regulations are not needed to ensure that employer health plan sponsors pay a competitive price for PBM services. Employer health plan sponsors are sophisticated, repeat-purchasers of PBM services that can simply compare the services offered and the price of services among different PBMs. Moreover, existing contracts require PBMs to pass through to plan sponsors a significant portion of the rebates and discounts they negotiate, and empirical evidence indicates that PBMs do pass on the majority of their negotiated savings. Finally, health plans are already able to negotiate contract terms that include disclosure and audit rights when they want them and are willing to bear the additional resulting administrative costs. The ability of plan sponsors to negotiate tailored disclosure and audit rights renders mandatory disclosure regulations superfluous.

This testimony will then discuss the various costs that mandatory disclosure regulations will impose on PBMs. The additional disclosure directly increases costs for PBMs as they collect, prepare, and present the new information. Mandatory disclosure also enables pharmacies and pharmaceutical manufacturers to obtain PBMs’ competitively-sensitive cost information, reducing PBMs’ ability to negotiate discounts with pharmacies and rebates with drug manufacturers. Mandatory disclosures will weaken competition in the PBM industry, compelling both consumers and employer health plan sponsors to pay more for prescription drugs and prescription drug coverage.

Next, this testimony will present the conclusions of the Federal Trade Commission (“FTC”) on the likely impacts of mandatory disclosure regulations in the PBM industry. The FTC has repeatedly determined that these regulations are unnecessary for ensuring that health

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plan sponsors pay a competitive price for PBM services; health plan sponsors already negotiate with PBMs to offer their desired disclosure terms in private contracts. Moreover, the FTC has concluded that mandatory disclosure will reduce competition in the market for PBM services, increase the prices that health plan sponsors and consumers pay for prescription drugs, and decrease access to important drugs for many Americans.

Finally, this testimony explains how the PBM disclosure rule under consideration by the DOL would likely differ significantly from the PBM disclosure required under the Affordable Care Act. The Affordable Care Act requires PBM disclosure of only aggregate information and contains strong confidentiality protections. In contrast a rule adopted by the DOL could require disclosure of detailed cost information and will likely not contain meaningful confidentiality safeguards to protect against anti-competitive harms. As a result, the DOL disclosure rule will impose greater costs and threaten competition more than disclosure requirements under the Affordable Care Act.

1. BACKGROUND ON PBMS

PBMs act as the intermediaries among consumers with prescription drug coverage, pharmacies, drug manufacturers, and third party payers. They influence what consumers pay for drugs, which pharmacies they use, and even which drugs they take. PBMs reduce consumer drug prices through multiple avenues, including specialization, economies of scale, and the leverage large purchasers can bring to bear for consumers in the market.² By specializing in pharmaceutical benefits, PBMs quickly acquire critical knowledge helpful to patients.³ For example, PBMs' computer systems track availability of generics, patient eligibility for prescription refills, physician prescribing patterns, and chronically ill individuals' treatment information.⁴ Similarly, PBMs deploy economies of scale for patient convenience. For example, PBMs assemble networks of retail pharmacies where consumers may readily fill prescriptions for a pre-arranged copayment.⁵ PBMs achieve economies of scale through ownership or use of mail-order pharmacies as well, allowing nationwide filling of prescriptions to covered patients at lower prices.⁶ PBMs also offer significant savings through streamlined procedures for processing and paying prescription drug benefits, sparing both beneficiaries and

² See Thomas Gryta, *What is a 'Pharmacy Benefit Manager?*, WALL ST. J. (Jul. 21, 2011), available at <http://online.wsj.com/article/SB10001424053111903554904576460322664055328.html>; FED. TRADE COMM'N, PHARMACY BENEFIT MANAGERS: OWNERSHIP OF MAIL-ORDER PHARMACIES 36, (2005), available at <http://www.ftc.gov/reports/harmbenefit05/050906pharmbenefitrpt.pdf>; U.S. GEN. ACCOUNTING OFFICE, EFFECTS OF USING PHARMACY BENEFIT MANAGERS ON HEALTH PLANS, ENROLLEES, AND PHARMACIES 10-11 (2003) [hereinafter GAO REPORT], available at <http://www.gao.gov/cgi-bin/getrpt?GAO-03-196>.

³ FED. TRADE COMM'N, *supra* note 2, at 1-2.

⁴ *Id.*

⁵ Gryta, *supra* note 2.

⁶ FED. TRADE COMM'N, *supra* note 2, at iv-v; GAO REPORT, *supra* note 2.

employers the trouble of negotiating an often complicated process.⁷ As of 2011, the top three PBMs each managed approximately 20 percent of almost four billion prescriptions dispensed in the U.S. annually; in 2012 two of these—Express Scripts and Medco—merged. These largest firms save businesses and health plans untold hours processing billions of claims.⁸

But one of these cost-saving functions—the power to negotiate with pharmacists and drug manufacturers for better prices—has inspired industry attempts (particularly by the retail pharmacy industry) to regulate PBMs. PBMs negotiate on health plans' and consumers' behalves with pharmacists and drug manufacturers for discounts on prescription drugs.⁹ PBMs first use their vast patient networks to negotiate for better prices with drug manufacturers.¹⁰ PBMs, along with health plan sponsors, compile a list of drugs—a formulary—for different medical conditions for which the plan will provide preferred or exclusive coverage.¹¹ PBMs negotiate directly with drug manufacturers for rebates on both brand-name and generic prescriptions in exchange for inclusion on a plan's formulary.¹² Competition among drug manufacturers encourages greater rebates as manufacturers compete for remunerative formulary positions, reducing PBMs' and consumers' drug costs.¹³

PBMs also achieve discounts on prices at the retail pharmaceutical level. PBMs negotiate drug prices that consumers jointly pay to retail pharmacies, which the employer, insurer, and consumer ultimately share by the terms of the patient's benefits plan.¹⁴ PBMs assemble networks of these pharmacies, offering covered individuals significant financial incentives, such as lower copayments, for filling prescriptions at network pharmacies.¹⁵ Inclusion in a network generally leads to significant revenues for the pharmacies, generating intense pharmacy competition to be included in a PBM's network.¹⁶ PBMs use this competition to negotiate substantial discounts with pharmacies, passing these savings on to consumers through lower health plan costs and reduced drug prices.¹⁷

Empirical data demonstrates that PBMs effectively reduce drug costs.¹⁸ As mentioned above, PBMs reduce end consumer drug prices by negotiating rebates from drug manufacturers

⁷ Joanna Shepherd, *The Fox Guarding the Henhouse: The Regulation of Pharmacy Benefit Managers by a Market Adversary*, 9 NW. J. L. & SOC. POL'Y. 1, 5 (2013), available at <http://scholarlycommons.law.northwestern.edu/njls/vol9/iss1/1/>; see also Gryta, *supra* note 2.

⁸ Gryta, *supra* note 2.

⁹ Shepherd, *supra* note 7, at 4-5.

¹⁰ FED. TRADE COMM'N, *supra* note 2, at 1.

¹¹ Shepherd, *supra* note 7, at 4-5.

¹² *Id.* at 5.

¹³ *Id.*; FED. TRADE COMM'N, *supra* note 2, at 6-7.

¹⁴ Shepherd, *supra* note 7, at 4.

¹⁵ See FED. TRADE COMM'N, *supra* note 2, at 1.

¹⁶ FED. TRADE COMM'N, STATEMENT OF THE FEDERAL TRADE COMMISSION CONCERNING THE PROPOSED ACQUISITION OF MEDCO HEALTH SOLUTIONS BY EXPRESS SCRIPTS, INC., 2-5 (2012), available at <http://www.ftc.gov/speeches/rosch/120402expressmedcostatement.pdf>.

¹⁷ *Id.* at 2; see also Shepherd, *supra* note 7, at 6-7.

¹⁸ GAO REPORT, *supra* note 2, at 11-12.

and discounts from retail pharmacies. One 2012 annual survey of health plans estimated that PBMs negotiated an average rebate of \$16.70 from drug manufacturers per brand name prescription and an average \$6.13 rebate per generic prescription.¹⁹ The U.S. General Accounting Office (“GAO”) found that PBMs negotiated with pharmacies for an 18 percent discount on brand-name drugs relative to the prices that non-covered consumers paid for the same drug at the same retail pharmacies; this discount rose to 47 percent for generics.²⁰ These rebates from manufacturers and discounts from pharmacies translate into significant aggregate cost savings for consumers. The FTC has found that, compared to customers without prescription-drug insurance, customers with PBM-administered prescription drug coverage pay 15 percent less for brand-name drugs without generic alternatives, 25 percent less for brand-name drugs with generic alternatives, and 50 percent less for generic drugs.²¹

2. BACKGROUND ON PBM CONTRACTING

Modern PBMs offer a wide range of options to satisfy the varying priorities of employer health plan sponsors. The industry has evolved to offer many different kinds of pricing and revenue-sharing arrangements. In order to remain competitive, most PBMs also provide the transparency and disclosure requested by plan sponsors. This section will discuss some of the basic options available to plan sponsors in their PBM contracts.

PBMs and sponsors agree on a specific pricing arrangement that best suits their needs. Although the possible combinations of pricing strategies are essentially endless, most options are a variation of either “spread pricing” or “pass-through pricing”.²² Under a spread-pricing arrangement, PBMs earn revenue by keeping some portion of the “spread”, or the difference between the payment the PBM negotiates for a drug (after pharmacy discounts and pharmaceutical manufacturer rebates) and the amount the sponsor reimburses for that drug. For example, a sponsor and PBM will contractually agree on a guaranteed price the sponsor will reimburse for a specific drug. The PBM will then negotiate payment to a pharmacy for a different price when the drug is dispensed. When the price difference is positive, the PBM earns revenue; when it is negative, the PBM absorbs the loss. In this way, the PBM bears the risk of fluctuating retail prices: PBMs lose money when the guaranteed price reimbursed by the sponsor under the contract is less than the negotiated payments to the pharmacy and pharmaceutical manufacturer. However, spread-pricing arrangements also give PBMs the incentive to negotiate aggressively with pharmacies and drug companies; the lower the rate they negotiate, the more

¹⁹ PHARMACY BENEFIT MANAGEMENT INSTITUTE, 2012-2013 PRESCRIPTION DRUG BENEFIT COST AND PLAN REPORT, 29 (2012), *available at* <http://benefitdesignreport.com>.

²⁰ GAO REPORT, *supra* note 2, at 9.

²¹ FED. TRADE COMM’N, *supra* note 2, at 36.

²² URAC, PBM Purchaser’s Guide: A Quality Management Toolkit 22-25 (2009), *available at*: <http://www.dol.gov/ebsa/pdf/PBM010711.pdf>.

the PBMs earn.²³ And the lower the price the PBM negotiates, the less consumers and plan sponsors ultimately pay for prescription drugs.

Pass-through pricing is generally thought of as the opposite of spread pricing.²⁴ Under pass-through pricing arrangements, PBMs pass the revenues or losses directly to the plan sponsor. Any discounts, rebates, or other savings that PBMs negotiate with manufacturers or pharmacies are passed on to the plan sponsor who then pays the PBM an administrative fee on a per-member or per-claim basis. Pass-through pricing allows sponsors to examine all relevant costs and savings, creating additional audit and administrative costs. In contrast to spread pricing, pass-through pricing forces sponsors, rather than PBMs, to bear the risk of fluctuating prices. Moreover, pass-through arrangements generally don't generate the lowest prescription benefit costs because PBMs have less incentive to negotiate aggressively with pharmacies and manufacturers and to steer plan members to generic drugs or lower-cost brand drugs.

Thus, spread pricing and pass-through pricing produce different incentives and risks.²⁵ Under spread pricing, PBMs bear the risk of fluctuating or unexpected prices, but they also receive the benefit of fortunate price changes or favorable negotiations. As a result, spread pricing gives PBMs the incentive to negotiate aggressively and often produces the lowest drug costs for sponsors and consumers. Under pass-through pricing, sponsors receive the benefit of positive price changes or negotiations, but they also bear the risk of negative ones. Pass-through arrangements provide less incentive for PBMs to negotiate aggressively, and as a result, are more likely to result in higher drug prices for sponsors and consumers.

A recent J. P. Morgan survey of human resources executives at 50 large employers across the United States illustrates current pricing arrangements in PBM contracts.²⁶ Across all respondents, PBMs retain approximately 10 percent of manufacturer rebates; thus passing 90 percent of rebates to the plan sponsors. This 10 percent retention represents a significant decline from the 18 percent of rebates PBMs retained in 2013, 19 percent in 2012, 16 percent in 2011 and 17 percent in 2010. Moreover, 66 percent of respondents reported that they do not allow their PBM to share *any* of the manufacturer rebates (compared to 46 percent in 2013 and 41 percent in 2012). Among the respondents that do share rebates with their PBM, PBMs retain 31 percent of the rebates on average (compared to 34 percent in 2013, 33 percent in 2012, 29 percent in 2011, and 36 percent in 2010). The survey also indicates that 88 percent of respondents are satisfied with the level of savings they realize from generic drugs and that 90 percent feel that the economic incentives for PBMs to promote generics are fair.

²³ *Id.* at 23.

²⁴ *Id.* at 24.

²⁵ *Id.* at 25.

²⁶ J. P. Morgan, "Pharmacy Benefit Management, Takeaways from Our Proprietary PBM Survey" May 21, 2014 (copy in author's file).

PBM contracts also provide for varying levels of disclosure and transparency. In order to remain competitive, PBMs typically offer the amount of transparency demanded by the market and prospective sponsor partners.²⁷ Different arrangements call for different degrees of disclosure. Under spread-pricing arrangements, sponsors typically require enough disclosure or transparency so they can confirm how their PBM earns revenue. Under pass-through pricing, sponsors require disclosure to ensure they are receiving the discounts and savings to which they're entitled under the contract. Individual sponsors negotiate for the level of disclosure they value, bearing in mind that disclosure can increase costs for PBMs that are then passed through to sponsors and plan members. Negotiated disclosure provisions also typically include binding confidentiality rules that prevent plan sponsors from disclosing sensitive information to third parties. The next section explains why, given the transparency plan sponsors already negotiate in existing PBM contracts, mandatory disclosure regulations are unnecessary.

3. MANDATORY DISCLOSURE REGULATIONS ARE UNNECESSARY

There is no theoretical or empirical reason to believe mandatory disclosure regulations are essential to ensure that employer health plan sponsors pay a competitive price for PBM services. Evidence suggests that PBMs pass through the vast bulk of the manufacturer rebates to sponsors, and sponsors are already able to negotiate pass-through rates and disclosure terms in existing contracts. Allowing competition among PBMs is more likely to yield efficient rebate pass-through and disclosure than are mandatory disclosure regulations. In this section, I discuss the arguments and evidence suggesting that disclosure regulations are unnecessary.

First, when health plan sponsors contract with PBMs, they know the price of the services they are obtaining, and can compare prices among competing PBMs. Mandatory disclosure regulations are premised on the belief that health plan sponsors also need to know the PBM's costs, which are affected by the rebates PBMs are able to negotiate with manufacturers, to ensure plan sponsors are getting a "good deal".²⁸ Thus, disclosure requirements are analogous to requirements that firms reveal aspects of their cost structures to consumers purchasing their finished products.²⁹ However, in most markets, consumers don't know anything about underlying costs and there are no regulations premised on the idea that they should; purchasers of consumer goods know nothing about underlying raw material costs and purchasers of services know nothing about the sellers' opportunity costs which inform their hourly rates. Similarly, consumers of PBM services do not need to know anything about PBMs' costs to ensure they are

²⁷ *Id.* at 21.

²⁸ Federal Trade Commission, Letter to Assembly Member Greg Aghazarian, California State Assembly, 9 (September 7, 2004), available at <http://www.ftc.gov/be/V040027.pdf> [hereinafter Letter to Assembly Member Greg Aghazarian].

²⁹ Federal Trade Commission, Letter to Senator Nellie Pou, New Jersey General Assembly, 12 (April 17, 2007), available at <http://www.ftc.gov/be/V060019.pdf> [hereinafter Letter to Senator Nellie Pou].

paying a competitive price. When health plan sponsors contract with PBMs, they know the price of the services they are obtaining, and can simply compare prices among competing PBMs.

Second, empirical evidence indicates that the potential problems that mandatory disclosure regulations attempt to address are not prevalent. Both the FTC and GAO have conducted extensive analyses of the PBM industry and found that PBMs reduce health plan prescription benefit costs by agreeing to pass through to plans a significant portion of the payments they receive from drug manufacturers.³⁰ The FTC has found that, although the pass-through of manufacturer rebates varies among PBMs, PBMs typically pass on more than 50 percent of manufacturer rebates to health plan sponsor clients.³¹ More recent information indicates that PBMs pass through to plan sponsors almost 90 percent of manufacturer rebates.³² Consequently, the GAO found that PBMs' sharing of manufacturer payments reduce total annual drug spending by as much as 9 percent.³³

Indeed, most contracts between PBMs and plan sponsors require that PBMs share with the plan sponsor a very large fraction of the rebates and discounts they negotiate with manufacturers.³⁴ Moreover, as competition for sponsor contracts has intensified, evidence suggests that the contractually-agreed amount of manufacturer rebates that PBMs pass through to health plan sponsors has increased.³⁵ As a result, a recent survey of health plan sponsors indicates the vast majority of sponsors are happy with the amount of rebate and discount sharing in their PBM contracts.³⁶

Finally, reviews of contracts between health plan sponsors and PBMs show that mandatory disclosure regulations are unnecessary. Health plans are already able to negotiate contract terms that include disclosure and audit rights when they want them and are willing to bear the resulting additional administrative costs.³⁷ Indeed, many contracts provide for full disclosure to client health plans, even without mandatory disclosure regulations.³⁸ Vigorous competition for health

³⁰ FED. TRADE COMM'N, *supra* note 2, at 57-60.

³¹ FED. TRADE COMM'N, *supra* note 2, at 59.

³² PHARMACY BENEFIT MANAGEMENT INSTITUTE, 2012-2013 PRESCRIPTION DRUG BENEFIT COST AND PLAN DESIGN REPORT (2013), available at <http://benefitdesignreport.com/>. See also Adam J. Fein, *A Peek at Manufacturers' Rebates*, DRUG CHANNELS (Jan. 24, 2013), <http://www.drugchannels.net/2013/01/a-peek-at-manufacturers-pbm-rebates.html#more>.

³³ GAO Report, *supra* note 2, at 11-12.

³⁴ FED. TRADE COMM'N, *supra* note 2, at 57-58.

³⁵ FED. TRADE COMM'N, *supra* note 2, at 57-58.

³⁶ Pharmacy Benefit Management Institute, *Plan Sponsors' Satisfaction with PBMs Remains Relatively Unchanged* (2014), available at: <http://www.pbmi.com/news-releases.asp>.

³⁷ FED. TRADE COMM'N, *supra* note 2, at 58.

³⁸ See, e.g., Milt Freudenheim, *Employers Unite in an Effort to Curb Prescription Drug Costs*, N.Y. Times (Feb. 3, 2005), <http://query.nytimes.com/gst/fullpage.html?res=9C00E5D9133BF930A35751C0A9639C8B63&sec=health&spon=&pagewanted=1>; Milt Freudenheim, *Big Employers Join Forces in Effort to Negotiate Lower Drug Prices*, N.Y. TIMES (June 12, 2004), <http://www.nytimes.com/2004/06/12/business/big-employers-join-forces-in-effort-to-negotiate-lower-drug-prices.html?pagewanted=all&src=pm>.

plan contracts encourages the PBMs to disclose cost and rebate information when their clients want that information. Just as competitive forces induce PBMs to offer their best price and service combinations to prospective clients, competition also encourages PBMs to offer the desired disclosure terms in private contracts.

A. FTC Opinions on the Need for Mandatory Disclosure

The FTC has continually maintained that mandatory disclosure regulations are not necessary to ensure that health plan sponsors pay a competitive price for PBM services.

The FTC has repeatedly explained that plan sponsors do not need to know PBMs' underlying cost structures to ensure they are getting a good deal. For example, addressing the competitive effects of proposed California legislation to require PBMs to disclose revenue information to plan sponsors, the FTC stated that:

*One of the primary goals of AB 1960 is to provide purchasers of PBM services with detailed information about the cost structure of the PBMs with whom they do business. In the overwhelming majority of markets, however, consumers have limited or no information about the cost structure of those with whom they do business. More importantly, in general, consumers do not need such information to make efficient purchasing decisions. Instead, consumers make purchasing decisions based on the price and value of goods and services, without regard to a vendor's costs of production. AB 1960 thus holds PBMs to a standard that does not apply to other industries.*³⁹

The FTC has also maintained that the potential problems that mandatory disclosure regulations attempt to address are not prevalent. Discussing the likely effects of the mandatory disclosure requirements in proposed New Jersey legislation, the FTC indicated that “*there is no theoretical or empirical reason to assume that consumers require sellers' underlying cost information for markets to achieve competitive outcomes.*”⁴⁰

The FTC has also explained that health plan sponsors are sophisticated, repeat-purchasers of PBM services that often use a bidding process to choose a PBM, and there is no reason to think they are unable to get a good deal on their own. Discussing the implications of mandatory disclosure in a New York bill, the FTC stated that:

Although sometimes mandatory disclosures of price and quality information can improve how markets function - and the Commission enforces several rules that require sellers to disclose this type of information - health plans do not need them. Although a few lawsuits have challenged particular types of PBM conduct, empirical evidence suggests that the conflicts of interest that the Bill attempts to address are not prevalent.

³⁹ Letter to Assembly Member Greg Aghazarian, *supra* note 28, at 8.

⁴⁰ Letter to Senator Nellie Pou, *supra* note 29, at 12.

In addition, the Commission's analysis of PBM health plan contracts in its PBM STUDY shows that health plans already are able to negotiate contract terms - including diverse disclosure and audit rights - that protect them from conflicts of interest. Press reports too suggest that many contracts provide for full disclosure to client health plans.⁴¹

Finally, the FTC has repeatedly noted that competition for health plan contracts encourages optimal disclosure. Discussing proposed mandatory disclosure legislation in California, the FTC concluded that:

[V]igorous competition in the marketplace for PBMs is more likely to arrive at an economically efficient level of transparency than regulation of those terms. Just as competitive forces encourage PBMs to offer their best price and service combinations to health plan sponsors in order to gain access to subscribers, competition also encourages disclosure of the information group health plan sponsors require to decide which PBM to contract with, including but not limited to the magnitude of any rebates the PBMs might receive, the circumstances under which those rebates will be paid, and how those rebates will be shared between PBMs and group health plan sponsors.⁴²

4. THE COSTS OF MANDATORY DISCLOSURE REGULATIONS

Not only are mandatory disclosure regulations unnecessary to achieve competitive outcomes, the regulations also impose significant costs on PBMs. In this section, I discuss how mandatory disclosure regulations increase costs for PBMs and weaken competition in the PBM industry. In turn, mandatory disclosures will cause the cost of prescription drugs and drug coverage for consumers and employer health plan sponsors to increase.

First, regulations requiring additional disclosure directly increase costs for PBMs as they collect, prepare, and present the required information. Typical disclosure costs include the costs of gathering, processing, auditing (if the information is audited), and disseminating the information.⁴³ Although the extent of additional disclosure will vary depending on the specific regulation, the out-of-pocket costs of additional disclosure can be substantial. PBMs will initially pay these additional costs out-of-pocket; however, the costs will eventually be passed on to health plans and consumers in the form of higher prices.

Mandatory disclosure regulations will also weaken PBMs' competitive positions. Regulations requiring financial disclosure will likely enable pharmacies and pharmaceutical manufacturers to obtain PBMs' competitively-sensitive cost information. This will reduce

⁴¹ Federal Trade Commission, Letter to Senator James L. Seward, New York Senate, 6 (March 31, 2009), available at <http://www.ftc.gov/os/2009/04/V090006newyorkpbm.pdf> [hereinafter Letter to Senator James Seward].

⁴² Letter to Assembly Member Greg Aghazarian, *supra* note 28, at 10.

⁴³ Robert K. Elliot & Peter D. Jacobson, *Costs and Benefits of Business Information Disclosure*, 8 ACCT. HORIZONS 80, 84 (1994).

PBMs' ability to negotiate discounts with pharmacies and rebates with drug manufacturers, thus increasing the drug prices for consumers. As a result, prescription drug spending will increase.

Pharmacies typically compete with one another by offering deeper discounts or lower dispensing fees in order to be included in a PBM's limited network or to become a preferred provider. However, pharmacies are less likely to offer the same price terms to PBMs when they know their rival pharmacies can learn the specifics of the arrangement.⁴⁴ When rivals can see the arrangement and offer the same or better terms, it blunts the incentive to offer PBMs favorable terms in the first place.⁴⁵ Hence, the disclosure of sensitive financial information will undercut the most efficient pharmacy network contracts, leading to higher prescription drug prices.

Similarly, if pharmaceutical manufacturers discover the precise details of rebate arrangements or price discounts offered by their competitors, then tacit collusion among them becomes possible.⁴⁶ Absent such knowledge, manufacturers have powerful incentives to bid aggressively in order to have their drugs listed on the health plan's list of preferred drugs; formulary status offers the prospect of significant sales. When manufacturers do not know what rebates or price discounts their competitors are offering, they have the incentive to bid aggressively to try to outbid the "unknown" deals. However, when the arrangements become known, this incentive to outbid unknown price terms disappears. As a result, disclosure of sensitive business information will raise the price that consumers pay for pharmaceutical coverage by reducing competition among pharmaceutical manufacturers for preferred formulary treatment.

A basic tenet in the economics and industrial organization literature is that sharing information about cost, transaction prices, and other competitively-sensitive information among rivals makes tacit collusion more likely.⁴⁷ Similarly, numerous empirical studies have also established that the disclosure of competitively-sensitive information is associated with higher

⁴⁴ Federal Trade Commission, Letter to Representative Mark Formby, Mississippi House of Representatives, 7 (Mar. 22, 2011), available at http://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-letter-honorable-mark-formby-mississippi-house-representatives-concerning-mississippi/110322mississippipbm.pdf. [hereinafter Letter to Representative Mark Formby].

⁴⁵ *Id.*

⁴⁶ See, e.g., Svend Albaek et al., *Government Assisted Oligopoly Coordination? A Concrete Case*, 45 J. INDUS. ECON. 429 (1997).

⁴⁷ See Kai-Uwe Kuhn, *Fighting Collusion: Regulation of Communication Between Firms*, 16 ECON. POL'Y. 169, 170 (2001) ("The notion that communication is central to collusion is without doubt part of the general folklore of competition policy at least going back to Adam Smith."); Albaek et al., *supra* note 46, at 430 ("At least since Stigler's seminal article, [industrial organization] literature has stressed the importance for (tacitly) colluding oligopolists of observing firm-specific transactions prices of their rivals and rapidly detecting changes in these. Otherwise, collusion is prone to break down.").

prices.⁴⁸ As firms learn of their rivals' cost structures, their willingness to bid aggressively disappears.

Hence, regulations requiring PBMs' disclosure of sensitive business information will reduce competition in the market for prescription drugs. Pharmacies and manufacturers will no longer compete as intensely for PBM contracts when financial arrangements are no longer private. Moreover, PBMs will no longer be able to effectively compete for contracts with employer health plan sponsors by offering exclusive prices that they were able to negotiate with pharmacies and drug manufacturers. This will ultimately lead to higher prices for PBM services and pharmaceuticals.

For this reason, many plan sponsors indicate that they are satisfied with their existing PBM relationships⁴⁹ and don't want mandatory disclosure. For example, at the 2010 Hearing on Reasonable Contracts or Arrangements for Welfare Benefit Plans Under Section 408(b)(2), the U.S. Chamber of Commerce (representing 3 million businesses) and the American Benefits Council (representing Fortune 500 companies) both argued against mandatory disclosure for PBMs.⁵⁰

A. FTC Opinions on the Costs of Disclosure

The FTC has also warned that mandatory disclosure regulations will increase PBMs' costs and weaken competition in the PBM industry. These effects will, in turn, increase the cost of prescription drugs and drug coverage for consumers and health plan sponsors.

The FTC has repeatedly concluded that the PBM's direct costs of additional disclosure will increase prices for consumers and plan sponsors. Discussing the cost increases that would result from the mandatory disclosure requirements in a New York bill, the FTC stated that:

*[T]he bill by imposing unneeded and unwanted disclosures will increase health care costs, and such costs may be reflected in the price of drug plans that health plans are able to offer New York health care consumers, the scope of coverage consumers receive under such plans, or the number of consumers who have access to such coverage.*⁵¹

The FTC and the Department of Justice have also maintained that information sharing

⁴⁸ See Stephen W. Fuller et al., *Effect of Disclosure on Price: Railroad Grain Contracting in the Plains*, 15 W. J. AGRIC. ECON. 265 (1990); see also Maura P. Doyle & Christopher M. Snyder, *Information Sharing and Competition in the Motor Vehicle Industry*, 107 J. POL. ECON. 1326 (1999) (finding evidence that automakers respond strategically to production announcements by rivals).

⁴⁹ Pharmacy Benefit Management Institute, *Plan Sponsors' Satisfaction with PBMs Remains Relatively Unchanged* (2014), available at: <http://www.pbmi.com/news-releases.asp>; JP Morgan survey *supra* note 26

⁵⁰ United States Department of Labor, *Hearing on Reasonable Contracts or Arrangements for Welfare Benefit Plans Under Section 408(b)(2), Welfare Plan Fee Disclosure* (2010) available at: <http://www.dol.gov/ebsa/regs/cmt-1210-AB37.html>

⁵¹ Letter to Senator James Seward, *supra* note 41, at 4.

among rivals “*can blunt a firm’s incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals*” and “*also can enhance a firm’s incentive to raise prices by assuaging the fear that such a move would lose customers to rivals.*”⁵²

The FTC has similarly concluded that regulations enabling pharmacies to know the pricing details of their competitors’ arrangements with PBMs will likely increase the prices of prescription drugs. Addressing the competitive harms that would result from the disclosure requirements in a Mississippi bill, the FTC explained that

*[P]harmacies may compete with one another by offering deeper discounts or lower dispensing fees in order to be included in a PBM’s limited network or to become a preferred provider. Knowing that rivals will see and can respond to one’s prices can dilute incentives to bid aggressively. Thus, depending on the information the board requires, the disclosure provisions may undercut the most efficient pharmacy network contracts, leading to higher prescription drug prices.*⁵³

Federal antitrust agencies have long recognized that the disclosure of sensitive business information can lead to tacit collusion among pharmaceutical manufacturers and higher prices: “*the sharing of information related to a market in which the collaboration operates or in which the participants are actual or potential competitors may increase the likelihood of collusion on matters such as price.*”⁵⁴ Similarly, the FTC notes that disclosure of price and cost information is particularly harmful to competition: “*the sharing of information relating to price, output, costs, or strategic planning is more likely to raise competitive concern than the sharing of information relating to less competitively sensitive variables.*”⁵⁵

The FTC has also repeatedly stated that disclosure of rebate and discount information will reduce competition among pharmaceutical manufacturers. FTC explained this reduction in competition in its analysis of the likely effects of mandatory disclosure under a New Jersey bill:

If pharmaceutical manufacturers know the precise details of rebate arrangements offered by their competitors, then tacit collusion among them may be more feasible. Absent such knowledge, manufacturers have powerful incentives to bid aggressively for formulary position, because preferential formulary treatment offers the prospect of substantially increased sales. Unprotected disclosures thus may raise the price that New Jersey

⁵² U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES §7 (2010), available at <http://ftc.gov/os/2010/08/100819hmg.pdf> (describing anticompetitive effects of coordination among rivals).

⁵³ Letter to Representative Mark Formby, *supra* note 44, at 7.

⁵⁴ THE FEDERAL TRADE COMMISSION AND THE DEPARTMENT OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS §3.31(b) (2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>.

⁵⁵ *Id.*

*consumers pay for pharmaceutical coverage by softening competition among pharmaceutical companies for preferred formulary treatment.*⁵⁶

5. MANDATORY DISCLOSURE REGULATIONS INCREASE COSTS FOR CONSUMERS AND PLAN SPONSORS

By imposing direct costs and reducing competition in the market for prescription drugs, mandatory disclosure regulations will lead to higher prices for pharmaceuticals and pharmacy services, and in turn, a reduction in access to necessary drugs for many Americans. Discussing the specific risks of disclosure in the health care industry, the FTC and DOJ have explained that "*information exchanges among competing providers may facilitate collusion or otherwise reduce competition on prices...resulting in increased prices, or reduced quality and availability of health care services.*"⁵⁷ Similarly, discussing the competitive harms of mandatory disclosure regulations in a California bill, the FTC stated that:

*To the extent AB 1960 increases prices for pharmaceutical and health insurance and restricts the availability of insurance coverage for pharmaceuticals, the result is likely to be an increase in the number of Americans who do without pharmaceuticals and/or health insurance.*⁵⁸

Mandatory disclosure regulations will also increase administrative costs and legal costs for plan sponsors. Because of their fiduciary duty to enrollees, sponsors will feel pressure to analyze the additional disclosure to minimize their litigation risk. And unlike in situations where the parties negotiate the extent of contractually-agreed disclosures, there is likely to be superfluous information disclosed under regulatorily-mandated disclosures. Nevertheless, sponsors will have the incentive to scrutinize even useless information to avoid litigation claims that they have shirked their fiduciary duties. Depending on the complexity of the information, this could be a timely, costly process for the sponsors, especially when they are performed to avoid litigation rather than to produce an economic benefit for enrollees. Moreover, there is likely to be uncertainty and potential disagreement over the proper role of the fiduciary in scrutinizing the additional disclosure. The resulting lawsuits – even when ultimately determined to be groundless – can impose significant costs on sponsors. Legal fees, court awards, and, most likely, the costs (made strictly as business decisions) to settle dubious litigation claims can be substantial.⁵⁹ Moreover, there can be additional reputational costs resulting from any negative

⁵⁶ Letter to Senator Nellie Pou, *supra* note 29, at 11.

⁵⁷ THE FEDERAL TRADE COMMISSION AND THE DEPARTMENT OF JUSTICE, STATEMENTS OF ANTITRUST ENFORCEMENT POLICY IN HEALTH CARE Statement 6 (1996), available at <http://www.ftc.gov/bc/healthcare/industryguide/policy/hlth3s.pdf>.

⁵⁸ Letter to Assembly Member Greg Aghazarian, *supra* note 28, at 12.

⁵⁹ Elliot & Jacobson, *supra* note 43, at 84.

publicity surrounding lawsuits.⁶⁰ Finally, distracting executives from productive activities as they deal with litigation creates efficiency costs for sponsors.⁶¹

In order to streamline and simplify their fiduciary responsibilities concerning disclosed information, sponsors may have the incentive to homogenize their contractual relationships with PBMs. Working with attorneys, sponsors will likely identify contractual pricing arrangements that use the disclosed information in a way that is perceived to minimize their litigation risk. For example, even though doing so may increase overall costs, sponsors might gravitate towards contractual relationships that pass through 100 percent of discounts negotiated with pharmaceutical manufacturers in order to avoid litigation. This will prevent sponsors from negotiating individual contracts with different PBMs in order to get the best deal for their enrollees.

6. LESSONS FROM OTHER MANDATORY DISCLOSURE REGULATIONS

Although any form of mandatory disclosure for PBMs is unnecessary, some forms of mandatory disclosure are more harmful than others. Regulations that require disclosure of detailed cost structure information will impose greater costs and threaten competition more than regulations requiring only aggregate information. And regulations with weak confidentiality protections will increase the risk that sensitive proprietary information will leak out in a way that discourages pharmaceutical manufacturer rebates, facilitates tacit collusion by pharmaceutical manufacturers or pharmacies, or constrains competition between rival PBMs.

Both the Congressional Budget Office (CBO) and the FTC have addressed the potential harm from disclosure of sensitive cost information. In 2003, the CBO considered a proposal that would have required each PBM involved in delivering a Medicare Part D benefit to provide a detailed report annually to the HHS Inspector General and the Justice Department specifying the rebates and other payments the PBM has received from *each pharmaceutical manufacturer – both in the aggregate and for each of the top 50 drugs – and payment arrangements with pharmacies for each of those drugs.*⁶² While the proposal specified that the Justice Department could make the information public in only limited situations, it also indicated that this was not intended to prevent disclosure of the information that is collected to Congress or to any duly authorized committee or subcommittee. Because this increased the risk that sensitive information would leak further, CBO estimated that the bill provision containing the mandated disclosure would increase the estimated costs of the legislation by \$40 billion over ten years:

CBO expects that private firms would perceive a significant risk of public disclosure of the detailed information on drug pricing that this provision would require them to

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² Congressional Budget Office, Cost Estimate for H.R. 1 and S. 1 14-15 (July 22, 2003), *available at* <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/44xx/doc4468/hr1s1.pdf>

compile and provide to the federal government....Consequently, PBMs operating as part of the Medicare prescription drug plan would find it more difficult to obtain significant price concessions and rebates from drug manufacturers, who would be concerned that the terms of those favorable deals could be determined by competitors or other purchasers. Consequently, CBO estimates that, with this amendment, the degree of drug-cost management under S. 1 would decline and would no longer exceed the levels of cost management seen in the current employer market. The greater difficulty of using price discounts as a way to control drug spending would also reduce the likelihood of having risk-bearing drug plans deliver the Part D benefit, and thus would increase the share of beneficiaries in less tightly managed fallback plans. As a result, CBO estimates that section 133 would increase the estimated costs of S. 1 over the 2004-2013 period by \$40 billion.⁶³

In 2004, the FTC examined a California legislative proposal that would have required PBMs to disclose certain financial information to purchasers, prospective purchasers, and prescribers. The FTC concluded that the bill posed significant risks because it contained no confidentiality restrictions on the disclosure of information to prescribers:

Thus, financial information disclosed by PBMs to prescribers may become public, and a knowledgeable pharmaceutical manufacturer might well be able to use this information to calculate the rebate a competitor was offering. If pharmaceutical manufacturers learn the exact amount of the rebates offered by their competitors (either because the safeguards on subsequent disclosure by purchasers and prospective purchasers are insufficient or because the mandated disclosure to prescribers provides sufficient information for pharmaceutical manufacturers to calculate these amounts) then tacit collusion among manufacturers is more feasible. Consequently, the required disclosures may lead to higher prices for PBM services and pharmaceuticals.⁶⁴

Thus, based on the CBO and FTC analyses, the risk of competitive harm from mandated disclosure by PBMs is high if (1) mandated PBM disclosures are specific enough to permit market participants (pharmaceutical manufacturers, pharmacies, other PBMs) to calculate specific rebates or prices or (2) safeguards against further disclosure are insufficiently stringent.

In contrast, the Affordable Care Act requires PBM disclosure of only aggregate information and contains strong confidentiality protections. Specifically, the Affordable Care Act requires PBMs that manage drug coverage under a contract with a Medicare Part D drug plan or qualified health benefits plans offered through a state exchange to disclose certain financial and prescription drug dispensing information relating to their client contracts.⁶⁵ The

⁶³ *Id.* at 15

⁶⁴ Letter to Assembly Member Greg Aghazarian, *supra* note 28, at 9.

⁶⁵ See 42 U.S.C. § 1320b-23 (Supp. V 2011).

required information includes: (1) “the aggregate amount, and the type of rebates, discounts, or price concessions . . . that the PBM negotiates that are attributable to patient utilization under the plan,” (2) “the aggregate amount of the rebates, discounts, or price concessions that are passed through to the plan sponsor,” (3) “the total number of prescriptions that were dispensed,” and (4) “[t]he aggregate amount of the difference between the amount the health benefits plan pays the PBM and the amount that the PBM pays retail pharmacies, and mail order pharmacies]” The Affordable Care Act includes provisions to protect the confidentiality of information disclosed by the PBMs.⁶⁶

The 2010 enactment of the Affordable Care Act reflects a determination by Congress that the Act’s mandatory disclosure rules are sufficient to allow plans to calculate amounts relevant to the contractual arrangement between the PBM and plan sponsors. Yet, the Act’s required disclosure of only *aggregate data* reduces the risk of competitive harm because market participants cannot calculate specific rebates and prices. Moreover, the Act contains strong statutory confidentiality restrictions rather than restrictions merely imposed by contract or regulatory fiat. Nevertheless, the Affordable Care Act disclosure rule is new, and it remains to be seen whether its provisions will be sufficient to prevent competitively-sensitive information from leaking to other participants in the prescription drug market.

Absent a statutory change, a PBM disclosure rule adopted by the DOL would not, and could not, contain the meaningful confidentiality safeguards to protect against anti-competitive harms. If the 2010 interim final rule for pension plan services providers serves as a framework for the disclosure standards applicable to PBMs, confidentiality will be weak. The 2010 rule contains no confidentiality protections that protect proprietary financial information and the service provider cannot condition its disclosure on the parties’ contractual agreement to meaningful confidentiality restrictions. Moreover, plans have the broad authority to request whatever information they deem appropriate, without consideration of the potential competitive harms.

Even if the DOL includes confidentiality protections in a rule for PBM disclosure, they will almost certainly be insufficient. ERISA, which would supersede any contractual confidentiality restrictions agreed upon by the parties, requires plan sponsors to furnish any contracts under which a plan operates, without regard to the proprietary nature of the information. Presumably this would include PBM contracts with proprietary cost information. Moreover, PBMs would likely have to report rebates on their annual Form 5500 filed with the DOL and IRS; Form 5500 is publicly available for review and subject to FOIA. Moreover, even if the DOL includes confidentiality protections in its regulations, there is no mechanism in ERISA’s enforcement provisions that provide PBMs any meaningful remedy for confidentiality breaches. Without enforceable restrictions on disclosure, including applicable penalties for

⁶⁶ See U.S.C. § 1320b-23(c) (Supp V 2011) (“Information disclosed by a health benefits plan or PBM under this section is confidential and shall not be disclosed by the Secretary or by a plan receiving the information . . .”).

violation of a federal law, any information disclosed under the new regulations would inevitably leak out.

Even if there were explicit statutory rules protecting the confidentiality of PBM compensation disclosures, there is a significant likelihood that the proprietary information would leak out. Plan sponsors often use pharmacy benefit management consultants to help them determine which PBM to choose. These consultants, by virtue of assisting numerous plans, would have access to the compensation disclosures from every PBM under contract with the consultants' clients. Thus, any information contained in PBM-mandated disclosures would inevitably cross-pollinate into future negotiations between plans and PBMs.

CONCLUSION

Mandatory disclosure regulations are premised on the belief that, to ensure that employer health plan sponsors are paying a competitive price for PBM services, the sponsors must know the details of the rebates and discounts that their PBM partners are able to negotiate with manufacturers and pharmacies. However, there is no theoretical or empirical reason to believe mandated disclosure of this information is necessary to ensure that health plan sponsors are paying a competitive price for PBM services. Employer health plan sponsors are sophisticated, repeat-purchasers of PBM services that can simply compare the services offered and the price of services among different PBMs. Moreover, existing contracts require PBMs to pass through to plan sponsors a significant portion of the rebates and discounts they negotiate, and empirical evidence indicates that PBMs do pass on the vast bulk of their negotiated savings. Finally, health plans are already able to negotiate contract terms that include disclosure and audit rights when they want them and are willing to bear the resulting increased administrative costs, rendering mandatory disclosure regulations superfluous.

Instead, mandated disclosures to employer health plan sponsors will increase the risk of competitively-sensitive information leaking to other market participants (pharmacies, pharmaceutical manufacturers, other PBMs). This will weaken the ability of PBMs to negotiate discounts with pharmacies and rebates from pharmaceutical manufacturers. Mandated disclosures will also increase administrative and litigation costs for PBMs and plan sponsors. As a result, mandated PBM compensation disclosures will likely increase prescription benefit costs for both employer health plan sponsors and consumers.