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An Audit Report on

**Pharmacy Benefit Manager
Contracts at Selected State
Agencies and Higher Education
Institutions**

August 2008
Report No. 08-042



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Overall Conclusion

The Teacher Retirement System, the Employees Retirement System, the University of Texas System, and the Texas A&M University System have contracts for pharmacy benefit manager (PBM) services that include provisions that generally address high-risk areas. Having contract provisions that address high-risk areas helps to ensure that these organizations have required their PBM contractors to disclose the information necessary to sufficiently and appropriately manage their contracts. Auditors also determined that the agencies and higher education institutions have PBM contracts that include most of the applicable, essential provisions that are required by the *State of Texas Contract Management Guide*.

Opportunities exist to enhance PBM contracts by strengthening contract provisions for each of the high-risk areas auditors reviewed. Specifically:

- **Audit rights:** Contracts should include provisions that ensure agencies' and higher education institutions' ability to audit PBM contractors is not limited or unreasonably restricted. Current contract provisions restrict agencies', higher education institutions', and independent auditors' access to information necessary to verify prescription drug plan costs and PBM contractors' compliance with their contracts.
- **Costs, discounts, and other fees associated with the services provided by PBM contractors:** Agencies' and higher education institutions' contracts define prescription drugs prices, discounts, and other fees that apply to their plans. However, additional contract provisions could help to ensure that agencies and higher education institutions clearly understand the true costs and discounts associated with their plans.

Background Information

Pharmacy benefit manager (PBM) contractors administer the prescription drug portion of a health insurance plan offered by self-insured employers, insurance companies, and health maintenance organizations (HMOs). PBM contractors provide pharmacy claims processing and mail order pharmacy services, as well as other services, such as rebate negotiations with drug manufacturers, development of pharmacy networks, formulary management, review of drug usage, generic drug substitution, and disease management programs.

In fiscal year 2007, the state agencies and higher education institutions audited reported paying the following total costs for the services delivered by their PBM contractors:

- The Teacher Retirement System paid approximately \$469 million to its PBM contractor for 383,679 covered members.
- The Employees Retirement System paid approximately \$334 million to its PBM contractor for 449,664 covered members.
- The University of Texas System paid approximately \$117 million to its PBM contractor for 147,614 covered members.
- The Texas A&M University System paid \$32 million to its PBM contractor for 34,092 covered members.

See Appendix 2 for additional details on prescription drug plan costs for fiscal year 2007.

- **Drug formulary management:** Contracts should clearly state whether PBM contractors are allowed to or are prohibited from substituting a prescribed drug with a different drug preferred by the PBM contractors. In addition, agencies and higher education institutions do not always require PBM contractors to provide notification before adding, removing, or making other changes to the list of drugs that can be purchased through a prescription drug plan.
- **Protection of confidential data:** Agencies' and higher education institutions' contracts include provisions that require PBM contractors to protect the personal identities of their plan members in accordance with federal and state laws. However, contracts should define whether PBM contractors are allowed to or are prohibited from selling plan data from which plan members' personal information has been removed.
- **Contract monitoring:** Although agencies and higher education institutions generally define contract provisions to measure the performance and contract compliance of PBM contractors, there are inconsistencies in how performance standards are defined for standard services provided by all PBM contractors, such as cost-savings initiatives and customer service. In addition, agencies and higher education institutions did not consistently require PBM contractors to disclose any policies, practices, or business relationships that could conflict with their obligations under PBM contracts.

Other opportunities exist for agencies and higher education institutions to strengthen their PBM contracts. Specifically:

- Agencies and higher education institutions have limited guidance in developing contract provisions for PBM services. The Texas Health Care Policy Council can provide additional guidance for developing consistency in the provisions within contracts for PBM services.
- Agencies and higher education institutions do not identify the specific contract information that is considered proprietary. By clearly identifying proprietary information included in their PBM contracts, agencies and higher education institutions can respond more quickly to information requests. Auditors identified the rebate amounts that each of the agencies and higher education institutions received from PBM contractors for fiscal year 2007; however, information regarding those rebate amounts is not included in this report because certain agencies and higher education institutions questioned the proprietary nature of that information. See management's responses in Appendix 8 for additional details.
- Agencies and higher education institutions can adopt specific practices to provide assurance that contract provisions clearly recognize and benefit the interests of their plans and members. For example, agencies and higher education institutions should (1) incorporate key procurement documents and other agreements made during the contract procurement process in the final

PBM contract and (2) obtain professional advice from outside consultants in developing PBM contract provisions.

Summary of Management's Response

The agencies and higher education institutions audited agreed with most of the recommendations in this report. Their responses indicated that they would consider certain recommendations involving audit rights; costs, discounts, and other fees; and drug formulary management when they implement future PBM contracts. Their responses suggest that the relevance and implementation of certain recommendations depends on whether the recommendations conflicted with or impaired their ability to negotiate cost-effective contracts for high-quality PBM services and benefits. The Employees Retirement System's responses indicated that most of the recommendations in this report are included in its new PBM contract, which becomes effective on September 1, 2008.

The Texas Health Care Policy Council (Council) agreed with the recommendation that it develop a contract management guide for PBM contracts. However, the Council responded that the proposed statutory language for implementing the recommendation was not necessary because its current statutory authority allows it to implement the recommendation.

Detailed responses from the agencies, higher education institutions, and the Council are presented in Appendix 8.

Summary of Objectives, Scope, and Methodology

The objectives of the audit were to (1) determine the similarities and differences among PBM contracts at the Teacher Retirement System, the Employees Retirement System, the University of Texas System, and the Texas A&M University System and (2) to assess whether there are contract provisions that would provide better value to other state entities or that would be advantageous if the State used a single PBM for all state health plans.

The scope of the audit included contracts and other contract procurement-related documents for PBM services during the period from fiscal year 2005 through February 2008 for the Teacher Retirement System, the Employees Retirement System, the University of Texas System, and the Texas A&M University System.

The audit methodology included reviewing information on PBM services, contracts, lawsuits and settlements, and best practices recommended by public and private sectors; interviewing auditors and consultants; and analyzing agency and higher education institution policies, procedures, and other PBM service-related documents.

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Detailed Results

Chapter 1

Opportunities Exist to Strengthen Provisions of PBM Contracts in Certain High-risk Areas

High-risk Areas of PBM Contracts

Auditors conducted a risk assessment to identify the following high-risk areas associated with contracts for PBM services:

- **Audit rights:** Contract provisions that describe an agency's or higher education institution's right to audit their PBM contractors' operations and costs, including access to necessary documents and other information.
- **Costs, discounts, and other fees associated with the services provided by PBM contractors:** Contract provisions that define financial terms for which agencies, higher education institutions, and their plan members pay PBM contractors, retail pharmacies, independent pharmacies, or mail order pharmacies for the purchase of generic drugs, brand name drugs, specialty drugs, and other services.
- **Drug formulary management:** Contract provisions that define agencies', higher education institutions', and PBM contractors' roles in managing and changing the placement of drugs on a plan's formulary. A formulary is a list of drugs developed by a PBM contractor that provides the highest benefit to the plan's members at a relatively low cost. For brand name drugs with several close substitutes, PBM contractors negotiate with drug manufacturers for lower prices and rebates in return for placing drug manufacturers' products on a plan's formulary.
- **Protection of confidential plan data:** Contract provisions requiring compliance with the U.S. Health Insurance Portability and Accountability Act (HIPAA) and applicable state laws for protecting and safeguarding personal health information, including provisions that address the sale of prescription drug plan data from which personal information has been removed.
- **Contract monitoring:** Contract provisions that define measures to determine satisfactory performance and PBM contractor compliance including provisions that address potential conflicts of interests.

The Teacher Retirement System, the Employees Retirement System, the University of Texas System, and the Texas A&M University System have contracts for pharmacy benefit manager (PBM) services that include provisions to generally address the high-risk areas associated with PBM services. Specifically, their contracts addressed:

- Audit rights.
- Costs, discounts, and other fees associated with the services provided by PBM contractors.
- Drug formulary management.
- Protection of confidential plan data.
- Contract monitoring.

Opportunities exist to strengthen certain contract provisions that address high-risk areas associated with contracts for PBM services. Strengthening these provisions can provide agencies and higher education institutions additional and necessary assurances, as well as greater accountability for the cost and performance of services their PBM contractors provide.

In addition, auditors determined that these agencies and higher education institutions have PBM contracts that include most of the applicable, essential provisions required by the *State of Texas Contract Management Guide* (see Appendix 7 for additional details).

Agencies and Higher Education Institutions Should Strengthen Contract Provisions Regarding Audit Rights

Agency and higher education institution PBM contract provisions define these organizations' audit rights in terms of:

- Who can perform an audit.
- Whether advance notice of the audit is required.
- What can be audited.
- The time period to be audited.
- The number of audits to be conducted.
- Reporting requirements.

These provisions, however, are generally defined in a manner that limit the agencies' and higher education institutions' ability to conduct the audits necessary to verify prescription drug costs and the PBM contractors' compliance with their contracts. Agencies and higher education institutions generally limit their right to audit to only audits that verify the accuracy of payments they make to their PBM contractors; this may include testing plan member eligibility, payment timelines, pharmacy payment and drug dispensing accuracy, related performance guarantees and the associated plan benefit requirements, and selected administration procedures.

Drug Manufacturer Rebates

Rebates are amounts a drug manufacturer reimburses a plan or PBM contractor for each unit of a specified drug dispensed under a plan. These arrangements are "after market" events because the rebate is not based on an individual sale but on the total prescriptions filled for a particular drug. Rebates may be calculated only on certain drugs and are often contingent on PBM contractors meeting minimum sale targets or by restricting coverage for certain drugs.

The right to audit also should allow agencies and higher education institutions to conduct other types of audits such as rebate audits and various audits to verify contractor compliance. Rebate audits could verify (1) the amount of rebates a PBM contractor receives from drug manufacturers and (2) the amount of rebates that are passed back to agency's or higher education institution's prescription drug plan. Audits that verify contractor compliance can provide assurances that a PBM contractor complies with non-payment-related performance guarantees and other contract requirements.

Contract audit provisions should ensure that agencies and higher education institutions have access to all documentation to verify costs and services provided by PBM contractors.

The provisions of contracts auditors reviewed did not always provide agencies and higher education institutions with access to information related to the costs and services associated with their plans (such as access to PBM contractors' facilities, financial records, contracts, medical records,

agreements, and relationships with subcontractors and other information as deemed necessary). Access to this information is necessary to allow agencies, higher education institutions, and their independent auditors to verify costs and discounts associated with drug claims, PBM contractor compliance with contract requirements (including performance guarantees), and services provided by subcontractors.

Agencies and higher education institutions should ensure audits are performed in accordance with auditing standards.

Although agencies and higher education institutions have contract provisions that give them the authority to conduct limited audits, they do not always conduct these audits in accordance with auditing standards. Audits conducted in accordance with auditing standards ensure that (1) the underlying business processes and activities related to the audit objectives are reviewed and tested for compliance and reliability and (2) sufficient, appropriate evidence is captured to support any reported findings or conclusions. Audits performed in accordance with auditing standards also must disclose that they were conducted in compliance with auditing standards.

The State Auditor's Office reviewed the audits that agencies and higher education institutions have conducted of their PBM contractors. These audits did not always (1) disclose that they were conducted in accordance with auditing standards and (2) include examination of other significant information to provide reasonable assurance regarding the accuracy and completeness of payments (such as the billing invoices the PBM contractors received from pharmacies or the contracts between PBM contractors and pharmacies).

Contract provisions should define requirements for PBM contractors' audits of pharmacy networks.

Agencies and higher education institutions have not generally defined reporting requirements for audits that their PBM contractors conduct of the retail pharmacies, independent pharmacies, and mail order pharmacies that serve their plans. These audits are conducted as anti-fraud activities that assist PBM contractors in identifying erroneous overpayments they make to pharmacies. Although PBM contracts generally require PBM contractors to conduct audits of the pharmacy network, the PBM contracts lack provisions defining the information that PBM contractors should provide to agencies and higher education institutions concerning these audits. Specifically, contract provisions do not always define (1) how audit results should be reported, (2) how often audit results should be reported, and (3) whether the PBM contractor is required to return recovered overpayments to the prescription drug plan.

PBM contractors also may not be objective when it conducts audits of their own mail order pharmacies. A mail order pharmacy is part of the pharmacy

network and is commonly managed by the same PBM contractor providing management services to the plan. (See Appendix 6 for additional details.) However, contract provisions do not define requirements for ensuring PBM contractors' objectivity when they conduct audits of their mail order pharmacies.

Recommendations

Agencies and higher education institutions should:

- Ensure that their contractual right to audit a PBM contractor is not limited to only certain types of audits.
- Ensure that their contractual right to audit a PBM contractor requires PBM contractors to provide access to all financial records, contracts, medical records, and other information associated with the services PBM contractors or their subcontractors provide to a plan.
- Ensure that their contractual right to audit a PBM contractor requires that audits be conducted in accordance with auditing standards.
- Define reporting requirements for audits that PBM contractors conduct of the pharmacy network. At a minimum, these requirements should describe (1) what information should be reported, (2) how often audit results should be reported, and (3) whether the PBM contractor must return recovered overpayments to the prescription drug plan.
- Require that audits of mail order pharmacies owned by their PBM contractors be conducted by independent auditors that are selected by and report to the agencies and higher education institutions.

Chapter 1-B

Agencies and Higher Education Institutions Should Strengthen Contract Provisions Regarding Costs, Discounts, and Other Fees

Agencies' and higher education institutions' contracts generally define the prescription drug prices, discounts, and other fees that apply to their plans with regard to (1) the types of drugs on the formulary (generic, brand name, or specialty drug) and (2) the type of pharmacy where drugs are dispensed (retail pharmacy, independent pharmacy, or mail order pharmacy). (See Appendix 3 for additional details and definitions.)

However, additional contract provisions could help to ensure that agencies and higher education institutions clearly understand the true costs of their plans. Specifically:

- Contract provisions should allow agencies and higher education institutions access to discount agreements between PBM contractors and drug manufacturers, drug wholesalers, or pharmacies. Contract provisions generally prohibit access to any documentation or information concerning a PBM contractor's agreed-upon discounts with drug manufacturers, drug wholesalers, and retail and independent pharmacies (see Chapter 1-A for additional information). Without access to this information, it is not clear whether the payments that agencies and higher education institutions make to PBM contractors are reasonable or excessive with respect to the costs and discounts PBM contractors have agreed upon with drug manufacturers, drug wholesalers, and pharmacies.
- Contract provisions should identify the database that establishes pricing for drug purchases. Contract provisions are ambiguous in identifying which third-party entity's database PBM contractors must use when calculating the billing drug costs to agencies and higher education institutions. Identifying the database that should be used for pricing drug purchases (1) establishes a consistent baseline for agencies and higher education institutions to assess their plan costs during the term of a PBM contract and (2) minimizes the risk that PBM contractors will manipulate the third-party database used for pricing drugs to benefit their financial interests.
- Contract provisions should require PBM contractors to provide additional information concerning the methodology for calculating rebate amounts. Contract provisions that define the methodology for determining the rebate amounts that agencies and higher education institutions receive from PBM contractors lack conditions necessary to ensure that those amounts are reasonable when compared with the total amount of rebates a PBM contractor actually receives for a specific plan. Contract provisions do not require PBM contractors to (1) provide the methodology they use to calculate the total rebates they receive for a plan or (2) provide or identify the data they use to calculate the rebate amounts. Contract provisions define only how agencies and higher education institutions can calculate rebate amounts that are based on a flat payment rate multiplied by the total number of prescriptions filled and paid during a specified period. However, in contracts in which PBM contractors have agreed to pass through all or a percentage of rebates back to a plan, defining only the calculation used to determine the amount of rebates to be paid to a plan is not sufficient for ensuring that PBM contractors are passing the correct amount of rebates back to the plans.
- Contract provisions should list specialty drugs and their associated costs. Contract provisions do not always identify the specialty drugs and the associated discounts applicable to an agency's or higher education institution's plan. Specialty drugs are the most expensive category of drugs for a plan. Agencies and higher education institutions should ensure that they know

what specialty drugs their plans pay for and how much their plans pay for those drugs.

- Contract provisions should require PBM contractors to disclose the maximum allowable cost (MAC) list applicable to a plan. Contract provisions do not always define the MAC list or require PBM contractors to disclose the MAC list that is applicable to an agency's or higher education institution's plan. Agencies and higher education institutions do not have any certainty regarding what MAC price is being assigned to the drugs purchased by their plans. In addition, PBM contractors develop several different MAC lists for each of their clients. These conditions create uncertainty regarding the reasonableness and appropriateness of MAC prices.

Maximum Allowable Cost (MAC)

The MAC is the highest amount a third party will pay a pharmacy for dispensing specific multiple source drugs (drugs for which generic equivalents exist). Public programs and private prescription drug programs primarily use MAC pricing. There are no standard MAC lists. The lists are developed by the PBM contractors and are different for different vendors and can change throughout the course of the contract.

Contract provisions should provide agencies and higher education institutions the ability to take advantage of lowering costs for PBM services during the term of the contract.

Agencies' and higher education institutions' PBM contract provisions do not always define short-term contracts or include contract termination rights that would allow an agency or higher education institution to terminate contracts early in order to take advantage of favorable changes in the marketplace. The PBM services industry is under constant change as the result of activities such as business mergers and alliances involving PBM contractors, retail pharmacy chains and drug manufacturers; the introduction of new drugs (brand name drugs and generic drugs) to the marketplace; and risks disclosed by lawsuits and settlements against the pharmaceutical industry and PBM contractors. These ongoing changes in the marketplace can lead to lower competitive costs for the services provided by PBM contractors. However, the manner in which certain contract provisions are defined can prevent agencies and higher education institutions from taking advantage of favorable market conditions during the life of a contract. Specifically:

- Contract time periods should enable agencies and higher education institutions to benefit from changes in the marketplace. The length of the contracts between agencies and higher education institutions and their PBM contractors varies from three years to six years. Agencies and higher education institutions rely on market competition among vendors to be able to purchase PBM services with the best value in terms of quality and price. Contract terms of three years or fewer provide agencies and higher education institutions with the ability to return to the marketplace more frequently to benefit from favorable changes that may result in lower costs to their plans. Contracts that are longer than three years may result in agencies and higher education institutions being unable to benefit from changes in the marketplace in a timely manner.

- Contract provisions regarding contract termination should be strengthened. Contract provisions do not always allow agencies and higher education institutions to terminate PBM contracts at their discretion, which is referred to as “termination without cause.” This type of contract provision would allow agencies and higher education institutions to terminate their contracts for any reason, as long as they give prior notification within a specified timeframe. The ability to terminate a contract in this manner would provide agencies and higher education institutions the leverage to take immediate advantage of changes in the marketplace by either (1) renegotiating the contract provisions or (2) terminating the contract to pursue changes in the marketplace that may result in improved service quality or lower costs for their plans and their plans’ members.

Recommendations

Agencies and higher education institutions should:

- Include provisions in PBM contracts that require all documentation and data concerning PBM contractors’ financial agreements with drug manufacturers, drug wholesalers, and the pharmacy network be accessible to their agencies’ and higher education institutions’ staff and independent auditors.
- Include provisions in PBM contracts that specify the third-party entity database the PBM contractor must use when billing drug costs to agencies and higher education institutions.
- Include provisions in PBM contracts that define the methodology the PBM contractor will use to periodically calculate (1) the total rebates received from drug manufacturers for their plans and (2) the amount of rebates that will be passed through to their plans.
- Include provisions in PBM contracts that describe the documentation that will be used to support the rebate amounts calculated by the PBM contractor.
- Include provisions in PBM contracts that identify the specialty drugs that are included in their plans’ formularies, including the applicable costs and discounts.
- Include provisions in PBM contracts that define the MAC list prices that the PBM contractor will use.
- Include provisions in PBM contracts that require PBM contractors to provide prior notification of all changes they make to the MAC list during the term of the contract.

- Ensure that the maximum length of PBM contracts does not exceed three years.
- Include provisions in PBM contracts that define contract termination rights allowing the contract to be terminated at the discretion of the agency or higher education institution. At a minimum, these contract provisions should require providing prior notification to PBM contractors within a specified timeframe.

Chapter 1-C

Agencies and Higher Education Institutions Should Strengthen Contract Provisions Regarding Drug Formulary Management

Contract provisions should clearly define PBM contractors' role in influencing therapeutic interchange decisions.

Agencies' and higher education institutions' contract provisions do not consistently address whether a PBM contractor is allowed to or prohibited from influencing therapeutic interchange (see text box for additional details). There are two general types of therapeutic interchange:

Therapeutic Interchange

Therapeutic interchange refers to situations in which a pharmacist dispenses an alternative drug that is chemically different, but therapeutically similar, to a drug prescribed by a physician. A PBM contractor may influence pharmacists, physicians, or members to change prescriptions through therapeutic interchanges in the interest of lowering a plan's costs.

- Brand-to-brand therapeutic interchange involves switching a member's prescription from (1) a prescribed, multi-source brand drug that is not on the formulary to (2) a brand drug that is on the formulary and is chemically different but has the same medicinal properties.
- Brand-to-generic therapeutic interchange involves switching a member's prescription from (1) a prescribed, single-source brand drug to (2) a generic drug that is chemically different but has the same medicinal properties.

Lawsuits involving drug manufacturers and PBM contractors have disclosed allegations suggesting that PBM contractors use therapeutic interchanges to promote prescribing and using expensive drugs rather than less expensive, alternative drugs in order to receive larger rebate payments from drug manufacturers. The promotion of expensive drugs may lead to higher overall costs to a plan. Agencies and higher education institutions should ensure that either allowing or prohibiting therapeutic interchange is to the benefit and interest of their plans and their plans' members.

Contract provisions should require PBM contractors to notify agencies and higher education institutions before changing drug formularies.

Agencies and higher education institutions do not consistently require prior notification before a PBM contractor makes changes to the drug formulary. Adding, removing, or changing drugs on the drug formulary commonly occurs

during the life of the contract. However, it is not always apparent how changes to the drug formulary will affect a plan's costs or its members. By requiring prior notification from PBM contractors, agencies and higher education institutions could ensure that they are aware of changes made to their plans' formularies and assess whether those changes serve the best interests of their plans and their plans' members.

Recommendations

Agencies and higher education institutions should:

- Include provisions in PBM contracts that clearly state which types of therapeutic interchanges are allowable or prohibited.
- Include provisions in PBM contracts that require PBM contractors to maintain and make available as necessary the documentation of all instances in which therapeutic interchange is used.
- Include provisions in PBM contracts that require PBM contractors to provide prior notification within a specified timeframe concerning any changes that they make to a plan's drug formulary.
- Include provisions in PBM contracts that require PBM contractors to provide documentation explaining the reason for changes they make to a plan's drug formulary. At a minimum, this documentation should provide both the medical and financial reasons for a PBM contractor's addition, removal, or change in placement of a drug on a plan's drug formulary.

Laws Protecting the Confidentiality of Member Data

Federal and state laws require that any organization that manages health information must maintain the privacy of personal health information:

- The U.S. Health Insurance Portability and Accountability Act (HIPAA) requires organizations and business entities that manage electronic health information to have security and safeguards in place to maintain the privacy of health information.
- Texas Insurance Code, Section 4151.103, prohibits PBM contractors from selling a list of patients that contains information through which the identity of an individual patient is disclosed. However, this section does not prohibit providing information regarding a specific pharmaceutical product or service.

Chapter 1-D

Agencies and Higher Education Institutions Should Strengthen Provisions Regarding the Sale of Prescription Drug Plan Data

Agencies and higher education institutions' contracts include provisions that require PBM contractors to protect the personal identities of their plans' members in accordance with federal and state laws (see textbox for additional details).

However, agency and higher education institution contract provisions do not consistently address the selling of a plan's data from which members' personal information has been removed. PBM contractors use plan data from which personal information has been removed to develop information such as demographic and drug usage patterns

data. This data is used by PBM contractors for managing a plan and it may be sold to entities in both the pharmaceutical industry and the medical community.

There are no federal or state statutes that prohibit the sale of data that does not contain personal information. However, agencies and higher education institutions should ensure that their expectations regarding the sale of any data associated with their plans, including any revenue-sharing agreements, have been clearly stated within their PBM contracts. In addition, agencies and higher education institutions should require disclosure of all sales of their plans' data when PBM contractors are permitted to sell this data.

Recommendations

Agencies and higher education institutions should:

- Include provisions in PBM contracts that clearly state whether a plan's data can be sold.
- Include provisions in PBM contracts that specify the conditions under which a PBM contractor is allowed to sell a plan's data. At a minimum, these contract provisions should require the PBM contractor to disclose the sale of any plan data in a timely manner and describe any revenue-sharing agreements between agencies or higher education institutions and the PBM contractor concerning the sale of plan data.

Chapter 1-E

Agencies and Higher Education Institutions Should Require PBM Contractors to Disclose Potential Conflicts of Interest

Agencies' and higher education institutions' contracts reviewed included performance guarantees that define measures to determine satisfactory performance and PBM contractor compliance. Opportunities exist for standardizing the performance guarantees defined by the agencies and higher education institutions for standard services that PBM contractors provide (see Chapter 2-A for additional details). However, agencies and higher education institutions did not consistently require PBM contractors to disclose any policies, practices, or business relationships that could conflict with their obligations under PBM contracts. PBM contractors serve as both (1) the managers and (2) the mail order pharmacists to agencies' and higher education institutions' drug plans (see Appendix 6 for additional details). This exposes agencies and higher education institutions to the risk that PBM contractors could manipulate drug costs through their mail order pharmacies to increase their profits (at the expense of the plans).

A PBM contractor's operation of a mail order pharmacy could represent a potential conflict of interest with its obligation to provide drugs at the lowest possible cost. This also could conflict with the PBM contractor's promotion of certain drug manufacturers' and drug wholesalers' drugs. Lawsuits and settlements have alleged that certain PBM contractors have sold drugs through their mail order pharmacies at prices that are higher than the prices retail pharmacies charge.

Recommendation

Agencies and higher education institutions should include provisions in PBM contracts that require PBM contractors to disclose any policies, practices, or business relationships that may represent a conflict of interest with their obligations under the PBM contract.

Chapter 1-F

Agencies and Higher Education Institutions Should Include All Essential Contract Provisions Required by the *State of Texas Contract Management Guide* in Their PBM Contracts

Agencies and higher education institutions contracts included most, but not all, of the essential contract provisions that are required by the *State of Texas Contract Management Guide* (Guide). (See Appendix 7 for additional details.) Texas Government Code, Section 2262.051(d), requires that essential contract provisions **must** be included in state agency contracts to protect the interests of the state.

The following essential provisions were not consistently included in the PBM contracts auditors reviewed:

- Abandonment or default clause.
- Antitrust clause.
- Affirmation clause.
- Buy Texas clause.
- Funding out clause.
- Intellectual property indemnification clause.
- Technology access clause.

Texas Government Code, Section 2262.052, requires state agencies to comply with the Guide. Higher education institutions are not required to include the contract provisions required by the Guide.

Recommendation

Agencies and higher education institutions should include all essential contract provisions required by the Guide in their PBM contracts.

Additional Opportunities Exist to Strengthen Agencies' and Higher Education Institutions' PBM Contracts

The PBM contracts that auditors reviewed demonstrated that agencies and higher education institutions have adjusted their contracts to the changing risks in the PBM service environment. While Chapter 1 of this report identified opportunities for agencies and higher education institutions to strengthen specific PBM contract provisions, this chapter identifies additional opportunities to strengthen PBM contract development activities. Specifically:

Texas Health Care Policy Council

House Bill 916 (79th Legislature, Regular Session) created the Texas Health Care Policy Council (Council). The goal of the Council is to bring together agencies and higher education institutions, as well as other health care experts from the public and private sector, to identify and correct problems in the health care system. One of the Council's objectives is to ensure the most effective collaboration among state agencies in the purchase of health care products or services, such as PBM services. As agencies and higher education institutions develop expertise in purchasing health care products or services, they will assist other agencies in the purchase of the same products or services.

The Council is composed of the administrative heads of the following agencies and higher education institutions:

- The Health and Human Services Commission.
- The Department of State Health Services.
- The Department of Aging and Disability Services.
- The Texas Workforce Commission.
- The Higher Education Coordinating Board.
- The Department of Insurance.
- The Employees Retirement System.
- The Teacher Retirement System.
- Each health care-related licensing agency identified by the Governor.
- Any other state agency or system of higher education identified by the Governor that purchases or provides health care services.

- Agencies and higher education institutions have limited guidance in developing contract provisions for PBM services. Auditors identified opportunities for the Texas Health Care Policy Council to provide additional guidance for developing contract provisions for PBM services (see text box for additional details).
- Agencies and higher education institutions do not identify the specific information contained in their contracts that is considered proprietary information belonging to their PBM contractors. As a result, agencies and higher education institutions delay disclosure of their contract information until necessary assurances are provided for maintaining the confidentiality of proprietary information. Although it is reasonable for agencies and higher education institutions to protect their PBM contractors' proprietary information, it is not reasonable for them to delay access to entire contracts because they contain proprietary information.
- Agencies and higher education institutions can adopt specific practices to provide assurance that contract provisions clearly recognize and benefit the interests of their plans and members.

The Texas Health Care Policy Council Should Create and Standardize Guidelines for Developing PBM Contracts

The Texas Health Care Policy Council (Council) should take additional action to ensure that agencies' and higher education institutions' PBM contracts are consistent in addressing the high-risk areas associated with these types of contracts.

The Council currently relies on the self-direction of its members to coordinate and collaborate with one another in developing expertise in purchasing health care products or services, such as PBM services, with the expectation that the agencies or higher education institutions with expertise will assist others in purchasing those services. However, the Council also should provide direction to its members to ensure that they can benefit from their experiences in developing PBM contracts. The Council's broadly defined statutory authority does not provide it with the ability to create a guide to identify and standardize the best practices its members can follow when procuring health care products or services such as PBM services. The creation of such a guide could assist in ensuring that all agencies' and higher education institutions' PBM contracts address high-risk areas and other concerns the Council identifies.

The Council should develop a standardized list of key performance guarantees that should be included in agencies' and higher education institutions' PBM contracts.

Agencies' and higher education institutions' PBM contracts include performance guarantees that define measures to determine satisfactory performance and PBM contractor compliance. These performance guarantees are in areas such as cost-saving initiatives, claims processing, mail order service, customer service, performance and financial reporting, and other administrative activities. However, there are differences in the types of performance guarantees contained in current PBM contracts. For example, agencies and higher education institutions do not always have performance guarantees for:

- Ensuring PBM contractors fulfill cost-savings initiatives such as agreed-upon discount rates on member purchases of brand name drugs or on member purchases made from retail pharmacies or mail order pharmacies.
- Ensuring the performance of certain customer service activities, such as conducting customer satisfaction surveys, managing the receipt and resolution of complaints, or ensuring the availability of the plan's Web site to plan members.

Development of a standardized list of key performance guarantees for all PBM contracts would provide all agencies and higher education institutions

with consistent measures for benchmarking and comparing the costs and the quality of PBM services.

The Council should standardize the length of time during which agencies and higher education institutions have the right to audit PBM contractor records.

The length of time during which agencies and higher education institutions have the right to audit the records of their PBM contractors varies from six months after the end of a contract term to seven years after a contract's expiration date. Agencies and higher education institutions should ensure that their audit rights provide them with sufficient time to audit the costs, performance of services, and contract compliance for the final year of a contract. For example, audit rights that end six months after the expiration date of a contract term would not allow an agency or higher education institution to complete an audit and verify the accuracy of rebates received in the final year of the contract (it can take PBM contractors up to 18 to 24 months to receive rebates from drug manufacturers). The U.S. Centers for Medicare and Medicaid Services requires that the right to audit its PBM contracts lasts for 10 years from the end of the final contract period.

Recommendation

The Legislature should consider requiring the Texas Health Care Policy Council to develop a best practices guide for the contract provisions, key performance guarantees, and the minimum time frame for audit rights that agencies and higher education institutions should include in PBM contracts. At a minimum, this guide should define standard contract provisions based on the recommendations made in this audit report. (For proposed statutory language associated with this recommendation, see Appendix 4.)

Chapter 2-B

Agencies and Higher Education Institutions Should Identify Proprietary Information in Their PBM Contracts

Agencies and higher education institutions contracts do not identify the specific proprietary information belonging to their PBM contractors in their PBM contracts. Although agency and higher education institution staff have a general understanding of the proprietary information in their contracts, the contracts themselves do not specify which contract provisions contain proprietary information. As a result, agencies and higher education institutions may delay releasing the contract because it contains proprietary information, and this approach can unreasonably delay the disclosure of public information included in those contracts. For example:

- The Office of the Attorney General has been challenged by PBM contractors for its rulings permitting the release of an agency's or higher education institution's PBM contract under the Texas Public Information Act. One reason for these challenges has been that the contractors asserted that the PBM contracts contained proprietary information.
- Auditors experienced difficulties in receiving copies of PBM contracts. Auditors were asked to provide assurances to certain agencies and higher education institutions, at the request of their PBM contractors, that proprietary information included in the contracts would continue to be protected by auditors.

It is reasonable for agencies and higher education institutions to protect the PBM contractor's proprietary information contained in the contract, but it is not reasonable for them to delay access to the entire contract because it contains proprietary information. By clearly identifying the proprietary information included in their PBM contracts, agencies and higher education institutions can respond more quickly to information requests from the public and other interested parties.

Recommendation

Agencies and higher education institutions should clearly identify and label the contract provisions that include proprietary information belonging to PBM contractors.

Chapter 2-C

Agencies and Higher Education Institutions Should Strengthen Their PBM Contract Development Practices

Agencies and higher education institutions have at times developed some of their PBM contracts based on standard contract provisions or contract templates that PBM contractors have developed. This approach:

- Allows PBM contractors to define certain contract provisions in ways that may result in agencies and higher education institutions inappropriately agreeing to limitations and restrictions, such as the restrictions on the right to audit previously discussed in Chapter 1-A.
- Could result in unclear or ambiguous language being incorporated into PBM contracts. For example, auditors identified contract provisions that stated an agency or higher education institution could review "only portions necessary" or "certain data" during an audit. Without clearly describing the specific documentation that such language refers to, the

information that agencies and higher education institutions can review during an audit remains unspecified, which could limit or restrict the effectiveness of an audit.

In addition, the use of contract provisions developed by PBM contractors increases the risk that agencies and higher education institutions may unintentionally agree to unreasonable contract requirements. For example, an agency or higher education institution could unintentionally agree to allow a PBM contractor to retain a percentage of overpayments recovered as the result of audits of the pharmacy network (a more reasonable expectation would be for the PBM contractor to pass through 100 percent of all overpayments it recovers back to the agency's or higher education institution's plan).

Agencies and higher education institutions should ensure that their contract provisions (1) do not place them at a disadvantage in maintaining PBM contractors' accountability or (2) unreasonably benefit the interests of the PBM contractors at a cost to the plan or the plan's members.

Agencies and higher education institutions should incorporate key procurement documents and other agreements made during the contract procurement process into the final PBM contract.

Agencies and higher education institutions do not consistently incorporate key procurement documents such as the request for proposal, the contractor's bid proposal, and other agreements made during the contract procurement process to their final PBM contracts. The requirements and agreements described in these documents provide more detailed information on the guarantees and financial projections that PBM contractors made to agencies and higher education institutions during the contract procurement process. Agencies and higher education institutions can ensure they have the ability to hold their PBM contractors accountable to these guarantees and financial projections by incorporating these key procurement documents into the final PBM contract.

Agencies and higher education institutions should obtain professional advice from outside consultants in developing PBM contract provisions.

Agencies and higher education institutions do not always obtain the professional advice of outside consultants in developing their PBM contracts. However, some agencies and higher education institutions do obtain professional advice from outside consultants such as actuaries, pharmacists, attorneys, auditors, and other industry-related professionals to assist in assessing the adequacy and reasonableness of service requirements and financial terms.

The PBM industry is changing continuously, and new practices and approaches for purchasing and developing contracts for PBM services are being identified. Although this report identifies high-risk areas associated with PBM contracts, outside consultants with technical expertise in assisting and

developing contracts for PBM services in both the public sector and private sector can provide an invaluable resource to agencies and higher education institutions. The advice of outside consultants also can improve agencies' and higher education institutions' understanding of the issues and risks associated with developing PBM contracts. There are no statutory requirements that direct agencies or higher education institutions to obtain professional advice from outside consultants in developing their PBM contracts.

Recommendations

Agencies and higher education institutions should:

- Refrain from using contract templates or draft contracts provided by PBM contractors when developing their PBM contracts.
- Ensure they incorporate key procurement documents as part of their final PBM contracts to recognize all requirements, agreements, guarantees, and financial projections made by PBM contractors during the contract procurement process.
- Obtain the advice of outside consultants in assessing the adequacy of PBM contract provisions that address service requirements, financial terms, and other contract requirements.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of the audit were (1) to determine the similarities and differences among pharmacy benefit manager (PBM) contracts at the Teacher Retirement System, the Employees Retirement System, the University of Texas System, and the Texas A&M University System and (2) to assess whether there are contract provisions that would provide better value to other state entities or that would be advantageous if the State used a single PBM for all state health plans.

Scope

The scope of the audit included contracts between pharmacy benefit manager vendors and the following state entities from fiscal year 2005 through February 2008: the Teacher Retirement System, the Employees Retirement System, the University of Texas System, and the Texas A&M University System.

Methodology

The audit methodology consisted of reviewing information on contracting with PBM contractors, including contract terms incorporated by the public and private sectors. Auditors (1) collected and reviewed state agency and higher education institution information, documentation, and contracts and (2) analyzed and evaluated state agency and higher education institution documentation against established criteria.

Information collected and reviewed included the following:

- Reports and documentation from the Legislative Budget Board.
- State agencies' and higher education institutions' policies and procedures.
- Reports and correspondence between the state agencies and higher education institutions and their PBM contractors.
- Questionnaires and interviews with state agency and higher education institution management and staff.
- Interviews with state agency and higher education institution contracted consultants and auditors.

- Interviews with attorneys from the Office of the Attorney General.
- Correspondence with members from the Texas Health Care Policy Council.
- Contracts between PBM contractors and state agencies and higher education institutions
- Financial and non-financial data obtained from the state agencies and higher education institutions.

Procedures and tests conducted included the following:

- Identifying high-risk areas associated with PBM contracts as defined by industry standards and the *State of Texas Contract Management Guide*.
- Analyzing state agencies' and higher education institutions' procedures and policies for contracting with PBMs.
- Comparing state agencies' and higher education institutions' PBM contracts with industry standards and the *State of Texas Contract Management Guide*.
- Identifying the similarities and differences among the state agencies' and higher education institutions' PBM contracts.
- Analyzing the advantages and disadvantages of the similarities and differences in the state agencies' and higher education institutions' PBM contracts.
- Performing a financial trend analysis on the state agencies' and higher education institutions' PBM data.
- Comparing the state agencies' and higher education institutions' financial trend analyses.

Criteria used included the following:

- The U.S. Health Insurance Portability and Accountability Act of 1996.
- Texas Government Code.
- Texas Insurance Code.
- *State of Texas Contract Management Guide*, Version 1.3.
- Legislation enacted in other states.

- Audit reports from the Office of Inspector General within the U.S. Department of Health and Human Services.
- Reports from the U.S. Food and Drug Administration.
- Reports from the U.S. Federal Trade Commission.
- Reports and analysis from the National Conference of State Legislatures.
- Publications, periodicals, and public reports on the PBM service industry.

Project Information

Audit fieldwork was conducted from January 2008 through July 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Willie J. Hicks, MBA (Project Manager)
- Barbette J. Mays (Assistant Project Manager)
- Dannyaal Cooper
- LaTonya Dansby
- Nicole Elizondo, CFE
- Michael Gieringer, CFE
- Tracy L. Jarratt, MAcy, CPA
- Christy L. Srubar
- Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
- Lisa R. Collier, CPA (Audit Manager)

PBM Drug Costs and Number of Members Covered for Selected State Agencies and Higher Education Institutions for Fiscal Year 2007

Table 1 shows total drug costs for fiscal year 2007 for selected agencies and higher education institutions that had pharmacy benefit manager (PBM) contracts.

Table 1

Total Drug Costs Associated with Selected Agency and Higher Education Institution PBM Contracts ^{a b} Fiscal Year 2007						
Agency or Higher Education Institution	PBM Contractor	Effective Date of Contract with PBM	Number of Members Covered	Plan Drug Costs (in thousands)	Members' Cost Share for Drugs (in thousands)	Total Drug Cost (in thousands)
Employees Retirement System	Medco Health Solutions, Inc.	September 1, 2005, through August 31, 2008	449,664	\$ 334,408	\$ 162,911	\$ 497,319
Teacher Retirement System - Medco	Medco Health Solutions, Inc.	September 1, 2002, through August 31, 2008	228,899	151,820	75,668	227,488
Teacher Retirement System - Caremark	Caremark, LLC ^c	September 1, 2004, through August 31, 2006; annual renewals through August 31, 2010	154,780	316,996	106,603	423,599
The University of Texas System	Medco Health Solutions, Inc.	September 1, 2006, through August 31, 2009	147,614	117,309	39,155	156,464
The Texas A&M University System	PharmaCare Management Services, Inc. ^c	September 1, 2006, through August 31, 2009; annual renewals through August 31, 2012	34,092	32,139	11,566	43,705
Totals			1,015,049	\$952,672	\$395,903	\$1,348,575
<p>^a Amounts shown for drug costs do not reflect rebates, refunds, or administrative costs incurred.</p> <p>^b For amounts in millions, totals may not sum precisely due to rounding.</p> <p>^c Caremark, LLC and PharmaCare Management Services, Inc. are subsidiaries of CVS Caremark Corporation.</p>						

Source: Unaudited information provided by each agency and higher education institution.

Table 2 shows the total cost of drug benefits for fiscal year 2007 for selected agencies and higher education institutions that had PBM contracts.

Table 2

Total Cost of Drug Benefits Associated with Selected Agency and Higher Education Institution PBM Contracts (in Thousands) ^{a b c} Fiscal Year 2007				
Agency or Higher Education Institution	Drugs Costs for Retail Pharmacy Claims	Drug Costs for Mail Order Pharmacy Claims	PBM Administrative Costs	Total Cost of Drug Benefits
Employees Retirement System	\$ 343,327	\$ 153,992	\$ 0	\$ 497,319
Teacher Retirement System - Medco Health Solutions, Inc.	141,003	86,486	1,059	228,548
Teacher Retirement System - Caremark, LLC	178,396	245,203	4,351	427,950
The University of Texas System	87,921	68,543	193	156,657
The Texas A&M University System	27,331	16,374	158	43,863
Totals	\$777,977	\$570,598	\$5,762	\$1,354,337
<p>^a Amounts shown for drug costs do not reflect rebates, refunds, or administrative costs incurred.</p> <p>^b Administrative fees may include clinical fees, disease management fees, and other fees.</p> <p>^c Totals may not sum precisely due to rounding.</p>				

Source: Unaudited information provided by each agency and higher education institution.

Table 3 shows the total cost of drugs per plan member for fiscal year 2007 for selected agencies and higher education institutions that had PBM contracts.

Table 3

Total Cost of Drugs Per Plan Member Associated with Selected Agency and Higher Education Institution PBM Contracts ^a Fiscal Year 2007			
Agency or Higher Education Institution	Plan Drug Cost per Member	Members' Drug Cost Share per Member	Total Cost of Drugs per Member
Employees Retirement System	\$ 744	\$362	\$1,106
Teacher Retirement System - Medco Health Solutions, Inc.	\$ 663	\$331	\$ 994
Teacher Retirement System - Caremark, LLC	\$2,048	\$689	\$2,737
The University of Texas System	\$ 795	\$265	\$1,060
The Texas A&M University System	\$ 943	\$339	\$1,282
Average Costs per Member	\$ 939	\$390	\$1,329
^a Amounts shown for drug costs do not reflect rebates, refunds, or administrative costs incurred.			

Source: Unaudited information provided by each agency and higher education institution.

Glossary of Terms Associated with PBM Services

Brand Name Drug – A patented drug generally manufactured and sold by a drug manufacturer (single source brand name). There are instances in which more than one firm may produce a brand name drug. These types of brand name drugs are referred to as multi-source brand name drugs.

Brand-to-Brand Therapeutic Interchange - A type of therapeutic interchange involving the switching of a member's prescription from (1) a prescribed, multi-source brand drug that is not on the formulary to (2) a brand drug that is on the formulary, is chemically different, but has the same medicinal properties.

Brand-to-Generic Therapeutic Interchange - A type of therapeutic interchange involving the switching of a member's prescription from (1) a prescribed, single-source brand drug to (2) a generic drug that is chemically different but has the same medicinal properties.

Formulary – A list of drugs that a PBM contractor deems provides the highest benefit to a prescription drug plan's members at a relatively low cost. For brand name drugs with several close substitutes, PBMs negotiate with manufacturers for lower prices and rebates in return for placing the manufacturers' drugs on their formularies.

Generic Drug - A drug that is no longer protected by a patent. These drugs can be manufactured and distributed by different companies and must be approved by the U.S. Food and Drug Administration. Generic drugs are chemically identical to a corresponding brand name drug. Pharmacists generally can substitute a generic drug for a multi-source brand name drug without prior physician authorization.

Independent Pharmacy – A company that owns and operates three or fewer pharmacies. These are also referred to as community or neighborhood pharmacies.

Mail Order Pharmacy – A pharmacy that dispenses prescriptions to patients who submit their prescriptions by mail or fax. The pharmacy then mails the filled prescription to the patient. Mail order pharmacies generally serve patients on long-term drug therapies and those without immediate drug needs. The average size of prescriptions (that is, the number of capsules or tablets) dispensed by mail order pharmacies is usually three times larger than those dispensed by retail pharmacies.

Maximum Allowable Cost (MAC) - The highest amount a third party will pay a pharmacy for dispensing specific multiple source drugs (drugs for which generic equivalents exist). Public programs and private prescription drug

programs primarily use MAC pricing lists. There are no standard MAC lists. The lists are developed by the PBM contractors, are different for different vendors, and can change throughout the course of the contract.

Non-preferred Brand Name Drug – Designated prescription drugs that are available at a higher co-payment than most preferred brand name drugs. New drugs are designated as non-preferred until they are reviewed by a pharmacy and therapeutics committee.

Pharmacy Benefits Manager (PBM) contractor - An entity that administers the prescription drug portion of a health insurance plan offered by self-insured employers, insurance companies, and health maintenance organizations (HMOs). PBM contractors provide pharmacy claims processing and mail order pharmacy services, as well as other services, such as rebate negotiations with drug manufacturers, development of pharmacy networks, formulary management, review of drug usage, generic drug substitution, and disease management programs.

Pharmacy Network – Retail pharmacies, independent pharmacies, and mail order pharmacies under contract with a PBM contractor to provide services to a prescription drug plan, typically at a negotiated discounted fee.

Pharmacy and Therapeutics (P&T) Committee - A committee of independent members consisting of nationally recognized physicians and clinical pharmacists. The committee's purpose is to develop the formulary, prescribing guidelines, covered criteria (for example, prior authorization), and drug utilization review interventions. The committee meets quarterly to review information on safety and efficacy of each drug considered for inclusion or exclusion from the preferred and non-preferred brand name drug list.

Rebates – Amounts a drug manufacturer reimburses a prescription drug plan or PBM contractor for each unit of a specified drug dispensed under a plan. These arrangements are “after market” events because the rebate is not based on an individual sale but instead is based on the total sale of prescriptions filled for a particular drug. Rebates may be calculated only on certain drugs and are often contingent on PBM contractors meeting minimum sales targets or by restricting coverage for certain drugs.

Retail Pharmacy – A pharmacy that is part of a retail chain, such as chain drug stores, mass merchandisers, and food stores. The largest retail chains also maintain their own internal distribution system.

Specialty Drug - Pharmaceutical products that require administration through injection, orally, inhalation, or other non-oral methods. Specialty drugs require close supervision and monitoring and can be used to treat conditions

such as cancer, growth hormone deficiencies, infertility, multiple sclerosis, and rheumatoid arthritis.

Therapeutic Interchange – A practice through which a pharmacist dispenses an alternative drug that is chemically different, but therapeutically similar, to a drug prescribed by a physician. A PBM contractor may influence pharmacists, physicians, or members to change prescriptions through therapeutic interchanges in the interest of lowering a plan's costs.

Sources:

Allison Dabbs Garrett and Robert Garis, "Leveling the Playing Field in the Pharmacy Benefit Management Industry," *Valparaiso University Law Review*, Fall 2007.

Center for Medication Use Policy and Economics, University of Michigan College of Pharmacy, *Specialty Drug Whitepaper*, Developed for the University of Michigan Benefits Office, August 24, 2007.

Eastern Research Group, Inc., *Profile of the Prescription Drug Wholesaling Industry: Examination of Entities Defining Supply and Demand in Drug Distribution*, Prepared for the Office of Policy, Planning, and Legislation, Food and Drug Administration, U.S. Department of Health and Human Services, February 12, 2001.

Employees Retirement System request for proposal for PBM contract.

Federal Trade Commission, *Pharmacy Benefit Managers (PBM): Ownership of Mail-Order Pharmacies*, August 2005.

McGraw Wentworth, "Optimizing Your Pharmacy Benefit Manager Pricing," *Benefit Advisor*, November 2004.

Suggested Statutory Language for Enhancing the Role of the Texas Health Care Policy Council

Below is a draft of suggested statutory language requiring the Texas Health Care Policy Council to develop a best practices guide that defines standard contract provisions that, at a minimum, address the findings in this audit report.¹

§ 113.010. RESEARCH PROJECTS; REPORT. (a) The council shall identify gaps, flaws, inefficiencies, or problems in the health care system that create systemic or substantial negative impacts on the participants in the health care system, study those problems, and identify possible solutions for the state or other participants in the system.

(b) Not later than September 1 after each regular session of the legislature, the speaker of the house of representatives and the lieutenant governor may submit health care related issues to the governor for referral to the council. The health care related issues may include:

- (1) disparities in quality and levels of care;
- (2) problems for uninsured individuals;
- (3) the cost of pharmaceuticals;
- (4) the cost of health care;
- (5) access to health care;
- (6) the quality of health care; or
- (7) any other issue related to health care.

(c) The governor shall refer health care related issues to the council for research and analysis. The governor shall prioritize the issues for the council. The council shall study those issues identified by the governor and identify possible solutions for the state or other participants in the health care system.

(d) Not later than December 31 of each even-numbered year, the council shall submit a report of the council's findings and recommendations to the governor, lieutenant governor, and speaker of the house of representatives.

(e) The report submitted under Subsection (d) must include recommendations from the partnership and any other advisory body formed under Section 113.003.

(f) In consultation with the attorney general, the council shall develop and periodically update a guide for pharmacy benefit manager contracts for use by state agencies and institutions of higher education. The guide must include:

(1) model contract provisions, including provisions addressing findings in reports by the State Auditor;

¹ This statutory language is in draft form and is subject to review and redraft by the Texas Legislative Council.

(2) key performance guarantees; and
(3) a definition of the minimum length of time for audit
rights.

(g) State agencies and institutions of higher education shall follow the guidelines set forth in the contract guide developed under subsection (f) of this section when developing pharmacy benefit manager contracts.

Other States' Regulation of PBMs

Table 4 summarizes the regulation of pharmacy benefit managers (PBMs) in other states and the District of Columbia.

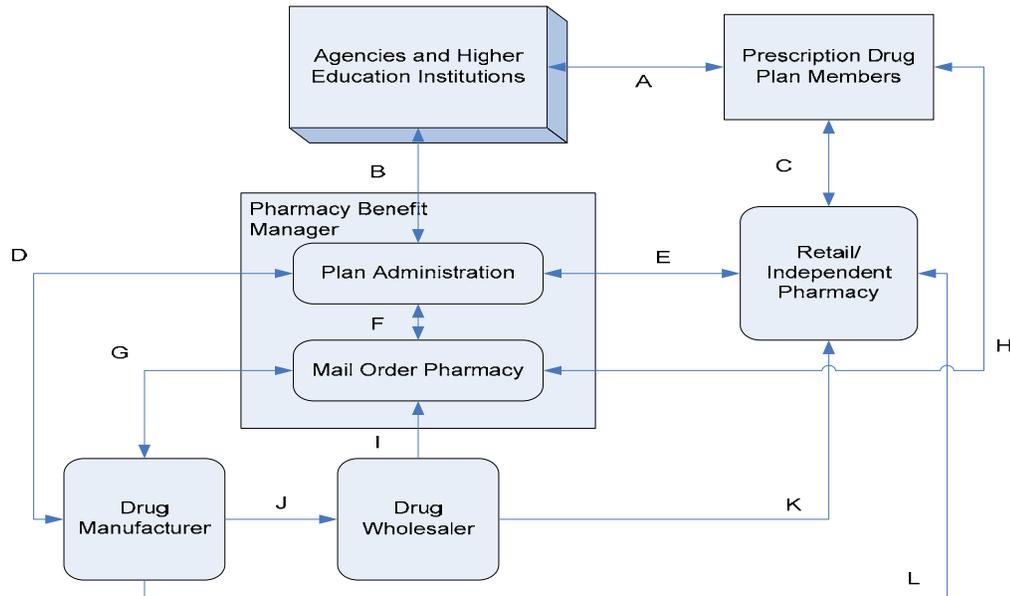
Table 4

Regulation of PBMs in Other States and the District of Columbia	
State	Summary of Legislation Passed
District of Columbia	2004 - Establishes fiduciary duty, requirements for transparent business practices, disclosure, and drug substitution (D.C. Code Annotated, Subsections 48-832.01 to 48-832.03).
Connecticut	2007 - Requires PBMs to obtain a certificate of registration from the Insurance Department before operating in Connecticut; applications require a list of individuals running the PBM, evidence of a security bond of at least \$25,000, and a \$50 annual fee. Permits the insurance commissioner to suspend, revoke, or deny registration for specified causes after notice and hearing. PBMs must apply annually for registration renewal. PBMs run by an insurer, hospital, or fraternal benefit society are exempt from registration requirements (Public Act 07-200).
Iowa	2007 - Creates regulations for PBMs and provides for penalties (Chapter No. 2007-193).
Kansas	2003 - Requires certification by the Insurance Department; establishes requirements for disclosure (Senate Bill 234). 2006 - Requires registration by the Insurance Department (Senate Bill 547).
Maine	2003 - Establishes fiduciary duty and requirements for rebates and disclosure (Maine Revenue Statutes Annotated, Title 22, Section 2699).
Maryland	2003 - Requires examination by the Insurance Department of PBMs that conduct utilization review (Maryland Code Annotated Insurance, Section 15-10B-20). 2004 - Establishes fiduciary duty and requirements for disclosure and drug substitution (House Bill 840) and registration by Department of Health and Mental Hygiene (House Bill 397). 2005 and 2006 - Requires registration by the Insurance Commissioner as third-party administrator; establishes requirements for disclosure and drug substitution, establishes pharmacy contracts standards (2005 - House Bill 1058 and 2006 - House Bill 493).
New Mexico	2003 - Certification by Superintendent of Insurance; establishes fiduciary duty (Senate Bill 871). 2005 - Licensure by Superintendent of Insurance, establishes pharmacy contract standards and requirements for disclosure and audit rights (House Bill 622 and Senate Bill 532). Additional legislation requires legislative task force to study the need to regulate PBMs (House Joint Memorial 98).
North Dakota	2005 - Requires licensure as administrators; establishes requirements for disclosure to Insurance Commissioner, disclosure to health plan sponsors, drug substitution, and pharmacy payments (North Dakota Century Code, Section 26.1-27).
South Dakota	2004 - Requires licensure as a third-party administrator; establishes requirements for disclosure to health plan sponsors, audit rights, and drug substitution (South Dakota Codified Laws, Subsections 58-29E to 29E-10).
Tennessee	2007 - Clarifies the duties of PBMs and mail order pharmacies, including providing protections for retail pharmacies during any audit by PBMs or by the state; requires 30-days advance notice and rights of appeals; and prohibits extrapolation of particular transactions. Also requires that reimbursement tables for payment by PBMs be updated every three days (Public Chapter 224).
Vermont	2007 - Increases "transparency of prescription drug pricing and information" by limiting "fraudulent" advertising of prescription drugs to consumers and health care professionals, requiring notice to clients by pharmacy benefit managers that certain types of contracts are available, expanding the Medicaid preferred drug list, and establishing an evidence-based education program (Chapter 80).
Washington	2007 - Requires health insurers, including private insurers, group health plans, service benefit plans, managed care organizations, PBMs, or other parties that are, by statute, contract, or agreement, legally responsible for payment of a claim for a health care item or service, as a condition of doing business in Washington, to increase their effort to share information with the department (Chapter 2007-179).

PBM Process Flowchart

The flowchart in Figure 1 shows the relationships among and activities performed by the various organizations and entities associated with a PBM contract.

Figure 1



Agencies and Higher Education Institutions

- A. Agencies and Higher Education Institutions collect monthly benefit payments from members and maintain eligibility records.
- B. Agencies and Higher Education Institutions contract for PBM services and pay PBM for members' pharmacy and mail order drug costs.

Prescription Drug Plan Members

- A. Members pay Agencies and Higher Education Institutions monthly benefit payments.
- C. Members pay a co-payment to receive retail and independent pharmacy drugs.
- H. Members pay a co-payment to receive mail order pharmacy drugs.

PBM Plan Administration

- B. PBM sends invoices to Agencies and Higher Education Institutions for members' retail and mail order drug costs. PBM passes through drug manufacturer rebates according to contract terms between Agencies and Higher Education Institutions and PBM.
- D. PBM negotiates contracts with drug manufacturers to receive manufacturer rebates and fees in exchange for drugs sales and placement on the PBM's covered drugs list.
- E. PBM administration establishes a retail and independent pharmacy network and reimburses pharmacy claims.
- F. PBM administration reimburses the PBM mail order pharmacy for drug claims.

PBM Mail Order Pharmacy

- G. PBM mail order pharmacy buys drugs from drug manufacturers.
- F. PBM mail order pharmacy files drug claims with PBM administration for reimbursement.
- H. PBM mail order pharmacy dispenses drugs to members.
- I. PBM mail order pharmacy buys drugs from drug wholesalers.

Retail/Independent Pharmacy

- C. Retail/Independent pharmacies dispense drugs to members.
- E. Retail/Independent pharmacies file claims with PBMs for reimbursement.
- K. Retail/Independent pharmacies buy drugs from drug wholesalers.
- L. Retail/Independent pharmacies buy drugs from drug manufacturers.

Drug Manufacturer

- D. Drug manufacturers give rebates and fees to the PBM administration according to contract terms.
- G. Drug manufacturers sell drugs to PBM mail order pharmacy.
- J. Drug manufacturers sell drugs to drug wholesalers.
- L. Drug manufacturers sell drugs to retail and independent pharmacies.

Drug Wholesaler

- J. Drug wholesalers buy drugs from drug manufacturers.
- I. Drug wholesalers sell drugs to PBM mail order pharmacy.
- K. Drug wholesalers sell drugs to retail and independent pharmacies.

Source: Prepared by the State Auditor's Office.

State of Texas Contract Management Guide *Essential Contract Provisions*

Table 5 lists the contract provisions identified in the *State of Texas Contract Management Guide* as essential provisions that must be included in all state contracts.

Table 5

<i>State of Texas Contract Management Guide</i>
Essential Provisions
Abandonment or Default - Specifies that the contractor will be held accountable for breach of contract or substandard performance without unfairly limiting competition in accordance with Texas Government Code, Section 2261.101.
Affirmation - Requires the contractor to affirm that all statements and information prepared and submitted in response to a solicitation are current, complete, and accurate.
Antitrust - Requires that the contractor represent and warrant that neither the contractor nor any firm, corporation, partnership, or institution represented by the contractor, or anyone acting for such firm, corporation, or institution has (1) violated the antitrust laws of the State of Texas under Texas Business and Commerce Code, Chapter 15, or the federal antitrust laws; or (2) communicated directly or indirectly the proposal to any competitor or any other person engaged in such line of business during the procurement process for the contract.
Buy Texas: "Contractor represents and warrants that it will buy Texas products and materials for use in providing the services authorized herein when such products and materials are available at a comparable price and in a comparable period of time when compared to non-Texas products and materials."
Consideration (contract price) - Describes a definite amount at a certain rate with a total maximum cost.
Contract specifications - Describe the services to be performed, and may specify that the agency will determine the answers to all questions that may arise as to the interpretation of the specifications, the quality or acceptability of work performed, the rate of progress of the work, and the conditions for determining the acceptable fulfillment of the service on the part of the contractor.
Contractor's responsibilities - Describes details of the contractor's responsibilities.
Dispute resolution - Describes a dispute resolution process in accordance with Texas Government Code, Chapter 2260.
Force Majeure: "An agency may grant relief from performance of the contract if the vendor is prevented from performance by an act of war, order of legal authority, act of God, or other unavoidable cause not attributable to the fault or negligence of the contractor. The burden of proof for the need of such relief shall rest upon the contractor. To obtain release based on force majeure, the contractor shall file a written request with the agency."
Funding out - Describes conditions if the contract term extends into the next biennium, for example "This contract is subject to cancellation, without penalty, either in whole or in part, if funds are not appropriated by the Texas Legislature."
Indemnification/damage: "Contractor shall defend, indemnify, and hold harmless the state of Texas, its officers, and employees, and the agency, its officers, and employees and contractors, from and against all claims, actions, suits, demands, proceedings, costs, damages, and liabilities, including without limitation attorneys' fees and court costs, arising out of, connected with, or resulting from any acts or omissions of contractor or any agent, employee, subcontractor, or supplier of contractor in the execution or performance of this contract. Contractor shall coordinate its defense with the Texas attorney general as requested by the agency. This paragraph is not intended to and shall not be construed to require contractor to indemnify or hold harmless the state or the agency for any claims or liabilities resulting from the negligent acts or omissions of the agency or its employees."

State of Texas Contract Management Guide

Essential Provisions

Independent Contractor:

"Both parties hereto, in the performance of this contract, shall act in an individual capacity and not as agents, employees, partners, joint ventures, or associates of one another. The employees or agents of one party shall not be deemed or construed to be the employees or agents of the other party for any purposes whatsoever. The contractor shall be responsible for providing all necessary unemployment and workers' compensation insurance for the contractor's employees."

Intellectual Property Indemnification - Requires that the contractor will indemnify, defend, and hold harmless the State of Texas and the system against any action or claim brought against the State of Texas/system that is based on a claim that software infringes any patent rights, copyright rights, or incorporated misappropriated trade secrets.

Introduction - Describes all parties involved in the contract that may include a contractor's complete name, any assumed names, and all addresses for the contractors.

Payment - Describes conditions such as the frequency of payment, time frame to submit payment, invoice specifications, and compliance with the Texas Prompt Payment law, Texas Government Code, Subtitle F, Chapter 2251.

Right to Audit - Describes that the State Auditor's Office's, the agency's, or any successor's right to conduct an audit or investigation and obtain all records requested.

Rights to Data, Documents and Computer Software (State Ownership) - Specifies that any research, reports, studies, data, or other documents prepared by the contractor in the performance of its obligations under the contract shall be the exclusive property of the State of Texas and all such materials shall be delivered to the State by the contractor upon completion, termination, or cancellation of the contract. In addition, conditions may describe instances in which the State does not wish the work products of the contractor to be made available to any other entity, public or private, but the contractor also is not entitled to any additional profit or benefit when payment for the said products was by public funds, unless the state agency has given its prior approval of the use of the materials.

Scope of work - Defines the scope of work from the solicitation document and may include the contractor's response outlining the proposed scope of work.

Technology Access

(1) Effective September 1, 2006, state agencies and institutions of higher education shall procure products which comply with the State of Texas Accessibility Requirements for Electronic and Information Resources specified in Title 1, Texas Administrative Code, Chapter 213, when such products are available in the commercial marketplace or when such products are developed in response to a procurement solicitation.

(2) Vendor shall provide the Department of Information Resources with the URL to its Voluntary Product Accessibility Template (VPAT) for reviewing compliance with the State of Texas Accessibility requirements (based on the federal standards established under Section 508 of the U.S. Rehabilitation Act), or indicate that the product/service accessibility information is available from the General Services Administration "Buy Accessible Wizard" (<http://www.buyaccessible.gov>). Vendors not listed with the "Buy Accessible Wizard" or supplying a URL to their VPAT must provide the Department of Information Resources with a report that addresses the same accessibility criteria in substantively the same format.

Term of contract - Describes the duration of the contract including the beginning date and ending date of the contract, and may include conditions for renewal and conditions for price increases.

Terminate - Specifies that, upon full performance of all requirements contained in the contract, unless otherwise extended or renewed as provided in accordance with the contract terms and conditions, the contract will terminate.

Management's Responses from the Agencies and Higher Education Institutions Audited and the Texas Health Care Policy Council

**Teacher Retirement System
of Texas**



1000 Red River Street
Austin, Texas 78701-2698

EXECUTIVE DIRECTOR
Ronnie G. Jung

800-223-8778 (512) 542-6400 www.trs.state.tx.us

August 7, 2008

Mr. John Keel, CPA, State Auditor
Texas State Auditor's Office
P.O. Box 12067
Austin, Texas 78711-2067

Dear Mr. Keel:

The accompanying sections of this letter contain the official TRS responses to the management letter recommendations from your office. We appreciate the professional manner in which this audit was conducted.

Sincerely,

A handwritten signature in cursive script that reads "Ronnie Jung".

Ronnie Jung

1-800-223-8778

Tel. (512) 542-6401

Fax. (512) 542-6585

Chapter 1-A
Agencies and Higher Education Institutions Should Strengthen Contract Provisions Regarding Audit Rights

Management's Response

TRS believes its contracts with the PBMs contain almost all elements of the recommendations. For the recommendation not in current contracts, TRS does not agree with the following:

- *Ensure that their contractual right to audit a PBM contractor is not limited to only certain types of audits.* TRS has contractual rights to audit its PBM contractors' records that pertain to transactions directly attributable to TRS plans' drug utilization and applicable contract terms, and does not need unlimited audit rights beyond the scope of these relationships. However, TRS will consider this recommendation during future contract negotiations.

Chapter 1-B
Agencies and Higher Education Institutions Should Strengthen Contract Provisions Regarding Costs, Discounts, and Other Fees

Management's Response

TRS believes its contracts with the PBMs contain most elements of the recommendations. TRS agrees with the following recommendation not included in one of the TRS contracts:

- *Include provisions in PBM contracts that identify the specialty drugs that are included in their plans' formularies, including the applicable costs and discounts.*

TRS will consider this recommendation during future contract negotiations.

TRS in part disagrees with the following recommendations:

- *Include provisions in PBM contracts that require all documentation and data concerning PBM contractors' financial agreements with drug manufacturers, drug wholesalers, and the pharmacy network be accessible to their agencies' and high education institutions' staff and independent auditors.*
- *Include provisions in PBM contracts that define the methodology the PBM contractor will use to periodically calculate (1) the total rebates received from drug manufacturers for their plans and (2) the amount of rebates that will be passed through to their plans.*

Through the competitive bidding process, TRS obtains the best possible terms for its PBM contracts. All elements related to TRS's ability to verify the PBM's financial data relevant to the agreed contractual reimbursements for prescription drugs, regardless of source is guaranteed in the contracts. TRS does not agree that its contracts should contain provisions that are outside the scope of the services and negotiated terms for the plans. For example, one TRS contract has a guaranteed flat rebate rate per applicable prescription. TRS disagrees that it should have access to full rebate data as this is irrelevant to the terms negotiated in the contract. However, TRS will consider these recommendations during future contract negotiations.

Chapter 1-C

Agencies and Higher Education Institutions Should Strengthen Contract Provisions Regarding Drug Formulary Management

Management's Response

TRS believes its contracts with the PBMs contain almost all elements of the recommendations. For the recommendation not in current contracts, TRS does not agree with the following:

- *Include provisions in PBM contracts that require PBM contractors to provide documentation explaining the reason for changes they make to a plan's drug formulary. At a minimum, this documentation should provide both the medical and financial reasons for a PBM contractor's addition, removal, or change in placement of a drug on a plan's formulary.*

TRS does not use a custom formulary, but the standard formulary developed by the PBM's independent Pharmacy and Therapeutic Committee for the PBM's entire book of business. TRS does not have the authority or expertise to manage a custom formulary and the standard PBM formularies are more cost-effective for the plans. Therefore, access to this information would not be meaningful to TRS. However, TRS will consider this recommendation during future contract negotiations.

Chapter 1-D

Agencies and Higher Education Institutions Should Strengthen Provisions Regarding the Sale of Prescription Drug Plan Data

Management's Response

TRS believes its contracts with the PBMs contain the elements of the recommendations.

Chapter 1-E
Agencies and Higher Education Institutions Should Require PBM Contractors to Disclose Potential Conflicts of Interest

Management's Response

TRS believes its contracts with the PBMs contain the elements of the recommendation.

Chapter 1-F
Agencies and Higher Education Institutions Should Include All Essential Contract Provisions Required by *the State of Texas Contract Management Guide* in Their PBM Contracts

Management's Response

TRS's contracts with the PBMs contain almost all essential contract provisions required by the State of Texas Contract Management Guide. TRS believes some clauses that have no relevance to the services being provided by the PBM do not belong in the contract. For example, the Intellectual property indemnification clause is not pertinent when the relationship involves no intellectual property. However, TRS will consider inclusion of all provisions during future contract negotiations.

Chapter 2-A
The Texas Health Care Policy Council Should Create and Standardize Guidelines for Developing PBM contracts

Management's Response

This recommendation is to the Texas Legislature, not TRS. However, TRS agrees to consider any resulting best practices guide developed by the Texas Health Care Policy Council.

Chapter 2-B
Agencies and Higher Education Institutions Should Identify Proprietary Information in Their PBM Contracts

Management's Response

TRS believes its contracts with the PBMs contain the elements of the recommendation.

Chapter 2-C
**Agencies and Higher Education Institutions Should Strengthen Their PBM
Contract Development Practices**

Management's Response

TRS believes its contracts with the PBMs contain the elements of the recommendations.



August 5, 2008

**EMPLOYEES
RETIREMENT
SYSTEM OF TEXAS**

Ann S. Fuelberg
Executive Director

Bill Ceverha
Chair

Yolanda Griego
Vice-Chair

Board of Trustees
Cydney C. Donnell
Don Green
I. Craig Hester
Owen Whitworth

John Keel, CPA
State Auditor
P. O. Box 12067
Austin, Texas 78711-2067

Dear Mr. Keel:

Thank you for the opportunity to respond to the State Auditor's draft audit report on "Pharmacy Benefit Managers Contracts at Selected State Agencies and Higher Education Institutions." We recognize the significant commitment of time and effort by your staff in this review.

Attached is our formal management response to the issues and recommendations raised in the report. In that contracts of four different entities were reviewed and the recommendations were combined as one, our management response pertains to those recommendations that are already in place in our current and upcoming contract and acknowledges those new ideas.

We would be remiss, however, if we did not bring up a concern with part of the document. In Appendix 2 Table 2, the auditors list some utilization data including the dollar amount of rebates. At the auditor's request, we have provided both the amount of the rebate which was paid to the PBM by Pharmaceutical Manufacturers but also the amount of rebates paid by the PBM to the Employees Retirement System of Texas. Rebates paid by pharmaceutical manufacturers to the PBM or the PBM payments to a client are considered by the PBMs to be confidential and proprietary. We supplied this information to your office under a confidentiality and non-disclosure agreement.

ERS does not have an opinion as to whether this information is or is not confidential under the Public Information Act, but would be happy to ask the Office of the Attorney General for its counsel.

We appreciate your efforts. Should you have any additional comments or would like to discuss this matter, please let us know.

Sincerely,

ANN S. FUELBERG
Executive Director

Attachment

18th & Brazos Streets ✪ P.O. Box 13207 ✪ Austin, Texas 78711-3207 ✪ (512) 867-7711 ✪ (877) 275-4377 Toll-free

ERS' Management Response to the SAO's Audit Report on Pharmacy Benefit Manager Contracts at Selected State Agencies and Higher Education Institutions

Chapter 1-A

The Employees Retirement System (ERS) agrees that PBM contracts should, as ERS' contract does, include provisions which enable ERS to conduct all types of audits necessary to ensure compliance with all the general and specific provisions and requirements outlined in the contractual agreements. ERS' audit provisions give audit rights not only to ERS but additionally to the Texas State Auditor to conduct an audit or investigation of the PBM and its subcontractors.

ERS' independent auditor follows Generally Accepted Auditing Standards (GAAS) in the audit process of the PBM.

Chapter 1 –B

ERS agrees that audit rights and all necessary documentation should be available to ERS and its designated auditors to verify the terms and conditions, accuracy, warranties and representations and compliance of the pharmacy benefit manager's response to the request for proposal and resulting contract that incorporates all the necessary documents. ERS contracts contain provisions that include a listing of specialty drugs covered in the formulary, a single MAC listing used in the ERS program, rights to include or exclude a drug on the formulary, which third party database is used in the billing of drug costs and a unilateral right to terminate the agreement without cause subject to notification.

Chapter 1 – C

ERS contracts contain provisions prohibiting the use of "therapeutic interchange" and give ERS the exclusive right to determine which drugs are included in the formulary and, therefore, which tiered co-pay is applied.

Chapter 1 –D

ERS agrees, and our contracts contain provisions which prohibit the sale of plan data, unless prior, express, written consent is obtained from ERS.

Chapter 1 –E

ERS contracts include a provision which requires the PBM to warrant and represent that there are no relevant facts or circumstances that could give rise to any conflict of interest or appearance of impropriety with regard to the contract, and create an ongoing duty on the part of the PBM to report any such incidents throughout the contract term.

Chapter 1 – F

ERS complies with the essential contract provisions contained within the State of Texas Contract Management Guide. Sections in ERS' contracts dealing with indemnification provide for extensive indemnification obligations on the part of the PBM in favor of ERS, and the fact that the PBM is contracting with over 4,000 retail pharmacy locations, who receive in excess of \$495,000,000 in pharmacy payments, and employ thousands of Texans demonstrates our compliance with the spirit of the guide provisions regarding buy Texas. ERS will continue to incorporate appropriate language in future contracts.

Chapter 2 –A

As a member of the Council, ERS works very closely with the Council on pharmacy benefit manager issues as well as other matters. We will continue to work with the Council in whatever role the Legislature deems appropriate.

Chapter 2 – B

ERS agrees, and, in accordance with the Public Information Act, ERS requires the PBM to clearly outline all information the PBM contends to be proprietary and confidential.

Chapter 2 – C

ERS has not utilized any contract, template or drafts contracts developed or provided by any PBM, and ERS will continue to utilize the outside review of our RFP for service requirements, financial terms and other requirements.



The University of Texas System
Nine Universities. Six Health Institutions. Unlimited Possibilities.

Office of Business Affairs
201 West 7th St, Suite 810A, Austin, Texas 78701
Phone: 512-499-4560 Fax: 512-499-4289

August 5, 2008

Willie J. Hicks
Project Manager
State Auditor's Office
1501 N. Congress Avenue
Austin, Texas 78701

Dear Mr. Hicks:

Thank you for the opportunity to respond to the audit report on Pharmacy Benefit Manager Contracts at Selected State Agencies and Higher Education Institutions.

Please find enclosed the letter of representation for The University of Texas System and The U. T. System Management Response to the State Auditor's Office.

If there are any questions regarding these documents, please contact The U. T. System Office of Employee Benefits at (512) 499-4616.

Sincerely,

Scott C. Kelley
Executive Vice Chancellor
for Business Affairs

Enclosures

cc: Members of the University of Texas System Board of Regents

Mr. H. Scott Caven, Jr., Chair
Mr. James R. Huffines, Vice-Chair
Mr. Robert B. Rowling, Vice-Chair
Mr. John W. Barnhill, Jr.
Mr. James D. Dannenbaum, P.E.
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Ms. Laura Chambers, Manager of Insurance Benefits

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The University of Texas - Pan American
The University of Texas
of the Permian Basin
The University of Texas at San Antonio
The University of Texas at Tyler

The University of Texas
Southwestern Medical Center at Dallas

The University of Texas
Medical Branch at Galveston

The University of Texas
Health Science Center at Houston

The University of Texas
Health Science Center at San Antonio

The University of Texas
M. D. Anderson Cancer Center

The University of Texas
Health Center at Tyler

www.utssystem.edu

The University of Texas System
Management Response to the
State Auditor's Office
Pharmacy Benefit Manager Contracts at Selected State Agencies
and Higher Education Institutions

August 5, 2008

Chapter 1-A

Agencies and higher education institutions should:

Ensure that their contractual right to audit a PBM contractor is not limited to only certain types of audits.

UT System Management Response: UT System ("System") agrees with and is already in compliance with this recommendation. Although the System's PBM Contract audit provision provides the PBM must specifically permit Systems to conduct claims and formulary audits; it does not limit System's right to conduct other audits. As stated in the procurement document, which is incorporated as part of the Contract, in addition to a claims audit, "...the System may, at its discretion, conduct other audits of the vendor as it may deem necessary." (Request for Proposals at Section 4.5). In addition, the Contract audit clause states the PBM understands and agrees the State Auditor is authorized by law to conduct an audit of any contract entered into by System. Taken together, it is clear from the Contract that the contractual right of System to audit a PBM contractor is not limited.

Ensure that their contractual right to audit a PBM contractor requires PBM contractors to provide access to all financial records, contracts, medical records, and other information associated with the services PBM contractors or their subcontractors provide to a plan.

UT System Management Response: UT System ("System") agrees with and is already in compliance with this recommendation. The audit clause in Systems PBM contract requires its PBM contractor to permit "representatives of System to audit and examine [contractor's] records and accounts which pertain, directly or indirectly to the Plan at such reasonable times as may be requested by System for purposes of confirming its contractual obligations under this Contract." This provision clearly encompasses access to each of these categories of information and System has the authority to require access to the records enumerated in the recommendation. In addition, Section VI of the Contract, "Records," requires the carrier to maintain adequate records of all transactions between the PBM and "providers, System and plan participants on behalf of System;" to maintain such records on behalf of System; to return them after the contract terminates; and to make them available for inspection by System, its authorized representative or a duly authorized governmental authority. However, in an abundance of caution, System will include in all future contracts that records and

accounts subject to audit by System which pertain, directly or indirectly to the Plan include but are not limited to all financial records, contracts, medical records and other information associated with the services PBM contractors or their subcontractors provide to a plan.

□ Ensure that their contractual right to audit a PBM contractor requires that audits be conducted in accordance with auditing standards.

UT System Management Response: UT System (“System”) agrees with and is already in compliance with this recommendation in regard to the PBM contract. Nothing in System’s contract audit clause prohibits System from conducting an audit in accordance with a particular audit standard. System believes this particular recommendation is actually intended to address the fact that System’s current contract with an independent auditor to conduct System’s claims audits does not state the auditing standard the auditor is required to employ. System agrees its contracts with the independent claims auditor should include this requirement and will make this a requirement in all such future contracts.

□ Define reporting requirements for audits that PBM contractors conduct of the pharmacy network. At a minimum, these requirements should describe (1) what information should be reported, (2) how often audit results should be reported, and (3) whether the PBM contractor must return recovered overpayments to the prescription drug plan.

UT System Management Response: UT System (“System”) agrees with and is already in compliance with this recommendation. The current contract includes a requirement the PBM will maintain a comprehensive system for the detection of fraud, overcharges, abuse, overpayments and deceptive and duplicitous billing, and specifically to conduct a Pharmacy Audit Program for the Retail Pharmacy Network. The PBM’s proposal, which is incorporated as part of the contract, describes its audit program and lists the information to be reported. The contract requires the PBM to provide quarterly reports. The PBM explicitly agrees all recoveries made on behalf of System appear as audit credits on bi-weekly billing invoices. System has consistently received audit recoveries from its contracting PBM.

□ Require that audits of mail order pharmacies owned by their PBM contractors be conducted by independent auditors that are selected by and report to the agencies and higher education institutions.

UT System Management Response: UT System (“System”) agrees it is reasonable to require a PBM conduct independent audits of its facilities and services areas, including its own mail order pharmacies, and that System may under the terms of the contract either conduct its own audits or engage an independent auditor to audit aspects of the PBMs mail order pharmacy that relate to the System plan; however, System notes that applicable laws and regulations, including 22 Texas Administrative Code Sec. Rule 501.7, require professional auditors to conform with state and national accountancy standards for independence of the auditor, regardless of who selects the auditor. Therefore, implementing this specific recommendation would not produce demonstrably better quality audit results than the

methods described above and would most likely impair System's ability to procure high value, low cost pharmacy benefits for its plan participants.

System, through the Director of the Office of Employee Benefits, will implement this recommendation during the next negotiation process or RFP process, whichever is earlier, if it determines that implementation will not impair the ability to procure high value, low cost pharmacy benefits.

Chapter 1-B

Agencies and higher education institutions should:

□ Include provisions in PBM contracts that require all documentation and data concerning PBM contractors' financial agreements with drug manufacturers, drug wholesalers, and the pharmacy network be accessible to their agencies' and higher education institutions' staff and independent auditors.

UT System Management Response: UT System ("System") agrees this could be considered should System enter into a full-transparency contract with a PBM; however, System also believes implementation of this recommendation may limit competition and increase cost. System is willing to incorporate these additional provisions as long as the recommendation does not increase the cost of the program or limit the competitive environment.

The Director of the Office of Employee Benefits will be responsible for including provisions requiring the PBM disclose their financial agreements during the next negotiation process or RFP process, whichever is earlier, if it determines that implementation will not impair the ability to procure high value, low cost pharmacy benefits.

□ Include provisions in PBM contracts that specify the third-party entity database the PBM contractor must use when billing drug costs to agencies and higher education institutions.

UT System Management Response: UT System ("System") agrees with and is already in compliance with this recommendation. System's PBM contract requires the PBM to utilize the use of First Databank's National Drug Data File as the third party data base for billing drug costs.

□ Include provisions in PBM contracts that define the methodology the PBM contractor will use to periodically calculate (1) the total rebates received from drug manufacturers for their plans and (2) the amount of rebates that will be passed through to their plans.

UT System Management Response: UT System ("System") agrees the PBM contractor should be contractually required to disclose their methodology to calculate their rebates. System

does receive a quarterly aggregate report from the PBM which provides information on the total rebates received from drug manufacturers which includes a summary of the portion that System receives. System relies on the expertise of the contracted PBM to negotiate drug manufacturer rebates and to ensure the plan receives the correct amount per contract specifications, and the System has the right to audit compliance with contract specifications. System relies on both the expertise of the PBM and the contracted actuary to ensure that System receives a contract with rebates which represent the best value to System.

During the next negotiation process or RFP process, whichever is earlier, the Director of the Office of Employee Benefits will be responsible for including recommendations that require a PBM to disclose their rebate calculation methodology provided it will not impair the ability to procure high value, low cost pharmacy benefits.

Include provisions in PBM contracts that describe the documentation that will be used to support the rebate amounts calculated by the PBM contractor.

UT System Management Response: UT System ("System"), through the Director of the Office of Employee Benefits, will be responsible for including requirements for supporting documentation on how rebate amounts are calculated during the next negotiation process or RFP process, whichever is earlier, if System determines that implementation does not impair the ability to procure high value, low cost pharmacy benefits.

Include provisions in PBM contracts that identify the specialty drugs that are included in their plans' formularies, including the applicable costs and discounts.

UT System Management Response: UT System ("System") agrees with and is compliance with this recommendation. System's PBM contract includes a schedule that contains this information.

Include provisions in PBM contracts that define the MAC list prices that the PBM contractor will use.

UT System Management Response: UT System's ("System") PBM contract defines the MAC list prices as those on a schedule developed by the contractor, and the contract recognizes the list and payment schedules will be frequently updated. This allows prices for generic drugs to change during the term of the contract to the benefit of the plan participants and the plan.

Additionally, when MAC is used to calculate the price of a prescription claim, that MAC price is included on the claims detail received by System. The MAC information can be used to ensure System receives the value of MAC pricing through the guarantees contained in the PBM contract. MAC pricing is derived to establish reasonable maximum costs for plans and includes a number of elements to reflect market place availability, wholesale price index and

usual and customary pricing in the market, similar to negotiated contract reimbursement rates for physicians who participate in health insurance carrier contracts.

The Director of the Office of Employee Benefits will be responsible for requiring the MAC list disclosure during the next negotiation process or RFP process, whichever is earlier.

Include provisions in PBM contracts that require PBM contractors to provide prior notification of all changes they make to the MAC list during the term of the contract.

UT System Management Response: UT System ("System") agrees with the recommendation that the PBM contractor should be contractually required to disclose the MAC list applicable to System's plan.

The Director of the Office of Employee Benefits will be responsible for requiring the MAC list disclosure during the next negotiation process or RFP process, whichever is earlier.

Ensure that the maximum length of PBM contracts does not exceed three years.

UT System Management Response: UT System ("System") agrees with and is already in compliance with this recommendation. This is a routine requirement for all vendors that contract with System's uniform group insurance program. All contracts are for a maximum three year period renewable at System's option.

Include provisions in PBM contracts that define contract termination rights allowing the contract to be terminated at the discretion of the agency or higher education institution. At a minimum, these contract provisions should require providing prior notification to PBM contractors within a specified timeframe.

UT System Management Response: UT System ("System") agrees with and is already in compliance with this requirement. This is a routine requirement for all of its vendors for its uniform group insurance program. The termination clause in System's PBM contract Page 6, Section VII(b)(3) states, "In addition to and without restricting any other legal, contractual or equitable remedies otherwise available, System may terminate the Contract without cause by giving [the PBM] ninety (90) days written notice."

Chapter 1-C

Agencies and higher education institutions should:

Include provisions in PBM contracts that clearly state which types of therapeutic interchanges are allowable or prohibited.

UT System Management Response: UT System ("System") agrees with and is already in compliance with this recommendation. System's plan does not permit brand to brand interchanges or low cost to high cost drug interchanges. Additionally, System receives claim

detail which provides interchange indicators and/or Dispense as Written (DAW) indicators for each claim to assist with claims audits.

Include provisions in PBM contracts that require PBM contractors to maintain and make available as necessary the documentation of all instances in which therapeutic interchange is used.

UT System Management Response: UT System (“System”) agrees with and is already in compliance with this recommendation. Page 5, Section VI of the contract requires the PBM to maintain all transactions between the PBM and providers and plan participants. Additionally, System is contractually entitled to receive this information from the PBM upon request at any time.

Include provisions in PBM contracts that require PBM contractors to provide prior notification within a specified timeframe concerning any changes that they make to a plan’s drug formulary.

UT System Management Response: UT System (“System”) agrees with and already practices this recommendation as a result of long established business practice. System will formalize the practice in an appropriate contract provision. Changes to the plan formulary are communicated sixty days prior to implementation and necessary communication to the membership is approved and sent thirty-days prior to the formulary change.

The Director of the Office of Employee Benefits will be responsible for formalizing the current practice of notifying System of formulary changes within a designated timeframe during the next negotiation process or RFP process, whichever is earlier.

Include provisions in PBM contracts that require PBM contractors to provide documentation explaining the reason for changes they make to a plan’s drug formulary. At a minimum, this documentation should provide both the medical and financial reasons for a PBM contractor’s addition, removal, or change in placement of a drug on a plan’s drug formulary.

UT System Management Response: UT System (“System”) agrees with this recommendation. UT System will, through the Director of the Office of Employee Benefits incorporate this recommendation during the next negotiation process or RFP process, whichever is earlier, if System determines that implementation does not impair the ability to procure high value, low cost pharmacy benefits.

Chapter 1-D

Agencies and higher education institutions should:

Include provisions in PBM contracts that clearly state whether a plan’s data can be sold.

UT System Management Response: UT System (“System”) agrees and currently requires all sensitive data, including all personally identifiable data about a plan participant, may not be disclosed. System does not place restrictions on de-identified aggregate data as it believes this is considered under industry standards to be the legitimate property of the PBM. As stated in the audit report, there is no prohibition against the sale of aggregate de-identified data as there is no possibility of harm to the Plan’s participants or the Plan. System believes placing limitations on the use of de-identified aggregate data would disrupt a PBMs ongoing business practices and could inhibit a PBM from bidding to provide PBM services, thus reducing System’s ability to benefit from a robust competitive bidding process without realizing any measurable benefit to System.

□ Include provisions in PBM contracts that specify the conditions under which a PBM contractor is allowed to sell a plan’s data. At a minimum, these contract provisions should require the PBM contractor to disclose the sale of any plan data in a timely manner and describe any revenue sharing agreements between agencies or higher education institutions and the PBM contractor concerning the sale of plan data.

UT System Management Response: As noted above, UT System (“System”) currently requires no sensitive data, including all personally identifiable data about a plan participant, be disclosed. System does not place restrictions on de-identified aggregate data as it believes this is considered under industry standards to be the legitimate property of the PBM. As stated in the audit report there is no prohibition against the sale of aggregate de-identified data as there is no possibility of harm to the Plan’s participants or the Plan. System believes placing limitations on the use of aggregate data would disrupt a PBMs ongoing business practices and could inhibit a PBM from bidding to provide PBM services, thus reducing System’s ability to benefit from a robust competitive bidding process without realizing any measurable benefit to System. To clarify the System’s intent in future PBM contracts, System will incorporate this additional provision as long as the incorporation does not increase the cost of the program or limit the competitive environment. If System were to enter into a revenue sharing agreement, the System agrees such an agreement should be documented in the contract.

Chapter 1-E

Agencies and higher education institutions should include provisions in PBM contracts that require PBM contractors to disclose any policies, practices, or business relationships that may represent a conflict of interest with their obligations under the PBM contract.

UT System Management Response: UT System (“System”) agrees with and substantially complies with this recommendation. System currently requires its PBMs to disclose any business relationships that could represent a potential conflict of interest as well as its action

plan for addressing unforeseen conflicts of interests as they arise. System agrees to include additional language requiring disclosure with regard to policies and procedures in future contracts.

The Director of the Office of Employee Benefits will be responsible for including additional language requiring disclosure with regard to policies and procedures in future contracts during the next negotiation process or RFP process, whichever is earlier.

Chapter 1-F

Agencies and higher education institutions should include all essential contract provisions required by the Guide in their PBM contracts.

UT System Management Response: These provisions, or sufficiently similar provisions, are part of the UT System (“System”) contract templates promulgated by the System’s Office of General Counsel and are incorporated in each contract in which the provisions are determined to be relevant and appropriate. System will review the relevance and appropriateness of the identified provisions to the System’s PBM contracts and, as applicable, will incorporate the provisions into future PBM contracts.

The Director of the Office of Employee Benefits will be responsible for incorporating applicable contract provisions during the next negotiation process or RFP process, whichever is earlier.

Chapter 2-A

The Legislature should consider requiring the Texas Health Care Policy Council to develop a best practices guide for the contract provisions, key Performance guarantees, and the minimum time frame for audit rights that agencies and higher education institutions should include in PBM contracts. At a minimum, this guide should define standard contract provisions based on the recommendations made in this audit report. (For proposed statutory language associated with this recommendation, see Appendix 4.)

UT System Management Response: As noted throughout the UT System’s (“System”) management responses, System already complies with the vast majority of the recommendations of the audit and therefore currently engages in best practices currently. While System would welcome a collaborative approach to identifying best practices, we believe legislation requiring the Texas Health Care Policy Council to develop a new and additional regulatory scheme in the form of a binding best practices guide for PBM contracts is neither desirable nor necessary.

The development of a best practices guide would be better accomplished through a collaborative effort of those entities with experience in PBM contracts. While the members of the Health Care Policy Council have broad expertise, most of the entities that compose the council have no experience with PBM contracts. Only the entities subject to this audit have responsibility for a PBM contract and, of those four entities, The University of Texas System and the Texas A&M University System are not statutorily named members of the council but rather participate at the discretion of the governor.

In addition, while the audit recommendation proposes development of a best practices *guide*, the draft legislation imposes a statutory requirement that the subject entities comply with the guide. Any best practices guide should be that—a *guide* providing useful tools to program and contracting officials—but not a new regulatory scheme imposing new legal obligations. A binding best practices guide is inappropriate for two reasons: (1) PBM contracts are negotiated based on the unique needs and circumstances of the negotiating entity; there may be valid reasons for a particular contract to not comply with a particular practice (an entity that varies from an identified best practice would, of course, have the opportunity and obligation to defend its varying practices in future audits.); and (2) a binding guide is counterproductive to what the audit itself notes-- that the, "PBM industry is changing continuously, and new practices and approaches for purchasing and developing contracts for PBM services are being identified"-- and would inhibit the ability of the contracting entities to timely adapt to those very changes in the PBM industry.

Chapter 2-B

Agencies and higher education institutions should clearly identify and label the contract provisions that include proprietary information belonging to PBM contractors.

UT System Management Response: UT System ("System") agrees with and already complies with this recommendation. All vendors who bid on System group insurance contracts, including PBMs are required to label any information they wish to claim as proprietary in their proposal submitted in response to the RFP. The proposal that is accepted is incorporated by reference into the contract.

Chapter 2-C

Agencies and higher education institutions should:

- Refrain from using contract templates or draft contracts provided by PBM contractors when developing their PBM contracts.

UT System Management Response: UT System (“System”) agrees with and is already in compliance with this recommendation. System develops a model contract for each group insurance plan procurement and requires all vendors submitting a proposal in response to an RFP to agree to sign the model contract.

☐ Ensure they incorporate key procurement documents as part of their final PBM contracts to recognize all requirements, agreements, guarantees, and financial projections made by PBM contractors during the contract procurement process.

UT System Management Response: UT System (“System”) agrees with and is already in compliance with this recommendation. System routinely incorporates key procurement documents as part of the final contract including the RFP, the Proposal submitted in response to the RFP and other relevant documentation for its PBM contract as well as its other group insurance plan vendor contracts.

☐ Obtain the advice of outside consultants in assessing the adequacy of PBM contract provisions that address service requirements, financial terms, and other contract requirements.

UT System Management Response: UT System (“System”) agrees with and is already in compliance with this recommendation. System contracts with an actuarial firm to provide this service for all major group insurance plan procurements.



THE TEXAS A&M UNIVERSITY SYSTEM
Office of the Chancellor

August 4, 2008

The State Auditor of Texas
P.O. Box 12067
Austin, Texas 78711-2067

Dear Sirs:

The following represents the management response of The Texas A&M University System to the audit report on Pharmacy Benefit Manager Contracts at Selected State Agencies and Higher Education Institutions.

Chapter 1-A

Agencies and Higher Education Institutions Should Strengthen Contract Provisions Regarding Audit Rights

Recommendations

Agencies and higher education institutions should:

- Ensure that their contractual right to audit a PBM contractor is not limited to only certain types of audits.
- Ensure that their contractual right to audit a PBM contractor requires PBM contractors to provide access to all financial records, contracts, medical records, and other information associated with the services PBM contractors or their subcontractors provide to a plan.
- Ensure that their contractual right to audit a PBM contractor requires that audits be conducted in accordance with auditing standards.
- Define reporting requirements for audits that PBM contractors conduct of the pharmacy network. At a minimum, these requirements should describe (1) what information should be reported, (2) how often audit results should be reported, and (3) whether the PBM contractor must return recovered overpayments to the prescription drug plan.
- Require that audits of mail order pharmacies owned by their PBM contractors be conducted by independent auditors that are selected by and report to the agencies and higher education institutions.

Management Response

The A&M System agrees that audit rights should be comprehensive and made available to the contracting party. Cost-benefit analysis provides insight into whether requiring full audit rights could potentially conflict with the ultimate goal of getting the best value for the State. PMB contracts will include sufficient audit rights to ensure the A&M System receives adequate contract rights.

Responsible for implementation: Kevin McGinnis, Director of Risk Management and Benefits Administration; Paul Bozeman, Health Plan Financial Analyst

Timeline: PBM services are being rebid this fall and a new contract taking the above recommendations into consideration will be in place for 9/1/09.

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Chapter 1-B

**Agencies and Higher Education Institutions Should Strengthen
Contract Provisions Regarding Costs, Discounts, and Other Fees**

Recommendations

Agencies and higher education institutions should:

- Include provisions in PBM contracts that require all documentation and data concerning PBM contractors' financial agreements with drug manufacturers, drug wholesalers, and the pharmacy network be accessible to their agencies' and higher education institutions' staff and independent auditors.
- Include provisions in PBM contracts that specify the third-party entity database the PBM contractor must use when billing drug costs to agencies and higher education institutions.
- Include provisions in PBM contracts that define the methodology the PBM contractor will use to periodically calculate (1) the total rebates received from drug manufacturers for their plans and (2) the amount of rebates that will be passed through to their plans.
- Include provisions in PBM contracts that describe the documentation that will be used to support the rebate amounts calculated by the PBM contractor.
- Include provisions in PBM contracts that identify the specialty drugs that are included in their plans' formularies, including the applicable costs and discounts.
- Include provisions in PBM contracts that define the MAC list prices that the PBM contractor will use.
- Include provisions in PBM contracts that require PBM contractors to provide prior notification of all changes they make to the MAC list during the term of the contract.
- Ensure that the maximum length of PBM contracts does not exceed three years. Include provisions in PBM contracts that define contract termination rights allowing the contract to be terminated at the discretion of the agency or higher education institution. At a minimum, these contract provisions should require providing prior notification to PBM contractors within specified timeframe.

Management Response

The A&M System agrees that contract provisions surrounding drug costs, discounts, and other fees must be included when negotiating PBM contracts. Several of the items mentioned in the recommendations above were either included in the RFP responses or are not applicable to the current form of the A&M System's PBM. A cost-benefit analysis, during the bid process, will provide insight into whether the requirement of PBM's to release any and all information with respect to MAC costs, etc., would potentially conflict with the ultimate goal of getting the best value for the state.

The current PBM contract is for an initial 3-year term with potential annual renewals for up to a total of 6 years. Current contract renews unless notification is provided by either party within 90 days notice of the annual anniversary. With this structure in place, the A&M System can take advantage of changes in the marketplace through adjustments in pricing and administrative fees, while minimizing disruption to employees, retirees, and their respective dependents. The A&M System agrees that termination rights should be discretionary and clearly spelled-out in the contract and annual extensions should only be permissible with a proactive extension notice requirement, eliminating any automatic extensions.

Responsible for implementation: Kevin McGinnis, Director of Risk Management and Benefits Administration; Paul Bozeman, Health Plan Financial Analyst

Timeline: PBM services are being rebid this fall and a new contract taking the above recommendations into consideration will be in place for 9/1/09.

Chapter 1-C

Agencies and Higher Education Institutions Should Strengthen Contract Provisions Regarding Drug Formulary Management

Recommendations

Agencies and higher education institutions should:

- Include provisions in PBM contracts that clearly state which types of therapeutic interchanges are allowable or prohibited.
- Include provisions in PBM contracts that require PBM contractors to maintain and make available as necessary the documentation of all instances in which therapeutic interchange is used.
- Include provisions in PBM contracts that require PBM contractors to provide prior notification within a specified timeframe concerning any changes that they make to a plan's drug formulary.
- Include provisions in PBM contracts that require PBM contractors to provide documentation explaining the reason for changes they make to a plan's drug formulary. At a minimum, this documentation should provide both the medical and financial reasons for a PBM contractor's addition, removal, or change in placement of a drug on a plan's drug formulary.

Management Response

The A&M System agrees that the contract provisions regarding drug formulary management, including therapeutic interchange, should be included when negotiating PBM contracts. The A&M System currently receives notification of formulary changes in advance, however it is not contractually required.

Responsible for implementation: Kevin McGinnis, Director of Risk Management and Benefits Administration; Paul Bozeman, Financial Plan Analyst

Timeline: PBM services are being rebid this fall and a new contract taking the above recommendations into consideration will be in place for 9/1/09.

Chapter 1-D

Agencies and Higher Education Institutions Should Strengthen Provisions Regarding the Sale of Prescription Drug Plan Data

Recommendations

Agencies and higher education institutions should:

- Include provisions in PBM contracts that clearly state whether a plan's data can be sold.
- Include provisions in PBM contracts that specify the conditions under which a PBM contractor is allowed to sell a plan's data. At a minimum, these contract provisions should require the PBM contractor to disclose the sale of any plan data in a timely manner and describe any revenue sharing agreements between agencies or higher education institutions and the PBM contractor concerning the sale of plan data.

Management Response

The A&M System will contractually restrict the sale of prescription drug plan data.

Responsible for implementation: Kevin McGinnis, Director of Risk Management and Benefits Administration; Paul Bozeman, Health Plan Financial Analyst

Timeline: PBM services are being rebid this fall and a new contract taking the above recommendations into consideration will be in place for 9/1/09.

Chapter 1-E

Agencies and Higher Education Institutions Should Require PBM

Contractors to Disclose Potential Conflicts of Interest

Recommendation

- Agencies and higher education institutions should include provisions in PBM contracts that require PBM contractors to disclose any policies, practices, or business relationships that may represent a conflict of interest with their obligations under the PBM contract.

Management Response

The A&M System considers avoiding conflict of interest to be paramount in doing business and completing contracts that provide benefits to employees and retirees of the State and will require PBM contractors to disclose any policies, practices, or business relationships that may represent a conflict of interest with their obligations under the PBM contract.

Responsible for implementation: Kevin McGinnis, Director of Risk Management and Benefits Administration; Paul Bozeman, Health Plan Financial Analyst

Timeline: PBM services are being rebid this fall and a new contract taking the above recommendations into consideration will be in place for 9/1/09.

Chapter 1-F

Agencies and Higher Education Institutions Should Include All

Essential Contract Provisions Required by the State of Texas

Contract Management Guide in Their PBM Contracts

Recommendation

- Agencies and higher education institutions should include all essential contract provisions required by the Guide in their PBM contracts.

Management Response

The A&M System agrees that all essential contract provisions required by the State of Texas Contract Management Guide should be considered when negotiating such contracts.

Responsible for implementation: Kevin McGinnis, Director of Risk Management and Benefits Administration; Paul Bozeman, Health Plan Financial Analyst

Timeline: PBM services are being rebid this fall and a new contract taking the above recommendations into consideration will be in place for 9/1/09.

Chapter 2-A

The Texas Health Care Policy Council Should Create and Standardize Guidelines for Developing PBM Contracts

Recommendation

- The Legislature should consider requiring the Texas Health Care Policy Council to develop a best practices guide for the contract provisions, key performance guarantees, and the minimum time frame for audit rights that agencies and higher education institutions should include in PBM contracts. At a minimum, this guide should define standard contract provisions based on the recommendations made in this audit report. (For proposed statutory language associated with this recommendation, see Appendix 4.)

Management Response

The development of a "best practices" guide would be a valuable tool for agencies and higher education institutions. The agencies and higher education institutions, as stakeholders, may provide valuable insight in the development of this guide. As "best practices" the guide should allow flexibility in addressing unique situations and opportunities that arise during PMB contract negotiations.

Responsible for implementation: Kevin McGinnis, Director of Risk Management and Benefits Administration; Paul Bozeman, Health Plan Financial Analyst

Timeline: PBM services are being rebid this fall and a new contract taking the above recommendations into consideration will be in place for 9/1/09.

Chapter 2-B

Agencies and Higher Education Institutions Should Identify Proprietary Information in Their PBM Contracts

Recommendation

- Agencies and higher education institutions should clearly identify and label the contract provisions that include proprietary information belonging to PBM contractors.

Management Response

Information provided to the A&M System as part of the RFP process is considered proprietary and confidential to the extent allowed by law. The A&M System agrees proprietary information should be clearly identified and labeled as such in the PBM contract.

Responsible for implementation: Kevin McGinnis, Director of Risk Management and Benefits Administration; Paul Bozeman, Health Plan Financial Analyst

Timeline: PBM services are being rebid this fall and a new contract taking the above recommendations into consideration will be in place for 9/1/09.

Chapter 2-C

Agencies and Higher Education Institutions Should Strengthen Their PBM Contract Development Practices

Recommendations

Agencies and higher education institutions should:

- Refrain from using contract templates or draft contracts provided by PBM contractors when developing their PBM contracts.

- Ensure they incorporate key procurement documents as part of their final PBM contracts to recognize all requirements, agreements, guarantees, and financial projections made by PBM contractors during the contract procurement process.
- Obtain the advice of outside consultants in assessing the adequacy of PBM contract provisions that address service requirements, financial terms, and other contract requirements.

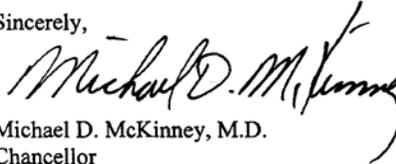
Management Response

The A&M System will be evaluating a wide range of both traditional and non-traditional PBM models. To assist in the complexities of evaluating the various types of PBMs, services of an outside consultant will be retained. This consultant will assist with development of the request for proposals, award and negotiation of contract, and vendor implementation. The requirements of this audit will serve as a guide in this process.

Responsible for implementation: Kevin McGinnis, Director of Risk Management and Benefits Administration; Paul Bozeman, Health Plan Financial Analyst

Timeline: PBM services are being rebid this fall and a new contract taking the above recommendations into consideration will be in place for 9/1/09.

Sincerely,



Michael D. McKinney, M.D.
Chancellor

MDM:km

cc: Cathy Smock
Kevin McGinnis



OFFICE OF THE GOVERNOR

RICK PERRY
GOVERNOR

TEXAS HEALTH CARE POLICY COUNCIL

August 5, 2008

Willie J. Hicks, MBA
Managing Senior Auditor
State Auditor's Office
P.O. Box 12067
Austin, TX 78711-2067

Dear Mr. Hicks,

Thank you for providing the staff of the Texas Health Care Policy Council (Council) with an opportunity to review a draft copy of *An Audit Report on Pharmacy Benefit Manager Contracts at Selected State Agencies and Higher Education Institutions*.

As noted in the draft report, the Council was established to research, analyze and provide recommendations on ways to improve the quality, safety, efficiency, and effectiveness of the health care system in Texas. The Council, which is composed of senior executives from the state's health and human services agencies, Employee Retirement System (ERS), Teacher Retirement System (TRS), Texas Department of Insurance, Texas Workforce Commission, and six systems of higher education, also has a specific statutory charge to ensure greater coordination and collaboration among state agencies and higher education systems on the purchase of health care products and services.

With the state's share of prescription drug expenditures continuing to rise, the Council has already been focused on identifying ways to manage prescription drug costs. The Council published a policy paper entitled *Improving State Pharmaceutical Purchasing in Texas* in 2006, and is currently working on a follow-up policy paper on pharmaceutical purchasing optimization options that will be published later this year. To inform the work of the Council and to ensure coordination and collaboration on best practices in pharmaceutical purchasing, the staff of the Council facilitated several workgroup meetings this year for agencies and systems that purchase prescription drugs indirectly through a pharmacy benefit management contract – like ERS, TRS, The University of Texas System, Texas A&M University System, and the Medicaid Drug Vendor Program – and agencies that purchase drugs directly from pharmaceutical manufacturers or wholesalers. I believe ongoing coordination and communication between state agencies and systems on purchasing practices would be beneficial.

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Mr. Willie J. Hicks
August 5, 2008
Page 2

I also appreciate the work of the State Auditor's Office (SAO) on this issue and would like to invite you or a representative from your office to present the results of the draft report for consideration by the Council on Thursday, August 21st. I would, however, ask the SAO to reconsider the recommendation included in Chapter 2-A of the report relating to a proposed statutory change to the Council's enabling statute.

As noted in the draft report, the Council's current enabling statute is very broad. This flexibility provides the Council with a considerable amount of latitude in the evaluation of the state's purchasing of health care products and services. Such latitude helps to mitigate against some of the challenges faced by the Interagency Council on Pharmaceuticals Bulk Purchasing (House Bill 915, 77th Legislature, Regular Session, 2001). In addition, the flexibility in the current statute is beneficial because it ensures the Council can adapt quickly and consider multiple strategies that control cost while also preserving access. This is especially important given the fluidity of pharmacy benefit management business practices and because several of our state agencies and health science centers purchase prescription drugs directly. While the Council may choose to adopt the recommendations stated in the draft report, among various others, statutorily prescribing what the Council should review may ultimately serve to impede its efforts.

Again, thank you for the opportunity to review and comment on the draft report. I look forward to working with the SAO on the recommendations included in the draft report.

Sincerely,



Tony Gilman, Executive Officer
Texas Health Care Policy Council

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