Don't Get Caught By PBMs' MAC Mousetraps

References to maximum allowable prices in contracts between plans and PBMs need to be scrutinized, since things are not always what they seem

By Linda J. Cahn

For most of the world, the letters MAC conjure up a Big Mac — the inviting supersized hamburger that people love but enjoy at their peril.

But for health plans providing prescription drug coverage, the acronym represents an incomprehensible concept inserted into prescription coverage contracts by pharmaceutical benefit management companies (PBMs).

Unfortunately, unbeknownst to most health plans, this MAC is far more pernicious than any oversized hamburger. In fact, PBMs insert the MAC concept into contracts in three ways to relieve health plans of millions in savings that they would otherwise obtain from using generic drugs over branded drugs.

I'll describe how PBMs use three contract ploys — the MAC definition, MAC pricing formulas, and so-called MAC guarantees — to deprive health plans of most savings on generics, and then I'll tell you what health plans must do to avoid the MAC mousetraps.

MAC definitions

Every PBM/client contract begins with many definitions, including a definition for the term MAC. While the definitions may at first appear to be entirely benign, they are anything but.

For example, here are two typical MAC definitions found in hundreds of PBM/client contracts:

> *MAC or "maximum allowable cost" means the unit price established by the PBM for a multi-source drug included on PBM's MAC drug lists developed for PBM's clients, which may be amended from time to time by PBM, in its sole discretion.*
>
> *MAC, the maximum allowable cost, consists of a list of off-patent drugs subject to maximum-allowable-cost payment schedules developed or selected by PBM. The payment schedules specify the maximum unit ingredient cost payable by client for drugs on the MAC list. The MAC list and payment schedules are frequently updated.*

While seemingly benign, these definitions actually allow PBMs to accomplish many things.

A PBM can create different MAC lists for different clients.

A PBM can include on — or exclude from — its MAC lists any drugs the PBM wants to include or exclude. For example, a PBM is free to include 500 drugs — or 2,000 drugs—and equally free to leave thousands of drugs off its MAC lists.

A PBM can change the drugs it includes — or excludes — whenever it wants to do so.

A PBM can select any prices it wants as the MAC prices for the drugs on its MAC Lists. For example, for a generic drug that actually costs $4, a PBM can create a MAC price of $40, or a MAC price of $100 (or any other price it wants).

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A PBM can change its MAC prices for any drug on its MAC lists whenever it wants to do so.

If a PBM does not include a drug on its MAC list, the drug's price will default to whatever other pricing exists in the contract.

In short, PBMs' control of MAC definitions allows them to manipulate the MAC concept in whatever ways they choose.

A health plan must eliminate loopholes in its PBM contracts, says Linda Cahn, so that PBMs can't manipulate terms to drive up costs.

PBMs' pricing formulas

Having inserted a MAC contract definition that awards them complete discretion, PBMs next ensure that their contract pricing formulas enable them to manipulate the MAC concept in whatever way they decide.

For example, here is a common contract formula establishing the pricing that PBMs will use to invoice clients for retail generic drugs:

> *Retail generic drugs: The lowest of (i) PBM's MAC or (ii) the retail pharmacy's U&C [usual and customary] or (iii) AWP minus 18 percent [82 percent of the average wholesale price].*

Under this formula, if a PBM does not include a generic drug on its MAC list, the first of the three alternatives will not exist, and the PBM's invoiced price to its client will be the lowest of the retail pharmacy's U&C or AWP minus 18 percent. Since the U&C price is the "usual and customary price" for an uninsured, walk-in retail pharmacy customer, the U&C will typically be above a drug's AWP. As a result, if a PBM does not include a generic drug on its MAC list, the PBM is very likely to invoice its client for that generic drug based on the last of the three alternatives, AWP minus 18 percent.

Notably, a discount of AWP minus 18 percent is equivalent to a brand discount, which means a PBM that invoices its client for retail generic drugs at AWP minus 18 percent is robbing its client of the savings available from generic drugs. Tellingly, an AWP minus 18 percent discount results in enormous profits for a PBM, since PBMs pay retail pharmacies for dispensing generic drugs at average discounts of approximately AWP minus 70 percent.

Under the three-prong formula found in hundreds of contracts, a PBM can not only deprive its client of generic savings by excluding a generic drug from its MAC list, it can do so as well by including a generic drug on its MAC list. All a PBM need do is generate a MAC price that is weaker than AWP minus 18 percent, and the MAC price will not be the lowest of the three alternatives, meaning the PBM will probably be able to invoice its client at AWP minus 18 percent.

Even if a PBM includes a generic drug on its MAC list and selects a MAC price that is better than AWP minus 18 percent, the PBM can still select any MAC price it wants, and change its MAC price whenever it wants, thereby invoicing the client at a price that is far weaker than the AWP minus 70 percent that the PBM is probably paying the retail pharmacy.

Other PBM pricing formulas

Many other pricing formulas can be found in PBM/client contracts, but regardless of their structure, if they include a MAC component, PBMs can manipulate the formulas. For example, here's a typical pricing formula that sets forth PBMs' contractually obligated invoice pricing for mail generic drugs:

> *Mail generic drugs: AWP minus 50 percent or PBM's MAC.*

Note that this formula does not contain a provision for the PBM to invoice its client at the lower of the two alternatives. As a result, regardless of whether a PBM generates a MAC price for a drug, the PBM can take the lion's share of generic drug savings.

For example, if a PBM doesn't generate a MAC for a generic drug, a PBM can invoice its client at AWP minus 50 percent, which is far below the average discount of AWP minus 80 percent at which most PBMs are purchasing generic drugs to distribute through their mail order pharmacies.

On the other hand, if a PBM generates a MAC for a generic drug, and its MAC is equal to a weaker discount for the client than AWP minus 50 percent (say, AWP minus 20 percent), the PBM is free to invoice the client at AWP minus 20 percent. However,

even if the PBM creates a strong MAC for the drug (say equal to AWP minus 90 percent), the PBM is not contractually obligated to use that discount when invoicing its client.

After all, the PBM's "formula" does not contain a provision that the PBM must invoice at the "lowest of" the two stated alternatives. Therefore, the PBM can create a MAC price that represents a better discount than AWP minus 50 percent, but still invoice the client at AWP minus 50 percent.

In short, regardless of how PBMs manipulate their mail pricing formulas, it is highly likely that clients will be robbed of potential mail generic drug savings and that PBMs will retain enormous profit spreads from mail generic drugs. In fact, if PBMs passed through to their clients the actual discounts that they obtain when purchasing drugs for their mail order pharmacies, they would be passing through discounts of approximately AWP minus 80 percent or greater. Instead, most PBMs provide average mail generic discounts of between 40 percent and 60 percent, and thereby retain a large portion of available generic drug savings.

"Generic guarantees"

When our consulting firm describes how PBMs manipulate MAC definitions and "pricing formulas" in PBM contracts, most PBM clients immediately exclaim, "But our PBM contract contains a generic pricing guarantee that ensures that our generic drugs have an average discount that's far better than the discounts you've described." In fact, we're frequently told by PBMs' clients that they have obtained generic pricing guarantees of, say, AWP minus 55 percent. Sometimes, we're even told that contracts contain generic guarantees as high as AWP minus 60 percent or even AWP minus 64 percent. I call this the pointed-to discount.

Unfortunately, when we review these PBM clients' contracts, we almost never see guarantees that every generic drug will be invoiced at the pointed-to discount. In fact, we rarely even see guarantees that all generic drugs that the PBM processes will have an average discount of the pointed-to amount.

Instead, the contracts we review contain a gigantic loophole that allows the PBM to include only a subset of generic drugs under its generic guarantee, meaning the PBM can invoice its client for all other generic drugs at whatever prices the PBM selects. As a result, PBMs take back whatever savings they may have provided by way of their limited generic guarantees.

For example, a typical contract provision enabling a PBM to include only a subset of generic drugs in its generic guarantee looks something like this:

> *Generic guarantee: PBM warrants that all drugs on PBM's MAC list will be guaranteed to have an average annual discount of AWP minus 64 percent.*

Clearly, that is no guarantee at all, since PBMs' MAC definitions allow them to exclude as many drugs as they want from their MAC lists. As a result, when auditors conduct audits of generic guarantees that are really only MAC guarantees, auditors often find that PBMs have satisfied the contract's MAC guarantee by providing average MAC discounts of AWP minus 64 percent on a small subset of generic drugs, but the PBMs' actual average generic price for all generic drugs is far less, frequently as little as AWP minus 40 percent.

Another example of a contract loophole that enables PBMs to include only a subset of generic drugs under their generic guarantees arises from PBMs' manipulation of the definitions of brand drug and generic drug. When PBMs define "brand drugs" to include "generic drugs" — for example, by stating that "brand drugs include any multisource drug that is equivalent to a brand drug" — they can exclude almost any generic drug from their generic guarantees. PBMs accomplish the same result when they write contracts that grant them the sole discretion to classify drugs as brand or generic.

Regardless of the methods that PBMs employ, as long as they write generic drug guarantees that allow them to include only a subset of generic drugs under their generic guarantees, they can end-run their guarantees by inflating their pricing on all generic drugs that are not included. In so doing, most PBMs eviscerate generic drug guarantees.

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of generic savings, it should be obvious what clients must do to eradicate PBMs' MAC mousetraps.

First, clients must entirely eliminate PBMs' boilerplate MAC definitions and MAC references from contracts.

Second, clients must write — and demand — contract pricing formulas that require PBMs to invoice them based on real pass-through pricing, meaning that for every retail and mail generic drug dispensed, the PBM must invoice the client based on the PBM's actual cost of the drug. Since PBMs are paying for retail generic drugs at average discounts of approximately AWP minus 70 percent — and mail generic drugs at discounts of approximately AWP minus 80 percent or more — it makes no sense to allow any PBM to hide, let alone retain, those discounts. PBMs must be required to pass through all such discounts to your health plan, and to instead make their profits through a single administrative fee per employee per month (PEPM) or per member per month (PMPM).

Note that real pass-through pricing requires the PBM to pass through not only its actual costs on every retail drug, but also the PBM's actual costs on every mail and specialty drug. Otherwise, whatever generic drug savings your health plan obtains from its retail pass-through pricing will be taken back by your PBM when it inflates its profit spreads on mail order and specialty drugs. Note also that almost every PBM that now claims to be providing pass-through or transparent pricing is actually only providing retail pass-through pricing.

Third, clients must write — and demand — generic guarantees that include every generic drug dispensed, not just a subset. Moreover, clients must include airtight definitions for brand drugs and generic drugs that preclude PBMs from miscategorizing generic drugs as brands and thereby excluding them from coverage under the generic guarantees.

Moreover, clients must explicitly include formulas in their contracts that set forth exactly how damages will be calculated if PBMs breach clients' all-inclusive generic guarantees. Clients should also write — and demand — contract provisions that preclude PBMs from using their success in exceeding certain guarantees to offset the damages they must pay for breaching other guarantees.

Finally, clients must ensure that they have removed all limitation-of-liability provisions that PBMs typically stuff into client contracts. It makes no sense for a client to write — and demand — an airtight PBM contract that requires a PBM to pass through all generic discounts — and includes extremely aggressive generic guarantees — if a PBM can simply violate those contract provisions and incur only limited liability or no liability at all.

Eliminate all other contract loopholes

Unfortunately, a health plan cannot rest after it has ensured that its contract is without any form of MAC mousetrap. Virtually every PBM/client contract contains many other loopholes that allow PBMs to manipulate contract terms to drive clients' costs up. Accordingly, if a health plan does not eliminate all of those loopholes as well, a PBM will simply inflate its pricing by way of the other loopholes and take back whatever savings the health plan achieved by eliminating PBMs' MAC mousetraps.

Ultimately, the goal of significantly increasing generic drug savings — and dramatically decreasing prescription coverage costs — is entirely determined by the contract terms that clients obtain. Therefore, clients must stop relying on PBMs' representations and promises and start writing their own airtight contracts. Moreover, clients must use the RFP (request-for-proposal) process to demand that PBM contestants agree to provide the airtight contract that clients have generated.

When clients seize the initiative to force PBMs to provide entirely different contract terms, their MAC mousetraps — and all other PBM contract manipulations — will disappear from the marketplace, and all drug payers will enjoy dramatically lower prescription coverage costs. MC

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