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Drugmakers Balk at Rebates

By Ceci Connolly

The nation's leading drug manufacturers are refusing to pay hundreds of millions of dollars in pharmacy rebates that Pentagon officials say they have been counting on to help control soaring medical costs.

The rebate program was designed in late 2002 to ensure that prescription drugs purchased at retail pharmacies by military personnel and their families would be sold at the same discount given to the Department of Defense for use in its hospitals, clinics and mail-order program. Rebates are based on the difference between the retail price and the bulk discount.

Pharmaceutical industry representatives contend it is illegal for the Pentagon to collect the refunds because individual beneficiaries are making the purchases rather than government buyers, who are entitled to bulk discounts. An industry group called the Coalition for Government Procurement has filed suit against the Bush administration, a move some drug company executives acknowledged has escalated tensions between the two sides and dampened hopes for a compromise.

"We had been negotiating with DOD since the beginning of this year to implement" a refund both sides would be satisfied with, said Mariann Caprino, spokeswoman for Pfizer, the top-selling drugmaker in the United States, with nearly \$30 billion in sales for the past 12 months. Although Pfizer is not a member of the coalition, Caprino said, the company is awaiting the outcome of the lawsuit filed in the U.S. Court of Appeals for the Federal Circuit.

Like private employers who are buckling under rising health care bills, the Defense Department has instituted several innovative -- and somewhat controversial -- measures for holding down costs. High on the target list is pharmaceutical spending, a line item that rose from \$1 billion in 2000 to nearly \$6 billion this year.

This year the Pentagon expects to spend \$2 billion on retail drug purchases, which on average are 24 percent more expensive than medications bought in bulk by the departments of Defense and Veterans Affairs, the Coast Guard, and the U.S. Public Health Service -- known as the "big four" purchasers.

Higher retail prices do not affect the 6.4 million active members of the military, retirees and their dependents who have prescription drug coverage through the Pentagon's Tricare health insurance plan.

Tricare, which serves 9.2 million beneficiaries, works similar to private health insurance, although the Pentagon covers a larger portion of the cost than most plans in the private

sector.

Col. James Young, who just retired as director of the Pentagon's pharmacy programs, said two main factors have exacerbated the military's cost crunch: a growing retiree population that tends to take more medications and more costly medications and a large shift toward using retail pharmacies as military bases and hospitals around the country have closed.

Average prescription costs for beneficiaries older than 65 almost doubled over the past three years, from \$791 in 2002 to \$1,462 this year, he said.

"Our beneficiaries do not have the same access to a military treatment facility pharmacy as they once did," he added. "Now they have greater access to a retail network. That was the trade-off" in the base-closing process.

In 1990, 98 percent of military retirees lived within 100 miles of a military hospital or clinic, Young said. Today, the number is less than 25 percent, and the Pentagon has contracted with 54,000 retail pharmacies. One-third of military retirees use retail pharmacies exclusively.

But the standoff with the pharmaceutical industry is costing taxpayers, Young said.

Lawmakers trimmed \$172 million from this year's defense budget in anticipation of collecting refunds, and military budget writers have said they expect larger savings in the future.

In recent weeks, the Pentagon has sent notices to about 100 drugmakers requesting second-quarter refunds, as well as back payments for late 2004, when the program began, and the first quarter of 2005.

To date, the military has received less than 20 percent of the projected \$300 million in rebates this year, Young said.

Military officials identified the 10 drug manufacturers the Pentagon says owe the most money, a list that is nearly identical to the 10 companies with the highest overall sales, according to IMS Health, a pharmaceutical information and consulting company based outside Philadelphia. It includes Pfizer, GlaxoSmithKline, Merck and AstraZeneca -- each expecting sales for the past 12 months to top \$12 billion. The Pentagon refused to release exact amounts owed by each company, saying it was proprietary information. But the total for the 10 is in the hundreds of millions, Young said.

Only Abbott Laboratories, ranking 12th, with \$7 billion in U.S. sales for the past 12 months, reported paying rebates to the Defense Department.

Several drugmakers referred questions to the coalition; others issued statements saying they had no comment until the litigation is resolved.

"Wyeth already provides medications to the Department of Defense at significantly discounted contracted rates," said spokesman Chris Garland. "This is going through the court system. It has not yet been determined they legally have the right" to collect refunds on retail purchases.

At the center of the legal wrangling is the definition of procurement.

Because the retail pharmacies are paid with military funds, the transaction is a government purchase entitled to the full discount, argued Melbourne Noel, a senior contract attorney in the Department of Veterans Affairs who is defending the case for the Pentagon. "DOD controls the purse," he said.

But Larry Allen, vice president of the coalition, noted that several middlemen, such as a drug wholesaler and the retail pharmacist, complicate the notion that the Pentagon is actually the purchaser.

"They don't ever take possession of the drugs," he said. "There are two or three degrees of separation from the pharmaceutical company to when it is dispensed."

Allen and some industry executives complained that the Defense Department has been unwilling to consider other cost-saving proposals, such as greater incentives for using the lower-priced mail-order system.

The outcome of the lawsuit will have implications beyond the military budget, Noel said. The Department of Veterans Affairs, in anticipation of treating an influx of soldiers who served in Iraq, is considering a similar retail pharmacy program. At the direction of former veterans affairs secretary Anthony J. Principi, the department intends to demand the same type of refunds.