



January 11, 2007

The Honorable Max Baucus  
Chairman, Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510-6200

Dear Chairman Baucus and Members of the Committee on Finance:

As Congress considers how Medicare should negotiate for lower prices on prescription drugs, we urge you to consider the effective use of preferred drug lists by state Medicaid programs and reject options that would ban Medicare from creating an open formulary for the Part D program.<sup>1</sup>

As Robert Pear recently reported in the New York Times (1/9/2007), spending on health care in the United States last year increased at the slowest pace in six years, mostly because of reduced spending by state Medicaid programs, which “pooled their buying power, negotiated larger discounts with drug manufacturers, made greater use of low-cost generic drugs and took other steps to rein in drug spending.”

Overall Medicaid spending by state governments increased less than the rate of inflation in 2005, while U.S. drug spending as a whole increased double the rate of inflation the same year.

The primary means used by state Medicaid programs to negotiate lower prices are so-called “open” formularies of preferred drugs,<sup>2</sup> also known as “preferred drug price lists” or “PDLs.” These lists provide necessary incentives for drug companies to offer lower prices without restricting patient access to the full range of available medicines.

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<sup>1</sup> The National Legislative Association on Prescription Drug Prices (NLARx) is a nonpartisan, nonprofit organization of state legislators from across the country who advocate for lowering prescription drug costs and increasing access to affordable medicines. Legislators from Alaska, Arizona, Connecticut, Colorado, Hawaii, Maine, Massachusetts, New Hampshire, New York, Oklahoma, Pennsylvania, Rhode Island, Texas, Vermont, West Virginia, and the District of Columbia are members of NLARx.

<sup>2</sup> An “open” formulary permits patients to receive drugs not listed on the formulary subject to prior approval by a plan administrator. A “closed” formulary restricts patient use to the defined list of drugs. No state uses a closed formulary for Medicaid and Congress should not establish a closed formulary for Medicare. It is highly appropriate, and necessary, however, to permit Medicare to create an open formulary that permits access to all drugs while also providing incentives for drug companies to lower prices to gain access to the list.

Pioneered in California in the mid-1990s, over three-quarters of states have created some form of PDL. A PDL defines a list of drugs that are “preferred” for use under the Medicaid program. Such drugs are pre-approved for use and reimbursement. Non-preferred drugs may still be used and reimbursed, but must receive approval through a web-based or telephone system.

Inclusion on a PDL is what pharmaceutical firms negotiate for when dealing with state Medicaid programs. Doctors favor prescribing preferred drugs because it is easier and more efficient. For this reason, drug companies are willing to grant large price concessions for the privilege of being included on the list.

PDLs have been very successful at cutting state spending on drugs. Michigan officials estimate that their state PDL saved \$60.5 million in its first year of operation.<sup>3</sup> Texas saved \$140 million over two years.<sup>4</sup> Florida saved almost half a billion dollars between 2000 and 2002 in drug purchases for its 2.2 million Medicaid recipients.<sup>5</sup>

Some versions of legislative language requiring Medicare to negotiate drug prices ban the use of “formularies” by the program. This language should be refined to ban only the use of so-called “closed” formularies that restrict patients to a defined list of drugs and contain no mechanism for patients and doctors to obtain reimbursement for a drug on not on the list.

Although banning closed formularies is in the best interests of U.S. patients, banning the use of open formularies, such as those used by states under the Medicaid program, would negate the ability of Medicare to obtain price concessions through negotiation. Even in the current Part D, each of the companies providing plans has a formulary and this is the basis of their negotiations.

One reason the Part D plan providers are not as effective as state government Medicaid negotiators or the VA is the splintered nature of the purchasing pool. With so many players and different formularies, no one has the clout of a large state, group of states or the VA using a unified formulary.

To obtain significant price concessions from pharmaceutical companies, Congress must grant Medicare (1) negotiation authority; (2) authority to establish an open formulary/PDL; and (3) authority to create a sufficiently large purchasing pool (all part D plans would be the best scenario) to leverage bargaining power in negotiations.

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<sup>3</sup> December, 2004. The Commonwealth Fund. *Michigan: Preferred Drug List & National Medicaid Pooling Initiative*. [www.cmwf.org](http://www.cmwf.org)

<sup>4</sup> January 2005. Texas Health and Human Services Commission. “Preferred Drug List Annual Report.” [www.hhsc.state.tx.us/](http://www.hhsc.state.tx.us/)

<sup>5</sup> “The Rx Factor.” By Misha Sigal. Pew Center on the States. [www.governing.com/medicaid/drug.htm](http://www.governing.com/medicaid/drug.htm). See generally Aaron Catlin, Cathy Cowan, Stephen Heffler, Benjamin Washington the National Health Expenditure Accounts Team. National Health Spending In 2005: The Slowdown Continues. *Health Affairs*, 26, no. 1 (2007): 142-153 [www.healthaffairs.org/](http://www.healthaffairs.org/)

For more information or to arrange for a briefing on this issue by state officials, please contact Sharon Treat at 207-242-8558, [nlarx@gwi.net](mailto:nlarx@gwi.net), or Sean Flynn at 202-294-5749, [sflynn@wcl.american.edu](mailto:sflynn@wcl.american.edu).

Sincerely,



Sharon Treat, Director



Sean Flynn, Counsel

Cc: Senator Jeff Bingaman  
Senator Jim Bunning  
Senator Maria Cantwell  
Senator Kent Conrad  
Senator Mike Crapo  
Senator Charles Grassley  
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