NASHP Model Pharmacy Benefit Manager Contract Terms

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I. Overview

In addition to legislative activity to control prescription drug prices,[2] states have also sought approaches to control spending on their public employees' prescription drug plans by requiring favorable contractual provisions of their pharmacy benefit managers (PBMs). States provide their employees prescription drug plans through a contract with a PBM that administers the drug benefit, including negotiating discounts with manufacturers, paying pharmacy claims, and establishing drug formularies (a list of covered drugs).

Entering into a favorable contract with a PBM via the procurement process may supplement or provide an alternative to direct regulation of PBMs. One potential limit of the seeking contractual, rather than legislative, PBM oversight is that it may only achieve savings for the public employee plans that the PBM contract covers. However, the National Academy for State Health Policy (NASHP) has separately proposed a model for a *State Purchasing Pool for Prescription Drugs* to expand the state's purchasing power for its state employee prescription drug plan to other non-state employees and insurance carriers, such as self-funded employers or insurance carriers providing coverage to small groups or individuals.[3] By combining a state prescription drug purchasing pool with a model PBM contract, a state may expand the scope of savings beyond the state employees. Thus, NASHP offers this model for favorable PBM contract terms as another tool for states to use their sizable purchasing power to control prescription drug costs.

Generally, PBM revenue is made up of a combination of administrative fees, spread-pricing, and retained manufacturer rebates and other revenues.[4] In spread pricing, the amount the PBM collects from the health plan is greater than the reimbursement to the pharmacy, allowing the PBM to pocket this "spread" as revenue.[5] In addition, PBMs negotiate and receive sizable rebates from drug manufacturers in exchange for favorable formulary placement, and though the PBM may share some of the rebates with the health plan, without transparency the PBM can retain a portion of rebates as revenue. In addition, PBMs may receive other types of revenues from manufacturers such as administrative, educational, switching, or clinical fees.

We examined PBM requests for proposals (RFPs) or contractual requirements from several states, including California, Connecticut, Minnesota, and Wisconsin, which all set forth compensation models designed to combat the lack of transparency and cost-saving incentives in typical PBM contracts by restricting PBM compensation to an administrative-fee-only model, eliminating spread-pricing, requiring 100 percent pass-through of rebates and other manufacturer revenue, including contractual cost-trend and pricing guarantees, and providing robust transparency for the state to monitor and enforce the PBM's compliance with contractual obligations. The following contractual provisions were drawn from an examination of these states' PBM RFPs and/or agreement terms:

- ***Administrative-fee only compensation.*** The sole compensation the PBM receives under the contract are administrative fees calculated on a per-member, per-month (PMPM) basis. Using a retail pass-through model eliminates spread-pricing by passing through to the state plan the prices the PBM pays to retail pharmacies.
- ***100 Percent pass-through of rebates and revenues.*** The PBM must pass 100 percent of rebates and other manufacturer-derived revenues to the state health plan.
- ***Cost trend and pricing guarantees.*** In addition to the compensation provisions above, states may also include additional incentives for the PBM to control costs for the state health plan, including guarantees on achieving certain cost-trend targets, minimum discounts, dispensing fees, and best-in-market prices. Pricing guarantees should be on a dollar-for-dollar basis, and provided with minimum (not fixed) basis, with 100 percent of contracted rates passed to the state plan.
- ***Transparency.*** To be able to confirm the 100 percent pass-through and elimination of spread-pricing, the state plan must have full transparency and an accounting of all rebates, manufacturer revenues, and amounts paid to pharmacies to the state health plan. In addition, the state agency or its designee must have full rights to audit and do market checks of all aspects of the PBM's business – financial, legal/contractual and operational – to confirm that it is receiving best-in-class pricing terms and guarantees.
- ***Member cost-sharing protections***. The PBM contract may also require specific protections to ensure that members will always pay the lowest co-pay or co-insurance rate available or the actual cost of the drug if that is lower than member cost sharing thresholds.

NASHP presents these model PBM contract provisions for state review and comment and will work though NASHP's Center for Prescription Drug Pricing[6] and State Rx Work Group to develop more specific guidance and to share experiences among states.

II. Questions and Considerations for PBM Requests for Proposals

When soliciting and evaluating bids for a PBM contract, the following considerations and questions may help to secure the most favorable contract provisions.

- **Role of consultants.** State employee plans may utilize consultants to help develop the RFP and score the cost components of the different PBM bids. Consultants should be familiar with the PBM market, innovative cost approaches, and be capable of robust mathematical analysis needed to evaluate different cost models and to help the state identify the overall bid with the lowest net cost
- **State's procurement rules**. State rules that require that the state to select the lowest-cost bid may constrain the RFP process without robust tools to evaluate the net costs to the state of varying PBM proposals. Novel PBM cost models and terms may appear in some categories to have higher fees (e.g., higher administrative fees per-member per-month), even if the overall cost model (e.g., with cost-trend or discount guarantees) is more favorable for the state. States should be familiar with their procurement rules and plan accordingly.
- **Reverse auction.** Using a reverse auction methodology can help a state secure the most favorable PBM terms. A reverse auction allows bidders to see certain quantitative and qualitative terms of other bids, and implementing successive rounds of bidding may substantially improve the terms of the final bids.
- **Lowest net cost.** The state's cost sheet criteria for evaluating bidders should include a measure of the overall net cost to allow the state to select the bid with the lowest overall net cost, even if particular cost components (e.g., admin fee PMPM or certain rebate guarantees) are higher than in other bids and to allow comparison between various PBMs' cost models (spread vs. pass-through vs. hybrid).
- **Claims file for bidders.** As part of the bidding process, states could send a sample claims file to each bidder (or finalist) to calculate the effects of the bidder's cost model on dimensions of concern for the state, such as the state's overall net cost, expected discounts, or formulary disruption.
- **Availability of feedback from other states**. As part-of the Rx Pricing workgroup, NASHP can identify a group of state officials experienced with PBM contract negotiations to provide other states with confidential feedback on PBM bids, financial models, and contract terms.

III. Model PBM Contract Terms

The following model contract terms were derived and aggregated from the financial provisions from several leading states' PBM RFP and contracts. These states have contracted with a variety of PBMs (e.g., Navitus, CVS, OptumRx), indicating that these terms can be negotiated with larger and smaller PBMs.

A. Administrative-Fee Only Compensation

1. <u>Administrative fee</u>. As payment-in-full for the services performed under this Agreement, the [State Plan] shall pay [Contractor/PBM] an administrative fee

(“Administrative Fee”), calculated by multiplying the per-member-per-month (“PMPM”) rate set forth in [Exhibit A] by the number of active members in the claims processing system by the [15th] day of each month. The Administrative Fee shall be the sole compensation the [State Plan] pays to [Contractor/PBM] for services performed under the Agreement.

2. Pharmacy pass-through. For covered claims paid by [Contractor/PBM], the [State Plan] shall reimburse the [Contractor/PBM] an amount equal to the actual amount the [Contractor/PBM] pays to the dispensing pharmacy, including any contracted dispensing fee. In no event shall [State Plan] owe [Contractor/PBM] more than the amount [PBM/Contractor] paid to the dispensing pharmacy, including any contracted dispensing fee.

[***Commentary on Sections A.2 – A.3.*** *As an alternative to A.2, the State can pay the pharmacy claims directly, with the PBM only adjudicating the claims, as set forth in subsection A.3, below:*

3. Pharmacy claims. [PBM/Contractor] shall adjudicate all claims for Covered Drugs dispensed and submitted by participating pharmacies. The [State Plan] shall reimburse participating pharmacies based on the pricing arrangements [PBM/Contractor] has negotiated with the pharmacy, but in no event shall the [State Plan] pay more than the lowest of (a) the pharmacy’s Usual and Customary price; (b) the Maximum Allowable Cost (“MAC”) plus any applicable dispensing fee; or (c) the Average Wholesale Price (“AWP”) less any contractual discounts plus any applicable dispensing fee. The [State Plan] shall reimburse members for out-of-network claims, based on the amounts charged by non-participating pharmacies, less a standard retail discount and member copay.]

4. Maximum allowable cost list. For the purposes of this Agreement, [PBM/Contractor] shall maintain a single Maximum Allowable Cost List (“MAC List”) for generic drug products to be used as the basis for payment of multi-source products from all distribution channels, including but not limited to retail, mail-order, and specialty pharmacies. If [PBM/Contractor] maintains more than one MAC list for other lines of business, [PBM/Contractor] shall provide [State Plan] with the lowest MAC price on any of its MAC lists for each generic drug or brand name drug for which a generic version is available or was taken off the market for reasons other than safety and efficacy. [PBM/Contractor] shall review and adjust the MAC List at least [quarterly/monthly] and shall provide [State Plan] with a copy of any proposed change or updates to the MAC List, including, but not limited to, drug additions, deletions, or price modifications, at least [fifteen (15)] days in advance of the effective date of the proposed change or update, provided that no update or change to the MAC List may go into effect if [State Plan] rejects such update or change.

B. 100 Percent Pass-Through

1. Definitions.

a. “Rebate(s)” means all price concessions paid by a manufacturer or any other third-party to [PBM/Contractor], including rebates, discounts, credits, fees, manufacturer administrative fees, or other payments that are based on actual or estimated utilization of a Covered Drug or price concessions based on the effectiveness of a Covered Drug.

b. "Other Manufacturer Revenue(s)" means, without limitation, compensation or remuneration received or recovered, directly or indirectly, from a pharmaceutical manufacturer for administrative, educational, research, clinical program, or other services, product selection switching incentives, charge-back fees, market share incentives, drug pull-through programs, or any payment amounts related to the number of covered lives, formularies, or [PBM/Contractor's] relationship with the [State Plan].

c. "Manufacturer-Derived Revenue(s)" means Rebates and Other Manufacturer Revenues.

2. Pass-Through of Manufacturer-Derived Revenue. [PBM/Contractor] shall guarantee Rebates on a minimum (i.e., not fixed) basis. [PBM/Contractor] and shall pay or credit the [State Plan] one-hundred percent (100 percent) of all Manufacturer-Derived Revenue [PBM/Contractor] receives, including any future Manufacturer-Derived Revenue, related to any Covered Drug provided under this Agreement on a [monthly/quarterly] basis, within [30] calendar days of the end of each [calendar month/quarter] of a Contract Year. [PBM/Contractor] shall diligently and in good faith negotiate, maximize, and pursue collection of all Manufacturer-Derived Revenue on behalf of [State Plan]. [PBM/Contractor] shall not charge [State Plan] any management or administrative fees associated with obtaining, collecting, negotiating any Manufacturer-Derived Revenue on behalf of, or paying any Manufacturer-Derived Revenues to, [State Plan]. This provision survives termination of the Agreement. PBM/Contractor shall pay all Manufacturer-Derived Revenue to [State Plan] on claims incurred prior to the termination of the Agreement until one hundred percent (100 percent) of earned Rebates and Manufacturer-Derived Revenues are paid.

3. Calculation of Manufacturer-Derived Revenues. For any Manufacturer-Derived Revenue amounts that [PBM/Contractor] receives that include non-[State Plan] members, [PBM/Contractor] shall calculate and report to the [State Plan] the share of Manufacturer-Derived Revenues that are attributable to [State Plan] and any share or shares attributable to any other members covered by this Agreement. By way of example only, if non-state public employee, health insurance carrier, or private employee health plans participate in a public purchasing pool under the terms of this Agreement, [PBM/Contractor] shall calculate and pass through each participating plan's share of Manufacturer-Derived Revenues to that plan.

Commentary on Section B.3. *This provision is intended to allow the state to negotiate one master PBM Agreement to govern a state purchasing pool for prescription drugs. If non-state employers (e.g., localities, counties, private employers), insurance carriers offering small-group or individual plans, or others (e.g., a state prescription discount card program) wish to participate in the state purchasing pool, this provision allows each participating entity to receive its share of pass-through manufacturer revenues.*

C. Guarantees

1. Cost-trend guarantee. (a) [PBM/Contractor] guarantees that [State Plan]'s annual expenditure growth rate for all covered drugs provided under this Agreement will not exceed the percentages specified in [Table C.1]. For any contract year, the drug cost per member per month (PMPM) is equal to the total amount paid by [State Plan] divided by the total member months. The annual expenditure growth rate is calculated by multiplying the drug cost PMPM for contract year x divided by the drug cost PMPM for contract year x-1. Administrative fees and the amounts members paid as copayments or coinsurance are excluded.

Table C.1

	2018	2019	2020	2021	2022
[State plan]	Baseline	___%	___%	___%	___%

(b) Within [ninety (90)] days after the end of each contract year, [State Plan] will calculate the annual expenditure growth rate. If the annual expenditure growth rate exceeds the amounts specified in [Table C.1] for any given year, [PBM/Contractor] shall pay [State Plan] a penalty according to the amounts set forth in [Table C.2]. Penalties shall be paid to [State Plan] within [thirty (30)] days of notifying [PBM/Contractor].

Table C.2

Percentage above guarantee	0.1 to 1.0%	1.1 to 2.0%	2.1 to 3.0%	3.1%+
Penalty	$	$	$	$

2. Pricing guarantees. The Discount Guarantees and Rebate Guarantees under this Section [C.2] are collectively referred to as "Price Guarantees." All Price Guarantees will be guaranteed, measured, and reconciled on a dollar-for-dollar basis, meaning that [PBM/Contractor] shall pay or credit [State Plan] one hundred percent (100 percent) of any amount below the Price Guarantee. [State Plan] shall retain one hundred percent (100%) of any additional savings achieved above the Price Guarantee. Any savings achieved in one category may not be used to subsidize any shortfalls in another category. Notwithstanding the foregoing, [State Plan] may waive and/or revise a Price Guarantee in order for [PBM/Contractor] to satisfy the

Cost Trend Guarantee, including if lower net cost products become available or significant changes to Rebates resulting in lower net costs to [State Plan].

(a) Discount guarantee. [PBM/Contractor] shall provide [State Plan] the minimum aggregate discount guarantees as provided in [Exhibit A] ("Discount Guarantee(s)"), as updated from time to time under the terms of this Agreement. In no event will the [State Plan] pay more than the actual reimbursement rate (including discounts and dispensing fees) paid to the pharmacy from which the claim originates, less the member copay or coinsurance.

(b) Rebate guarantee. [PBM/Contractor] shall pay or credit [State Plan] the rebate guarantees for brand-name drug claim as provided in [Exhibit A] ("Rebate Guarantee(s)") on a [quarterly] basis, within [thirty (30)] calendar days of the end of each quarter of a Contract Year. [PBM/Contractor] shall reimburse the [State Plan] one-hundred percent (100%) of any excess costs above the Rebate Guarantee in any category.

D. Specialty Drugs

1. Non-exclusive arrangement. [PBM/Contractor] may provide Specialty Drugs through retail, mail-order, or [PBM/Contractor's] specialty pharmacies, or other specialty pharmacies participating in [PBM/Contractor's] network. [PBM/Contractor's] provision of Specialty Drugs shall be non-exclusive. [State Plan] reserves the right to negotiate prices and enter into direct contracts with specialty pharmacies outside of [PBM/Contractor's] network.

2. Specialty drugs dispensed by specialty pharmacies or mail-order. [PBM/Contractor] shall adjudicate all Specialty Drug claims dispensed by a specialty pharmacy or mail-order pharmacy at the lowest of: (a) the Discount Guarantee for Specialty Drugs as provided in [Exhibit A] plus dispensing fee; (b) MAC plus dispensing fee; or (c) WAC plus dispensing fee. [PBM/Contractor's] pricing for all Specialty Drugs dispensed via specialty pharmacies or mail-order shall be less than or equal to [PBM/Contractor's] retail Discount Guarantee and dispensing fee.

3. Specialty drugs dispensed at retail. The retail Discount Guarantees and dispensing fees as provided in [Exhibit A] shall apply for all Specialty Drug claims dispensed at retail pharmacies. Specialty Drug claims originating at Retail Pharmacies will be included with all claims in the respective brand or generic retail guarantee calculation.

E. PBM Transparency

1. Transparency of rebate agreements and records. Within [five (5)] business days of [State Plan's] request, [PBM/Contractor] shall provide [State Plan] with unredacted copies of or access to all of [PBM/Contractors] books, records, and Rebate agreements with pharmaceutical manufacturers, intermediaries, subcontractors, wholesalers, or other third parties related to this Agreement.

2. Rebate reporting and reconciliation. [PBM/Contractor] shall provide [State Plan] a [quarterly] report within [thirty (30)] calendar days after the end of each [quarter] of the Contract year that itemizes all Rebate amounts received by National Drug Code number and manufacturer, amounts paid to [State Plan], the share of Rebates attributable to [State-Plan] and any non-[State Plan] participants as described in [Section B.3.], and indicates the time frames when the Rebates were received by [PBM/Contractor] and passed through. Within [30] calendar days of the end of [a quarter], [PBM/Contractor] shall reconcile all Rebates paid and owed to confirm [State Plan] is receiving all Rebates owed. State Plan shall receive the greater of 100% Rebates collected by [PBM/Contractor] or the Rebate Guarantee as provided under Section [C.2].

3. Pricing transparency. Within [five (5)] business days of [State Plan's] request or any material changes to the prices, pricing methodology, or Price Guarantees under this Agreement, [PBM/Contractor] shall provide [State Plan] with all of the following information:

(a) The Wholesale Acquisition Cost (WAC) negotiated between the [PBM/Contractor] and manufacturer, the MAC List, and the Average Wholesale Price ("AWP") at any point in time for each Covered Drug purchased under this Agreement
(b) The dollar amount of any reimbursements [PBM/Contractor] pays to contracted pharmacies and dispensing fees for each Covered Drug purchased under this Agreement.
(c) The net cost of all brand name drugs that are eligible for Rebates.

4. Market check. [State Plan], at its option, may retain an independent consultant to conduct a market check of the agreed upon Administrative Service fees, Price Guarantees as defined in [section C.2], and dispensing fees to ensure that [State Plan] is receiving best-in-class pricing terms, taking into account the volume, population mix, and plan design. The market check may be conducted annually and may start as soon as the first quarter of the second contract year. [PBM/Contractor] shall adjust [State Plan's] pricing to maintain best-in-class guarantees within [90] days of the completion of the annual market check, retroactive to the beginning of the contract year. [State Plan] may terminate this Agreement without penalty if the prices under this Agreement are not best-in-class among similar-sized groups.

5. Audits. The [State Plan] or its designee has the right to audit all financial aspects of [PBM/Contractor]'s business associated with claims, administrative fees, dispensing

fees, Rebates, Cost-Trend Guarantees, Pricing Guarantees, prices, and any other financial guarantee or revenue source that is the result of [State Plan] members' utilization under this Agreement annually. In addition, the [State Plan] or its designee has the right to audit all legal, contractual and operational aspects of the [PBM/Contractor]'s business. [PBM/Contractor] shall cooperate fully in the audit and make available all books, records, contracts, including contracts with manufacturers for Rebates or Other Manufacturer Revenue, or any other documentation needed to verify compliance with the Agreement, with no additional charge to [State Plan]. Furthermore, [PBM/Contractor] may not restrict who [State Plan] may select as their designee to perform audits or market check, and must ensure that their agreements with drug manufacturers, wholesalers, network pharmacies and/or other entities that [PBM/Contractor] engages to perform the duties required under this contract, will not restrict who the [State Plan] may select as there designee to perform audits.

6. Cooperation. [PBM Contractor] shall cooperate and comply with the provisions of this [Section E] by providing data relating to this Agreement as requested by [State Plan] or its designee. Failure to provide the information requested or failure to cooperate in any material respect will constitute a breach of this Agreement. Selection of any auditor, consultant, or third party to perform an audit under this section [E.5] or a market check under section [E.4] shall be within [State Plan]'s sole discretion.

F. Member Cost-Sharing Protections

1. [PBM/Contractor] shall process retail prescriptions to ensure that at the point of sale, Members pay the lowest of: (a) the applicable co-payment or co-insurance under the Plan; (b) the pharmacy's Usual and Customary price, including the pharmacy's sale price or available discounts (for example, cash-pay discounts or participating in retailer's generic drug discount program), if any; (c) the allowable claim amount for the prescription drug; or (d) the contracted discounted Average Wholesale Price (AWP) or Maximum Allowable Cost (MAC) price plus the dispensing fee.

Exhibit A – Discount Guarantees

Guaranteed Pricing Terms: Jan. 1, 2020 – Dec. 31, 2021		
[PBM / Contractor]	[State Plan] 2020	[State Plan] 2021
Base Admin Fee (PMPM)	$	$
Retail		
AWP Discounts – Brand	%	%
AWP Discounts – Generic	%	%
Dispensing Fees per Claim - Brand	$	$
Dispensing Fees per Claim - Generic	$	$
Minimum Rebate per Claim - Brand	$	$
90-Day Retail		
AWP Discounts – Brand	%	%
AWP Discounts – Generic	%	%
Dispensing Fees per Claim - Brand	$	$
Dispensing Fees per Claim - Generic	$	$
Minimum Rebate per Claim - Brand	$	$
Mail Order		
AWP Discounts – Brand	%	%
AWP Discounts – Generic	%	%
Dispensing Fees per Claim - Brand	$	$
Dispensing Fees per Claim - Generic	$	$
Minimum Rebate per Claim - Brand	$	$
Specialty		
AWP Discounts - PBM Specialty Pharmacy	%	%
Dispensing Fees per Claim - PBM Specialty Pharmacy	$	$
Dispensing Fees per Claim - Retail Specialty	$	$
Minimum Rebate per Claim - Specialty Medication	$	$

Notes

[1] Erin C. Fuse Brown is an Associate Professor of Law at Georgia State University College of Law and the Director of its Center for Law, Health & Society. Fuse Brown developed these model PBM contract provisions as an independent consultant to the National Academy for State Health Policy.

[2] *See* National Academy for State Health Policy, State Legislative Action to Lower Pharmaceutical Costs (updated July 11, 2019), https://nashp.org/rx-legislative-tracker-2019/.

[3] National Academy for State Health Policy, NASHP's Proposal for a State Purchasing Pool for Prescription Drugs, (Oct. 29, 2019), https://nashp.org/nashps-proposal-for-a-state-purchasing-pool-for-prescription-drugs/.

[4] Helpful illustrations of the typical supply chain and financial flow include, Neeraj Sood, Tiffany Shih, Karen Van Nuys, Dana Goldman, *The Flow of Money Through the Pharmaceutical Distribution System*, USC Schaeffer Center for Health Policy & Economics, June 2017, https://healthpolicy.usc.edu/wp-content/uploads/2017/06/USC_Flow-of-MoneyWhitePaper_Final_Spreads.pdf; Adam Fein, *U.S. Distribution and Reimbursement System: Patient-Administered, Outpatient Drugs*, Drug Channels, https://drugchannelsinstitute.com/files/Drug-Channels-2019.pdf.

[5] Trish Riley & Sarah Lanford, *States on the Front Line: Addressing America's Drug Pricing Problem*, 39 J. LEGAL MED. 81 (2019); Michael Carrier, *The Six-Step Solution to the PBM Problem,* HEALTH AFF. BLOG (Aug. 30, 2018), https://www.healthaffairs.org/do/10.1377/hblog20180823.383881/full/.

[6] National Academy for State Health Policy, Center for State Rx Drug Pricing, https://nashp.org/center-for-state-rx-drug-pricing/.