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## Health Plans Need to Drive New Drug Pricing Method as Average Wholesale Price (AWP) Practices are Deflated


By Craig Stephens, RPh MBA  
Senior Vice President & Practice Leader  
Evergreen Rx

Average Wholesale Price (AWP), the industry standard for pricing prescription drug products, and one that currently drives the entire process of reimbursements between payers and pharmacies, will be deflated in September 2009 and is on a trajectory to be abolished all together in 2011. That is unless a legal injunction occurs -- a possibility since many entities including the National Association of Chain Drugstores (NACDS) and the Food Marketing Institute (FMI) are pursuing.

But in essence, a March 2009 legal ruling will make what had become a way of life in the pharmacy benefits industry -- with deals structured based on "AWP discounts" -- a thing of the past.

Industry experts have known for years that AWP is a fictitious number that no one really pays for a drug. It is the quintessential "list price" diversion by which everyone perceives to get a deal. PBMs claim substantial value, by delivering lower than AWP costs.

Well, the sands have shifted. The frontier of a new mechanism to price prescriptions is exciting for all of us who have been through the evolution of managed care, PBMs and third party payers alike. It holds the opportunity for transparency and market knowledge on the cost of pharmaceuticals; cost being defined as the acquisition cost to place inventory on a pharmacy shelf. AWP has little or no relationship to the acquisition cost of a pharmaceutical product. Rather, AWP has enabled an environment in which significant financial margins on the distribution of prescription products exists, of course not always in the pockets of pharmacies themselves.



The future methodology to price prescription products is in flux. All stakeholders are watching partners and competitors, wondering what will evolve. One thing that is certain, without significant influence by the risk holders of healthcare dollars, the future mechanisms will likely not be in the best interest of these payers. Instead, a new pricing system will evolve to keep revenues and profits sustainable by those parties most threatened by AWP's dissolution.

Ultimately, it is the payers of prescription drugs that need to define the pricing model. After all, that is how a free market is supposed to work. Today, the market is responding in several ways, none of which is a long term solution. The most common short term alternatives under pursuit are identified below.

#### Alternative #1

When AWP is deflated in September 2009, some PBMs have plans to “re-inflate” the new, lower AWP to its higher pre-ruling level, thereby crafting a proprietary AWP to be applied to all existing contracts. While this is a simple way for the PBM to address the coming change, it is definitely not a good solution. Rather it creates another level of complexity and opacity to the pricing of prescription drugs with undefined pathways to reconcile the price changes to economic equilibrium.

#### Alternative #2

PBMs are undertaking internal initiatives to amend their existing pharmacy network contracts and client contracts (performance guarantees), to maintain a common economic outcome. This will most likely manifest as a new discount rate being stated in existing contracts at a lower numerical value, yet the true economic impact should be neutral as the starting AWP for which these new discounts are applied is a smaller figure.

The above two options will suffice in the short term and the payers must be prepared to substantiate that their individual economic outcome has not shifted. Evergreen Rx is an independent partner working on behalf of our clients to support their interests. Evergreen Rx can assess new pricing models as AWP disappears; with a clear understanding of the pros/cons as these new methods unfold. We are urging all payers to get involved early and not become spectators during this dynamic time; but rather join Evergreen Rx in setting the course for true-life prescription pricing.

For more information contact Evergreen Rx; Craig Stephens, Senior Vice President & Practice Leader, [cstephens@evergreenre.com](mailto:cstephens@evergreenre.com), (952) 345-0503; or Christine Heutinck, Senior Pharmacy Consultant at [cheutinck@evergreenre.com](mailto:cheutinck@evergreenre.com), 816-429-6424.