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**TESTIMONY OF
ATTORNEY GENERAL RICHARD BLUMENTHAL
BEFORE THE ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS
SUBCOMMITTEE OF THE SENATE JUDICIARY COMMITTEE
MARCH 15, 2006**

I appreciate the opportunity to submit testimony on the subject of federal regulation of hospital group purchasing organizations (GPOs)

My investigation of GPO abuses and irregularities was spurred by credible and now well-documented reports of GPO misuse of their purchasing power and the member hospitals' failures to accurately account for GPO revenues. Evidence from my investigation, and yours, supports aggressive Congressional action addressing such anti-consumer abuses.

Equally worthy of attention is possible action concerning an organization that I am investigating as part of my GPO investigation. The organization -- the Healthcare Research and Development Institute (HRDI) -- is a secretive for-profit company composed of a network of healthcare corporate executives as well as manufacturers and suppliers of medical and health care related goods and services that may well raise anti-competitive concerns. At the very least, it suggests insider dealings -- an insidious, incestuous, insider system -- symptomatic of the GPO industry.

Like the GPOs, its business model appears to rely on apparently opaque and ethically questionable business arrangements, as well as potentially anti-competitive business practices that these hearings and the proposed legislation seek to address and remedy.

HRDI is neither a trade organization nor a GPO. It is a for-profit limited liability company owned by leading chief executive officers of major hospitals and healthcare systems across the country. HRDI also comprises 45 or so "corporate members" who apply for membership in HRDI and, if accepted, pay significant annual dues and possibly additional fees. These corporate members are a "Who's Who" in the healthcare manufacturing, medical device and health services fields, including Becton Dickinson, Sodexo Healthcare, Heidrick & Struggles and MedAssets, a large GPO.

Organized over fifty years ago, HRDI claims a laudable purpose -- to provide a forum for these leading healthcare executives to "come together" with their corporate partners to "share ideas and strategies, ... seek ways to improve their hospitals and systems" and "to educate healthcare companies who serve the industry" in order to ensure their products and services

“better meet patient and provider needs ” HRDI’s structure, fee schedules, compensation practices and its limited and exclusive corporate membership appear to belie its stated purpose.

Simply put, HRDI provides its corporate members with the opportunity to purchase special access to hospital and healthcare system CEOs. These CEOs are in a position to directly or indirectly exert considerable influence on purchasing decisions relating to the products that the corporate members sell to the hospitals and health systems these CEOs represent.

The annual dues these corporate members pay to HRDI are used to compensate the CEOs for their “services” to the corporate membership.

HRDI subscribes to a “Rule of Two”. Its corporate membership is limited to two members in any particular category of product or service. For example, only two pharmaceutical wholesalers or two manufacturers of safety needles would be admitted. This, too, may raise anti-competitive concerns.

All of HRDI’s activities -- meetings and educational events that it sponsors -- are cloaked in secrecy. Members of this subcommittee who visit HRDI’s website at www.HRDI.com will find a website that is inaccessible to everyone but its corporate and individual members. You will be unable to identify HRDI’s individual members, corporate members, upcoming meetings, or anything else, for that matter. It leads me to question whether the boards of directors for the hospitals and healthcare systems where these CEOs work -- as well as state regulators -- are aware of HRDI’s activities, and precisely how much its individual members earn for their “services” to the corporate members.

To date, HRDI and its members have cooperated in my investigation. Nevertheless, my GPO investigation has broadened to determine whether HRDI serves to perpetuate the “pay-to-play” scheme that has infected so much of the healthcare industry, through GPOs, pharmaceutical benefit managers and the pharmaceutical marketers

Many GPOs are owned by consortiums of hospitals and major medical supply purchasers. They channel their purchasing power to obtain volume discounts and rebates from suppliers. They also receive administrative fees from the suppliers in return for the ability to sell their products to the GPO members through GPO-negotiated contracts.

My GPO investigation has uncovered suspect interrelationships and questionable business practices involving hospital, GPO and major medical supplier executives whose practices often benefit themselves, rather than patients, insurers and government programs that pay hospital bills.

Specifically, my office in cooperation with the state Medicaid agency has determined that some Connecticut Medicaid providers -- nursing homes, that purchase health care supplies through contracts negotiated by their GPO -- have not properly accounted for rebates received in connection with these purchases. The improper allocation of rebates, as well as discounts, fees and other incentives through these financial arrangements, have possibly increased costs to the Medicaid program. My office will continue to investigate these issues.

The preliminary findings of my investigation mirror the conclusions of two recent reports from the Office of the Inspector General of the Department of Health and Human Services (OIG). These reports -- auditing 6 GPOs practices over a 3-5 year period -- found that many member hospitals failed to properly account for more than \$60 million in rebates and other payments from the GPOs that medical suppliers paid.

The OIG reports raise a third major concern -- whether the GPOs' retention of almost \$500 million dollars for 'investment and reserve' purposes is a valid use of their member hospitals resources. Many of them are non-profit organizations.

As I stated in my previous testimony before the committee, I have a longstanding concern that GPOs create a myriad of conflicts of interest and anti-competitive behavior that must be regulated, if not prohibited. Certainly, this conclusion is supported by a recent jury antitrust award to Masimo Corporation, a producer of pulse oximetry devices, of \$420 million in damages against Tyco Healthcare Group and its affiliate, Mallinckrodt. The jury found that Tyco and Mallinckrodt used sole-source/high compliance contracts and bundled rebates to bar competitors, such as Masimo, from obtaining business from major hospital groups.

In sum, these concerns are significant and serious, requiring immediate Congressional action. Voluntary efforts offered by the GPO companies -- initiated shortly after withering criticism of industry practices -- are simply too little, too late.

I urge the committee to adopt legislation similar to Senator Herb Kohl and Senator Mike DeWine's Medical Device Competition Act of 2004. This legislation: (1) caps GPO administrative fees at 3% of the purchase price of the good or service; and (2) requires the Secretary of Health and Human Services, in consultation with the United States Attorney General and the Federal Trade Commission, to issue regulations on specifying purchasing practices that violate antitrust laws or ethical standards and prohibiting certain forms of payments and tightening the definition of what is acceptable compensation.

In addition, I reiterate my recommendations from last year. The committee should consider legislation to:

- Eliminate conflicts of interest in this industry by prohibiting GPOs and health care-related supply, medical device and equipment companies from having any ownership interest in each other. In addition, no member of a board of directors, officer, individual with contracting authority or owner of more than 5% of a GPO should have any ownership interest in health care-related supply and medical device and equipment companies.
- Strictly and vigorously prohibit any GPO from accepting any fees from vendors in excess of 3 percent of the purchase price of goods or services sold to members by these vendors. Excessive fees, and other reimbursements such as stock options may rise to the level of an improper inducement to influence a GPO's selection of vendors for its supply contracts, which poses potential conflicts of interest for the GPO, unfairly excludes smaller vendors from the contracting process and possibly taints the

vendor selection process, which ultimately may lead to higher prices or substandard products

- Require GPOs to report to the Department of Health and Human Services all fees or other remuneration from vendors. This information should arguably be kept confidential only if it clearly constitutes a trade secret. Such reporting will assist the Department in monitoring compliance with the fee limits
- Require that a GPO disclose to its hospital members any and all information concerning the quality, safety and efficacy of the products purchased from a health care-related supply, medical device or equipment company.
- Prohibit any GPO contract provision that prohibits or penalizes a member from testing or gaining information about a clinical preference item offered by a vendor that does not currently have a contract with the GPO.
- Prohibit sole source contracts by GPOs for clinical preference items unless there is no other means of obtaining such products. Health care providers should be able to access the most effective medical devices and products where there are valid, documented clinical preferences for more than one type of such medical device or product.
- Prohibit GPOs from tying or bundling products in a manner that unreasonably restricts competition or clinical preferences for medical equipment or devices.
- Limit GPO contracts with health care-related supply, medical device and equipment companies to no more than 3 years in order to encourage competition in the medical supply and product industries. Long-term contracts, especially by larger GPOs, can restrict competition by limiting the market for competing products.
- Require the Federal Trade Commission to promulgate regulations within two years of the effective date of the legislation to ensure robust competition in the GPO, hospital purchasing and medical supply industries
- Require each GPO to designate a compliance officer to monitor the GPO's compliance with federal regulations and laws governing GPO practices.

In addition to legislative changes, the subcommittee should urge more aggressive federal action to investigate and prosecute antitrust violations by GPOs, particularly in light of *LePage's v 3M Corp.*, which supports and encourages such antitrust enforcement against health care product bundling and other anticompetitive abuses. The effectiveness of any law depends on tough, sustained enforcement.

I will continue to move aggressively in my investigation and look forward to working with the committee in its legislative efforts.