

July 18, 2006

NY TIMES: MARKET PLACE

A Windfall From Shifts to Medicare

By **MILT FREUDENHEIM**

The pharmaceutical industry is beginning to reap a windfall from a surprisingly lucrative niche market: drugs for poor people.

And analysts expect the benefits to show up in many of the quarterly financial results that drug makers will begin posting this week.

The windfall, which by some estimates could be \$2 billion or more this year, is a result of the transfer of millions of low-income people into the new Medicare Part D drug program that went into effect in January. Under that program, as it turns out, the prices paid by insurers, and eventually the taxpayer, for the medications given to those transferred are likely to be higher than what was paid under the federal-state Medicaid programs for the poor.

About 6.5 million low-income elderly people or younger disabled poor people were automatically transferred into the Part D program for drug coverage. Because their other health needs are still covered by Medicaid, they are called dual eligibles.

The advent of Part D has not affected the drug coverage for the 45 million other low-income people whose drugs are still paid for under state Medicaid programs. Those programs closely monitor drug prices, and drug makers often typically end up paying rebates to the states.

It is too early to calculate the full effect of the shift of the former Medicaid patients now covered by Part D. But analysts expect it to generate hundreds of millions of additional dollars this year for the drug companies, which have long chafed under the pricing restraints of the state programs.

Drugs tend to be cheaper under the Medicaid programs because the states are the buyers and by law they receive the lowest available prices for drugs.

But in creating the federal Part D program, Congress — in what critics saw as a sop to the drug industry — barred the government from having a negotiating role. Instead, prices are worked out between drug makers and the dozens of large and small Part D drug plans run by commercial insurers.

Since Part D went into effect, the pharmaceutical industry has raised the wholesale prices of its brand-name drugs an average of 3.6 percent. Although the actual amount spent depends on what each insurer negotiates, in many cases the drugs for those 6.5 million people who used to receive their medicines through Medicaid will cost more now.

Initially, the added costs will be paid by the insurers administering the new Medicare drug program. But when it comes time for the insurers to settle accounts with the government, the costs of the 6.5 million drugs for the transferees will end up being passed along to federal taxpayers, according to analysts and health care economists.

The windfall for the drug makers was made possible by a provision of the 2003 Medicare law that exempts Part D drugs from “best price” rebates that the drug makers have been required to give to the state Medicaid programs since 1991. Those rebates are meant to make sure that state Medicaid agencies pay no more than the best prices drug companies offer to any big commercial insurer.

Under Medicaid, the federal government and state agencies paid more than \$14 billion annually for the drugs of the 6.5 million transferees. Without the best-price rebates, the cost would have been 25 percent higher, or about \$17.5 billion, said Stephen W. Schondelmeyer, a professor of pharmaceutical economics at the [University of Minnesota](#).

Nobody yet knows what the total drug bill will be for these people under Part D, beyond the assumption by many experts that it will be higher. Medicare will not have solid numbers until it can analyze the hundreds of monthly reports that the plans in the Part D system are required to file.

Yet, one indicator of the higher revenue from dual-eligibles has already been seen in reports by drug companies this year showing double-digit United States sales increases of certain drugs that are heavily used by Medicaid patients. For example, sales of Lamictal, an antipsychosis drug from [GlaxoSmithKline](#), were up 33 percent, to \$305 million in the first quarter; sales of Seroquel, an antipsychotic from [AstraZeneca](#), were up 29 percent, to \$590 million; and sales of Plavix, a blood thinner from [Bristol-Myers Squibb](#), were up 26 percent, to \$850 million.

Timothy Anderson, a pharmaceutical analyst with the Prudential Equity Group, estimates that if Part D were not in place the rebates for the makers for all of 2006 would have been more than \$2 billion for 13 drugs widely used by the people transferred from Medicaid to Part D.

Dr. Anderson estimates that because the companies will not have to pay those rebates under Part D, revenue to Glaxo from Lamictal will increase by \$298 million this year, AstraZeneca's Seroquel sales will rise by \$521 million, and Plavix revenue will increase \$169 million. Estimates on the rebate increases because of Part D are few, but all are in general agreement on the size of the rebate to drug makers.

Medicaid programs have been especially important for drugs like Seroquel and Lamictal, which are prescribed for [bipolar disorder](#) and other [mental health](#) problems

About two million of the people transferred to Part D are disabled and younger than 65, and "more than half of them have mental health problems," said Jim Verdier, a senior fellow at Mathematica Policy Research in Washington and a former Medicaid director in Indiana. "In the past, Medicaid was 80 to 90 percent of the total market for some high-end antipsychotic drugs," Mr. Verdier said.

Over all, the Medicaid best-price rebates have averaged about 15 percent of the list prices of the manufacturers, but some states, including California, New York and Maine have obtained even larger rebates, Professor Schondelmeyer said.

Now, under Part D, all sorts of price deals will be negotiated by dozens of Medicare drug plans, large and small. The prices will be reported to Medicare, but under a provision of the law pushed by industry lobbyists, they will otherwise be kept secret.

[Mark B. McClellan](#), administrator of the federal agency that oversees Medicare and Medicaid, said that the lowest-cost plans among the Part D offerings by commercial insurers were now getting "significantly better prices than Medicaid." But he did not provide specifics.

Dr. McClellan also noted that his agency was requiring the states to return a combined total of \$5.8 billion to Washington from federal funds dispensed to the Medicaid program. That money is based on a federal estimate of the amount states will be saving by no longer having to provide drugs to the dual-eligibles.

But the states, disparaging those refunds as "clawbacks," have disputed the federal formula that was the basis for the repayments. Last month, the Supreme Court declined to hear a case filed by the attorneys general of Texas and four other states seeking to quash the repayment formula as unconstitutional.

Now the plaintiffs, which also include Kentucky, Maine, Missouri, and New Jersey, are expected to take the fight to lower courts. Ten other states have supported the plaintiffs.

The states say the federal formula assumes higher drug costs than many Medicaid programs have been spending.

"We get 32 percent back in drug rebates," said Jude E. Walsh, a special assistant to Governor John Baldacci of Maine. She said Maine's Medicaid drug costs were rising only 2 percent to 3 percent a year, compared with national trends that are three to four times that.

The drug companies, for their part, have played down the size of the expected windfall from Medicaid transferees. And Bush administration officials say they do not know how much they will end up spending on those people. "No one is willing to quantify it," said Dr. Anderson, the Prudential analyst.

In one of the few public comments by a drug company official, Derica W. Rice, chief financial officer of [Eli Lilly](#), told analysts on a conference call in April that Lilly expected "modest price benefits due to lower rebates as patients move from Medicaid to Plan D."

Zyprexa, a Lilly drug for [schizophrenia](#), is another medication widely prescribed for Medicaid patients.

The drug makers do have reason to worry about long-run prospects under the vast new Medicare Part D program. There are currently 81 Part D drug plan sponsors, large and small, with varying degrees of negotiating power. But the plans are expected eventually to merge into a handful of large survivors, each of them presumably having more bargaining power with drug companies.

A further concern is that as the true costs of Part D become known, Congress may eventually impose spending ceilings.

For now though, as the drug industry begins to report its quarterly profits, the market for those 6.5 million poor people is likely to look rather lucrative.