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Deep Discounts By Drug Firms Draw Scrutiny

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IF A DRUG COMPANY can offer deep discounts on drugs to certain customers, why isn't it doing the same for Medicaid?

That's a question concerning officials and proponents of the federal and state governments' health-care program for the poor and disabled.

Federal law requires drug makers to give Medicaid the best price they offer any customer. But an exception in the 1990 law says that medicines sold at a discount of 90% or more don't have to be disclosed to the government or included in the best-price calculation.

The steep discount was meant to be used for charitable organizations in desperate need of inexpensive medicines. But two lawsuits—one unsealed this week and the other still under seal—allege that Merck & Co. improperly gave the 90%-and-up discounts (a practice called nominal pricing) to any hospital helping it achieve certain market-share goals. The extreme cut rate wasn't offered to Medicaid.

Last month, GlaxoSmithKline PLC disclosed a Justice Department subpoena requesting information about the company's nominal-pricing policies.

Other than the Glaxo subpoena and the two Merck lawsuits, there is no information that other drug manufacturers are being investigated over the practice. But attorneys and members of Congress believe the practice may be industrywide. A spokesman for GlaxoSmithKline declined to comment.

The Senate committee that oversees Medicaid last year demanded information from 19 drug companies about their nominal-pricing practices, an inquiry that is still under way. Last month, the committee sent out another round of letters seeking additional information on the topic from drug manufacturers, according to a committee staffer.

In one of the suits against Merck, unsealed in Second Judicial District Court for the State of Nevada this week, the attorney general in Nevada joined a complaint against Merck by a former employee. Quoting what it says are internal documents from Merck, the complaint alleges that Merck promised hospitals a 92% discount on its cholesterol drug Zocor if they boosted Zocor's share of their statin prescriptions to 70%. Such an increase would come at the expense of Pfizer Inc.'s statin, Lipitor.

According to documents reviewed by The Wall Street Journal, Merck was able to get a significant number of hospitals to achieve its market-share goal in return for the nominal price on Zocor. An internal memo states that the "primary objective" for the year 2000 for the Zocor program will be to "retain nominal price for those hospitals that are currently performing at this level."

One case in point is the 900-bed Henry Ford Hospital in Detroit. For most quarters in the past several years, the hospital has been able to maintain a market share of at least 70% for Zocor, and has been eligible to receive the 92%

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discount, according to Edward Szandzik, director of pharmacy. More than 12% of Henry Ford's patients are low-income or uninsured, so the program helps the hospital provide care at a lower cost, Mr. Szandzik says. But in the first quarter of this year, Henry Ford fell below Merck's 70% market share requirement, so instead, this quarter, the hospital will only get a 30% discount.

The nominal price could result in substantial savings. For instance, the list price of Zocor in 2004 was about $3.56 per pill and the best price reported to the government was about $2.30 per pill, according to a person familiar with Merck's list prices as well as the prices reported to the government. But with a nominal price discount of 92%, a hospital could buy Zocor for as little as 28 cents per pill in 2004.

The Nevada complaint also alleges that discount pricing was used to boost Vioxx, Merck's now-withdrawn painkiller. According to a Merck "terms and conditions" document reviewed by the Journal, hospitals could get a 92% discount on Vioxx if they gave it an 80% share or more of prescriptions for Cox-2 painkillers. In itself, nominal pricing isn't illegal. And the law governing nominal pricing doesn't specifically say who can receive the special pricing.

"It's perfectly legal to do nominal pricing under the right circumstances," says Carolyn McElroy, an attorney who represents drug companies on pricing issues and is the former director for the Maryland Medicaid Fraud Control unit. But, she notes, prosecutors may question arrangements where nominally priced drugs might be viewed as "an inducement to influence buying behaviors, such as tying a nominal price to market-share movement or the elimination of a competitor's product from formulary."

A spokesman for Merck says the company "believes that all of its pricing practices are consistent with the law" and that it can't comment on a lawsuit it hasn't seen.

At GlaxoSmithKline, a spokesman declined to comment.

Some defenders of the drug industry say nominal pricing can even benefit Medicaid because hospitals pass on their low-cost drug prices to the government. But critics dispute that. When patients leave the hospital, they say, Medicaid ends up paying a higher bill at times because patients have been put on a more expensive drug than needed. More fundamentally, the plaintiffs argue, Medicaid should be entitled to the deeply discounted price, since it's being offered for commercial rather than charitable reasons.

Nominal-pricing programs affect private insurers and cash-paying customers as well. Patients who are started on a particular drug in a hospital would likely continue to take that drug after they are discharged. Patients have no way of knowing whether a particular drug was chosen for them because the hospital got a cut-rate price for the drug—even though it would cost a lot more outside of the hospital.

State Medicaid programs are under enormous pressure as spending is bursting state budgets. Nationwide, the program covers 53 million people, nearly one in six Americans, and costs $300 billion a year in federal and state funds, recently surpassing spending on the federal Medicare program for the elderly.

The other case against Merck was filed in U.S. District Court for the Eastern District of Louisiana in New Orleans in 1999 by a physician who complained that his patients were routinely switched to the acid-reducer Pepcid from Zantac in the mid to late 1990s.

The lawsuit, filed by William St. John Lacorte, charged that outside of the hospital, Pepcid was much more expensive than GlaxoSmithKline PLC's Zantac. In 2003, the Justice Department declined to intervene in the case.

But in 2004, the state of Louisiana, through the state attorney general's office, did intervene, saying in court papers that Merck's practice of tying nominal prices for Pepcid to market-share movement resulted in Medicaid improperly paying more for drugs. In August of 2004, the case was refiled—this time under seal—so the Justice Department could determinine whether to join the case.