A new report criticizing Medicaid payments to pharmacies arrives as a federal lawsuit and congressional action may result in reduced payments to pharmacies for generic drugs. The pressure on pharmacy payments comes as the Obama administration and Congress seek to expand the use of generic brands as part of a broader health care reform effort.

In a report issued in March 2009, the Office of the Inspector General (OIG) at the Department of Health and Human Services (DHHS) found that Medicaid paid, on average, 17% more for 39 generic drugs than Medicare Part D did for the same drugs. Medicaid and Medicare payments are based on an ingredient fee (the cost of the drug) plus a dispensing fee.

Although the two giant federal programs are similar in some ways, for example, in depending on the average wholesale price (AWP) as the main component of the ingredient price, they also differ in some basic ways. For example, private Part D drug plans have more leverage over such matters as dispensing fees than the states do in Medicaid.

This difference may explain why the OIG determined that Medicaid’s dispensing fee exceeded Part D’s average dispensing fee by at least 55%. In two of the five states studied, Medicaid’s fee was more than twice the average Part D fee. Each state determines its Medicaid dispensing fee, which ranges from $1.75 to $12.50 per prescription.

Pharmacy groups have been very sensitive to threats to Medicaid payments. Bruce T. Roberts, RPh, Executive Vice President and Chief Executive Officer (CEO) of the National Community Pharmacists Association, says:

“The OIG report comparing pharmacy reimbursement for Medicare Part D and Medicaid is flawed because each program is structured differently. It’d be like comparing apples to oranges, and we all know how that goes.”

But the OIG report throws fuel on a long-burning controversy over Medicaid’s dependence on the AWP for pharmacy payments. Previous OIG reports had repeatedly criticized the AWP as bearing little resemblance to the price that pharmacies actually pay drug manufacturers. Those earlier reports led to provisions in the Deficit Reduction Act of 2005 (DRA), which would have reduced payments by Medicaid for generics, in good part by changing the formula from a dependence on the AWP to dependence on the average manufacturer price (AMP). The DRA said that starting in January 2008, payments to pharmacies would be based on 250% of the lowest reported AMP for each drug rather than 150% of the lowest price published in national compendia, the equivalent of the AWP. The AMP, which is defined by statute, is based on actual sales transactions. Additional provisions in the DRA would have expanded the number of drugs subject to the new AMP dictate.

Last summer, however, Congress interceded and passed the Medicare Improvements for Patients and Providers Act of 2008 (MIPPA). This act prohibits the Centers for Medicare and Medicaid Services (CMS) from establishing AMP pricing before October 1, 2009. The question is whether Congress will try to extend that moratorium and whether the Obama administration will accept such a move.

More likely, a compromise may be in the offing. In 2008, key Democrats introduced the Fair Medicaid Drug Payment Act, which endorsed AMP-based payments but at a higher level than the DRA would have allowed. Those bills were sponsored by Senator Max Baucus (D-Mont.), Chairman of the Senate Finance Committee, and Representative Frank Pallone (D-N.J.), a top-ranking member of the House Energy & Commerce Committee. The AMP definition would be altered to remove mail-order transactions from the calculation and would exclude discounts, rebates, and other price concessions that are not passed on to retail pharmacies. Thus, only items that make pharmacies’ acquisition costs cheaper would be counted.

This bill, in contrast to the DRA, is much more to the liking of pharmacies. The bill’s passage becomes even more important now, with the end of a critical federal lawsuit in sight. A suit was filed against First DataBank and Medi-Span, the two companies that publish AWPs. Judge Patti B. Saris of the U.S. District Court for the District of Massachusetts has apparently convinced the two companies to lower the AWPs they publish to 120% of the wholesale acquisition cost. That would automatically reduce Medicaid payments to pharmacies regardless of anything Congress does or does not do. Both companies would eventually stop publishing AWPs altogether.

Steven C. Anderson, President and CEO of the National Association of Chain Drug Stores, says:

“These new, approved settlements unduly and inappropriately penalize pharmacies as well as patients if pharmacies are forced to close or alter their business practices.”

The AWP reductions will cut Medicaid payments by about $68 million each year. Congress may use the Saris case as the political impetus to pass the Baucus–Pallone bill, especially because the House and Senate will be looking for federal budget savings with which to fund some of President Obama’s spending initiatives.