PHARMACY BENEFIT MANAGERS became a $250 billion industry by promising to save companies millions on employee medications. But critics say they make out better than their customers. by Katherine Eban
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IN LATE 2008, Meridian Health Systems, a nonprofit that owns and operates six hospitals in southern New Jersey, hired a new pharmacy benefits management (PBM) company to help reduce the surging medication costs for its 12,000 employees and their families. Express Scripts, which has since become the largest PBM in the country, projected that it would slice at least $763,000 from Meridian’s $12 million in annual drug spending. But just three months into the contract, Meridian discovered that its bills were soaring, on pace to balloon by $1.3 million in 2009. Express Scripts insisted
that, in reality, Meridian was saving money. Robert Schenk didn’t buy it. He oversees Meridian’s spending on medications for employees and its in-house pharmacy. Schenk, 57, had once owned two small-town drugstores but sold them in part because of relentless price-lowering pressure from PBMs. He knew firsthand how little pharmacies were paid relative to what customers were charged.

Schenk decided to figure out where Meridian’s money was going and why its drug costs were escalating. That was no easy task because, like most PBM customers, Meridian received data only on what it was being charged for each employee prescription. Meridian didn’t know what it cost the PBM to fill that order.

Then Schenk had a stroke of inspiration. He realized that Meridian had a second stream of data that almost no other PBM customers had: what it cost the PBM to fill that order. That meant data that almost no other PBM customers had: what it cost the PBM to fill that order. That meant data that the PBM was paying to buy drugs and what it was selling them for.

When he compared those lists, the mild-mannered pharmacist was shocked: Express Scripts was making huge gross profits (known as “spreads” in the PBM world) ranging from $5 per order to many multiples of that. In one particularly extreme example, Meridian was billed $92.53 for a prescription for generic amoxicillin filled at an outside pharmacy. Meanwhile, Express Scripts paid $26.91 to Meridian’s own pharmacy to fill the same prescription. That meant a spread of $65.62 on one bottle of a generic antibiotic. Express Scripts disingenuously defended the $65.62 spread by saying it was “the last 1% of the cost that the vast majority are satisfied with its service. And like any company—to state the obvious—it’s entitled to a profit. The question is, Who is making out better—the PBM or its customers? Many experts say the former. They argue that many companies stick with traditional PBMs because drug pricing is so impossible to untangle that customers have no way to verify how much they’re saving, if anything.

Meridian’s experience is far from unique, these experts say. PBMs effectively pad bills by $8 to $10 a prescription, according to Susan Hayes, who has audited more than 100 PBM contracts for her auditing and consulting firm Pharmacy Outcomes Specialists. As Hayes puts it, “The nation’s employers are being taken for a ride.”

PBMs started as paper pushers. They began handling medical claims in the 1970s and evolved into middlemen who touted their ability to use corporate customers’ combined purchasing power to negotiate huge discounts from pharmaceutical companies. Today, the top PBMs are as big as or bigger than their clients. Express Scripts generated $94 billion in revenues last year after merging with Medco, putting it at No. 24 on the Fortune 500. Its annual profit has grown from $200 million a decade ago to $6 billion in the 12 months ended in June, according to S&P Capital IQ. The company now manages benefits for more than 100 million Americans.

Total industry revenues exceed $250 billion, according to J.P. Morgan analyst Lisa Gill. The big prescription managers—Express Scripts, CVS Caremark, and OptumRx control about 70% of all U.S. prescriptions—have become some of the most potent players in health care. PBMs determine where patients fill their prescriptions. They decide what drugs people will take and how much pharmacists will get reimbursed for dispensing them. They shift patients to generic drugs and require them to fill basic prescriptions at the PBMs’ vast mail-order pharmacies. And with some 30 million Americans expected to gain prescription-drug coverage through the Affordable Care Act, PBM use is likely to continue increasing.

The debate as to whether traditional PBMs save money for clients has propelled the rise of a renegade group of relatively small, so-called transparent PBMs. These mostly newer competitors now depend on antiquated data and bear little relation to real costs. Drug industry relies on, such as the published average wholesale price, are results of a report by the Kaiser Family Foundation calls the PBM as assertions of Medicare savings “overstated” and said the reduced cost probably stemmed from incorrectly high predictions of prices and that Express Scripts would profit from spreads.

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"It’s a confuse-opoly,” says ClearScript VP Gary Gustavson. “Buyers don’t understand the PBM industry.”
Express Scripts emphasized that its interests would be aligned with those of its customer. “That’s not how it played out. Just three months after Express Scripts began handling its prescriptions, Meridian calculated that it was facing potential increase of $1.3 million in costs in the first year alone. Meridian executives were taken aback by the PBM’s response to this news. Rather than expressing sympathy or contrition, Schenk says, the Express Scripts representatives complained that the company wasn’t getting enough mail-order prescriptions from Meridian. Recalls Schenk: “Their attitude was, ‘Hey, you’re not giving us enough business.’” Express Scripts argued that Meridian’s projections had failed to account for rising drug prices. But those estimates weren’t Meridian’s alone. Kathleen Boushie, Meridian’s director of health and wellness, dug up Express Scripts’ original presentation, in which the PBM projected savings of $763,000 in the first year. The PBM also asserted that Meridian was actually saving money—but it was masked by increases in price and higher usage of medications, particularly very expensive specialty drugs (such as new bio-medications and drugs for rare diseases). Boushie researched this claim and found that utilization had not increased.

In October, 10 months into the contract, Schenk asked Express Scripts for all of Meridian’s specialty-drug claims. He got data for 800 claims—a total of $1.52 million, averaging $19,000 per claim. As he compared each charge with the industrywide average wholesale price (AWP), he discovered that Meridian was not getting the contractually agreed-upon discount of AWP minus 18%. Instead, it was getting AWP minus 13%, leaving Meridian with a $106,000 overcharge. Express Scripts responds in a statement: “Because of a setup error, there was a discrepancy in how specialty medications were being billed. Once we were made aware of the error, we addressed it and made sure Meridian was being reimbursed. The situation was not typical, and the error was an anomaly.”

**V E N T H E P B M  h i s t o r y has gone over the past two decades, it has been dogged by state investigations, class-action suits, and allegations that the industry uses opaque contracts to maximize profits. PBMs have been accused of everything from shorting pills in mail-order prescriptions to selling patient data they didn’t own to covertly shifting patients to higher-cost drugs. As a federal judge in Maine put it in 2005, PBMs “introduce a layer of fog to the market that prevents benefit providers from fully understanding how to best minimize their net prescription-drug costs.” In 2008, Express Scripts paid $9.3 million to settle a suit by New York and 28 other states that claimed it deceptively inflated costs for state employees, in part by secretly switching to higher-cost drugs, and that it allegedly pocketed millions in manufacturer rebates. Express Scripts agreed to reforms to make it more transparent. Mark Merritt of the PBM trade group says this settlement helped establish the “rules of the road” for an “emerging industry.”

Five years later the battles over transparency persist. Critics say the profit centers and the “spreadsheet games,” as PBM auditor Susan Hayes calls them, have changed. The PBMs’ biggest profits no longer lie in maximizing rebates on brand-name drugs or shifting patients to higher-cost medication. Instead, they come from maximizing spreads on generics.

Envision believes PBMs do this in a variety of ways, according to experts. Generic prices are typically set through lists of maximum allowable cost (MAC), which the PBMs establish. The PBMs may use multiple MAC lists to maximize spread, giving one set of prices to pharmacies and another to clients.

Most employers have no idea their contracts permit this. “It is completely hidden,” recalls the contract. The PBM had no restrictions on the spreads.

Express Scripts spokesman Brian Henry says Meridian’s dissatisfaction was highly unusual and adds, “When evaluating spread pricing, it’s important to take into account all drugs, including those taken to treat conditions where we take a loss or make only a few pennies per prescription.”

Again, we make money when the client saves money.” Henry referred to a client, the Tampa Electric Co., which says it’s very satisfied. Notes Brad Register, Tampa Electric’s director of compensation and benefits: “I wouldn’t say we’ve reduced cost, but we’re controlling the cost of increase.” Adds Henry: “Across the more than 3,500 clients we have (and our renewal rates are typically 95% and higher), we deliver the savings we promise by providing solutions that drive out pharmacy waste, control costs, and improve patient outcomes.”

If you know anything about pharmacy benefits from a clearer perspective. Visit www.envisionrx.com or email us at salesandmarketing@envision.com to learn more.