Testimony of

Mr. Lynn Everard

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Hospital Group Purchasing: Has the Market Become More Open to Competition?

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United States Senate Committee on the Judiciary

Subcommittee on Antitrust, Competition and Business and Consumer Rights

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Good afternoon Chairman DeWine, Senator Kohl, and distinguished members of the Subcommittee. My name is Lynn James Everard and I am an author, speaker, health care business educator, and supply chain strategist. For almost twenty-two years I have worked in the health care supply chain, studying its strengths, weaknesses, and prospects for improvement. I have held various supply chain management positions in the hospital, long-term care, homecare, and medical product distribution environments. I have worked with group purchasing organizations (GPOs), including sitting on a GPO pharmacy contract review committee. I am a Certified Purchasing Manager and a Certified Business Manager. During my years studying the health care supply chain, I have authored more than 75 published articles and four white papers including, "The Impact of Group Purchasing on the Financial Prospects of Health Systems: Changing Value Perceptions and Unintended Consequences", which some of you may have seen.

I am here today because of my deep concern for the safety of patients and caregivers and the financial viability of our nation's hospitals. The business practices of some large manufacturers and certain GPOs, fueled by the power granted to GPOs in the Safe Harbor exemption, have compromised competition in the health care supply chain. I am also here to ask you to carefully review the information being presented and reconsider the appropriateness of a Safe Harbor for health care group purchasing organizations. It is important that you know that I am completely independent from any player in the health care supply chain. However, I do freely admit that I represent an important special interest group: patients, caregivers, and their families who every day must deal with the consequences of unsafe or ineffective products. The financial power wielded by health care GPOs exacerbates this situation. Unchecked business practices of GPOs, in concert with some manufacturers and distributors, affect patients, caregivers, and their families, and threaten the ongoing financial viability of large numbers of hospitals.

Voluntary Codes of Conducts Have Not Spurred Enough Reform

I believe that robust competition in the health care supply chain will ultimately provide a significant dose of the financial healing that most hospitals will need to survive. As a health care supply chain strategist I struggle to understand the value of the Safe Harbor as currently drafted. I do not believe that the continuance of the Safe Harbor is good for either our hospitals or our health care system. I fear that voluntary GPO Codes of Conduct ("Codes") that fail to address many of the contracting and business practices will provide the public with a false sense of security and fail to fix the problems that were highlighted at last April's hearing. Last year Senator Kohl concluded the hearing by stating, "So this, I hope, is not a hearing, which so often on Capitol Hill, hearings that are hearings and then vanish into history." I share that sentiment and hope that the necessary reforms and oversight do not simply vanish into history as well. The only way that any Code of Conduct can be made acceptable is if it is a prerequisite for any GPO seeking the Safe Harbor exemption from anti-kickback laws and if it is given only upon a full review of the GPO's business practices and sources and uses of funds. To ensure that a GPO enjoying the Safe Harbor meets the obligations of its mission and the special exemption it is given, it must submit to regular, ongoing, and determined oversight. Accordingly, each GPO must provide full disclosure of its business and contracting practices, its organizational makeup, and its financial transactions.

The proposed Codes are incomplete and cannot possibly be made complete until the business practices of GPOs are fully investigated and the assumed bad behavior that the Codes seek to address are fully identified and evaluated. I believe that in order to qualify to retain the Safe Harbor exemption, each GPO should willingly submit to a thorough audit by the government agency that ultimately is delegated the task of providing oversight. For many years GPOs have been subjected to suspicion by many in the industry. A mandatory, verifiable and comprehensive Code of Conduct in exchange for the benefits of the Safe Harbor would be a small price to pay and would allow those GPOs desiring to clear their names and remove the suspicion from their practices to do so.

Is the Congressional Safe Harbor Being Used As Intended?

It is essential that each GPO be required to produce verifiable evidence of the value it produces for its members. In his testimony before this Subcommittee last year regarding the cost savings by his group Mr. Norling of Premier stated, "We estimate that we save our member hospitals over $1.5 billion per year..." With all due respect, we need real science, not estimates, of the savings produced by GPOs. Without this knowledge how can we know if the Safe Harbor, let alone a Code of Conduct, is worthy of this Subcommittee's time and effort?

By granting the Safe Harbor the Congress granted GPOs a great deal of power and a significant ability to create revenue for themselves. By ensuring the financial viability of GPOs, the Congress in effect created a quasi government agency. With that comes a responsibility to provide oversight and direction. In 1986 when the Safe Harbor was created the health care supply industry was very different from what it is today. Unfortunately, the lack of oversight over the activities of GPOs has led us to where we are now. There is a growing body of information and experience that suggests that, at best, GPOs are not focused on their original missions of saving hospitals money. At worst they are adding significant cost to the health care supply chain

while stifling innovation and creating a roadblock between caregivers and the products they need to provide safe patient care.

At the time the Safe Harbor was granted GPOs tended to be small regional contracting-focused organizations. Today the largest GPOs have become complicated, intertwined strings of related businesses that defy the ability to determine where the GPO ends and the rest of the conglomerate begins. The health care supply chain has become incredibly complex, due at least in part the presence and practices of GPOs. Before GPOs, a hospital and a supplier could actually enter into mutually beneficial business agreements that did not preclude the ability of any other hospital or supplier to thrive in its own marketplace.

Congress must fully understand the flow of money in the health care supply chain and the GPO's role in that flow in order to pronounce that the Safe Harbor is of benefit to patients and taxpayers. Last year, the GAO conducted a study, which showed that GPOs were not actually saving hospitals money in many cases. It was my understanding that a follow up study was going to focus on the "money trail", but my latest conversations with GAO suggest that study has been delayed. I do not believe that the Subcommittee should endorse Codes of Conduct without studying the "money trail". GPOs seeking to end years of speculation on the part of the public should welcome the opportunity to disclose fully their practices and sources and uses of revenue. Then, this entire industry can refocus its efforts on providing quality patient care in a safe work environment. Congress must also scrutinize the role of manufacturers in making excessive payments to GPOs. Do these payments make the GPO an accomplice in establishing product-pricing floors that give manufacturers permission not to compete for business and maintain the market power of the GPOs?

Our nation's hospitals are the backbone of our health care delivery system. I do not have to tell you that Medicare and Medicaid patients depend heavily on hospitals for care. In late 2002, the American Hospital Association reported that the average operating margin of U. S. hospitals was just 2.8 percent. Increasing demand for services, combined with diminishing reimbursement, a growing staffing shortage, increases in malpractice insurance costs and settlements, and cost of implementing HIPAA and other regulations are eroding that margin and placing many of the nation's hospitals in financial danger. Without a way to increase their operating margins or a major increase in government funding, hospitals will not be able to take on a flood of additional patients. For a hospital with an operating budget of $100 million dollars that is spending $33 million dollars in its supply chain, a supply chain savings of just 4% would increase that 2.8 percent operating margin to 4.1 percent. A twenty percent supply chain savings would move the 2.8 percent margin to 9.4 percent. Why is this significant? Hospitals that have left their GPOs are reporting savings of thirteen percent or more. For many hospitals the supply chain opportunity represents the largest single area of cost savings opportunity.

As a procurement professional, I am concerned that the Safe Harbor provides a special privilege to GPOs in allowing them to conduct business in a way that I or any other procurement professional in any industry would avoid for fear of losing our integrity, our jobs, and our careers. Procurement professionals shun kickbacks or other illegal financial incentives because they presents a serious conflict of interest and violate the agency relationship they have with their

employers or clients. These clients depend upon procurement professionals' unbiased and independent judgment in creating critical financial relationships, often worth billions of dollars.

Let me be clear. My intent here today is not to impugn the judgment of Congress for decisions made in the past. Given the circumstances and the challenges facing hospitals at that time, the decision to grant the Safe Harbor may well be beyond reproach. In the seventeen years that have passed since the Safe Harbor was granted, the health care industry and the health care supply chain have seen significant changes. For example, when the Safe Harbor was granted, hospital buying was largely a regional undertaking managed by a large number of small buying groups. Congress simply could not have foreseen the flurry of merger activity that would create the large groups that dominate the hospital buying landscape today.

Ongoing Concerns with GPO Contracting Practices

The practice of sole sourcing, when conducted in an open and transparent bid process and on a small scale, is typically the most effective tool in gaining lower product prices is the lifeblood of procurement for smaller hospitals or smaller regional groups. The problem comes when a large GPO uses sole sourcing. The difference in scope and scale is the difference between sound purchasing practice and wholesale marketplace foreclosure for a small manufacturer. This has the potential to reduce competition and increase pricing in the market. It is not the aggregation of volume that drives down prices once price equilibrium has been reached. Rather, competition produces price reductions.

Likewise the practice of bundling can result in market foreclosure. The wise and competent buyer knows that, in the long term, his best interests are always best served by making certain that there are enough viable competitors to make sure that real competition exists. Procurement professionals spend time cultivating familiarity with the products and services of companies that do not currently enjoy their business to ensure that competition exists at all times. This process is called supplier development. Procurement professionals know that their success largely depends upon their ability to cultivate competition. To learn more about this I urge the Members of the Subcommittee to study the procurement practices of government subcontractors and see how they work with small companies to make sure they are there to drive competition.

Competition is the lifeblood of a free, open, and capitalist society. In fact, competition in the health care supply chain may be the best financial hope this nation has in being able to afford to provide health care services to an estimated 42 million uninsured Americans.

GPOs and their large manufacturer counterparts claim to promote competition in the health care supply chain. In last year's hearing, Senator Kohl expressed concern about one GPO requiring its suppliers to participate in its E-Commerce company. For all intents and purposes there are only two remaining E-Commerce companies: Neoforma with Novation as its majority owner and primary source of its revenue; and GHX, also known as the Global Healthcare Exchange. Now GHX is owned mainly by several large manufacturers but it is also partly owned by Premier. Neoforma and GHX have a two year old collaboration agreement so there is even less competition now. In industries outside of health care where the E-Commerce companies are not owned by suppliers but instead are independently owned, they are producing actual line-item product cost savings along with some modicum of efficiency for users. That is what was

supposed to happen in health care. In fact, one of the first health care E-Commerce companies, Medibuy, was designed to be an open marketplace that would allow hospitals to access the entire universe of products and save time in the procurement process, while creating competition on-line and achieving a reduction in product costs. GHX proclaims on its web site that it is open and neutral but what incentive would the largest manufacturers in the industry have to create more competition for themselves? Likewise, why would Neoforma, or Novation, want to create an environment in which its members could locate other products from non-contracted suppliers? The E-Commerce monopoly that exists today in this industry has all but destroyed the competitive benefits of E-Commerce while providing little in the way of efficiency benefits.

How important is the E-Commerce monopoly to those who control it? Over the past year one start-up company has been blocked twice from market entry. The first time, a bank tied to an investment house that has seventy percent of its holdings in health care suppliers refused to provide the company with simple escrow services through a blatant misapplication of the USA Patriot Act. Most recently an international conglomerate that is a founder of GHX was willing to take a $15 million dollar loss on a real estate deal just to keep this company out of the market. There may be other companies who have tried to enter this market but who have also been blocked from doing so. When any industry's largest competitors are allowed to go into business together, even if it is allegedly to promote competition or efficiency, something is very wrong and someone needs to ask a lot of questions.

Certainly, when competition is threatened it makes perfect sense for the federal government to step in and act to restore competition. The Federal Trade Commission exists for that very purpose. I know that both Senators DeWine and Kohl wrote to the FTC last April concerning this issue and I would stress the importance of the FTC's continued involvement if competition and innovation are to be permanently restored in the healthcare marketplace.

While this Subcommittee has given GPOs the opportunity to implement self-imposed, voluntary Codes, I firmly believe that the current Codes fail to remedy the problem. Further action is required. I believe that in today's environment the Safe Harbor represents an unnecessary and unwelcome intrusion into a once open and competitive health care supply chain arena. The Safe Harbor combined with a lack of oversight have created an environment in which the actions of certain GPOs have served to reduce competition and perhaps even raise prices. Its repeal must be considered for the following reasons:

1. Any fees paid to a GPO by suppliers are ultimately paid by hospitals because suppliers must add additional markup to their prices to cover those costs.
2. The Safe Harbor treats hospitals as incapable of managing their own business affairs. If the government cannot trust hospitals to run their businesses, why should it trust them to deliver quality patient care? Both GPOs and hospitals must become more accountable for their business practices.
3. Some GPOs have become much larger and more powerful than the Safe Harbor could have contemplated. That power used on a wide scale has created an environment in which large suppliers dominate the marketplace and smaller less powerful suppliers are unable to compete. This has reduced competition and ensured the long-term dominance of large suppliers.
4. GPOs have failed to demonstrate their bottom-line value to hospitals. Studies contain no

science and are self-serving and inconclusive at best and are misleading and error prone at worst. For example, GPOs claim that without them a hospital would have to add as much as $300,000 in annual cost to make up for their absence. But, if one assumes that the GPO is only generating three percent in total fees from the suppliers and the hospital could itself be paid the admin fees, then a hospital that spends $50 million dollars per year through its GPO would actually come out ahead by $1.2 million dollars per year by spending the $300,000 per year, EVEN if it did not reduce the price of a single line item. Why should the government provide a special privilege for a class of entities who have not been able to demonstrate their value?

5. Some GPOs place too much emphasis on the creation of fee revenue. While some hospitals may come out ahead on fee revenue, others will end up paying for it because the cost of the revenue has to be paid for by someone. Fee revenue is nothing more than an additional product discount. If suppliers can pay enough in fees to produce fee revenue for hospitals then isn't that really an indication that their prices are inflated and that they can afford to sell their products to hospitals for less?

6. Self-contracting hospitals have shown that additional cost savings can be obtained without using GPOs. This may be an indication that the GPO is not the right vehicle to generate additional savings.

7. Senator Kohl, in your remarks during last year's hearing you expressed an interest in and a commitment to eliminating what you termed conflicts of interest. It is my belief that the Safe Harbor creates a conflict of interest for the GPO by allowing it to accept money from the suppliers among whom it is supposed to be creating increased competition. A kickback is a kickback regardless of who sanctions it.

8. The Safe Harbor provides a powerful incentive for GPOs to act as brokers in transactions representing both sides rather than as agents of their members. In court, an attorney cannot effectively represent both the defense and the prosecution.

9. Most GPO contracting-related press releases talk about renewals or extensions. Renewals and extensions do not stimulate competition but they do discourage new entrants into the marketplace.

10. The Safe Harbor allows GPOs to conduct business as they see fi,t and they are free to do whatever they want with no one to answer to but themselves. The Safe Harbor came with no provision for oversight and no rules of engagement against which compliance could be measured. GPOs claim that they are governed by their members, but an occasional meeting at a golf resort is not governance. Most hospital CEOs are either too busy with other issues in their hospitals or are not versed in supply chain management enough to provide any real significant oversight even if they were interested in doing so.

11. GPOs claim to take direction from their product councils. It is simply naïve to believe that total consensus on product can be created for as many as two thousand hospitals.

12. By submitting themselves to the decisions of GPO product councils with whom they have no fiduciary relationship, physicians may unknowingly outsource part of their medical decision making authority and responsibility to the GPO. If this is even legal it certainly cannot be comforting to patients and caregivers.

13. The Safe Harbor creates a flow of money from suppliers to GPOs and gives them significant financial leverage over their members. While GPOs argue that membership is voluntary, hospital CEOs know that the more compliant they are to the contracts, even if the contracts are not in the hospital's best interest, the larger their rebate checks will be. It is the rebate checks and not supply chain expertise that draw hospitals to GPOs. Without the Safe Harbor the rebate checks

would be smaller and hospitals would be forced to use sound judgment rather than rebate addiction to make their GPO membership decisions. When a hospital chooses to use a contracted but unsafe product instead of an available safe product it chooses money over patient and caregiver safety. In doing so, hospitals violate the trust of their clinicians and patients and perhaps fail to fulfill their own fiduciary responsibility.
14. Supply chain management has revolutionized competition for many companies in many different industries outside of the hospital market. Buyers are experts in their fields and use scientific methods and market intelligence to create sound procurement strategies. Hospitals, in their own way, are factories. The medical product raw materials purchased by hospitals are combined with clinical expertise to produce patient outcomes. Yet hospitals seem to buy pacemakers the same way they buy paper clips. Could it be that an over-reliance on GPOs has made hospitals lazy in how they manage their supply chains? While the hospitals have become weaker the GPOs have become stronger. The Safe Harbor perpetuates supply chain weakness in hospitals by effectively endorsing the use of GPOs.
15. Hospitals are in competition every day for patients, physicians, staff, payer relationships and community resources. Not every hospital in every market will survive. There are few potential strategic advantages for a hospital but one of them certainly should be the supply chain yet most hospitals are far too willing to trade the possibility of gaining a competitive advantage in their supply chain for the assurance that they won't do any worse than the competition. For a larger hospital, using a GPO may be an anti-competitive move against itself. It is ironic that in most well run businesses the management out sources the areas where it lacks expertise but retains strategic decision making for itself. Inexplicably, hospitals maintain tight control over inefficient internal supply chain processes but choose to outsource their strategic contracting decisions.

The GPO issue would not have made it to this Subcommittee without scores of complaints about alleged bad behavior of certain GPOs. Surely, those GPOs who operate under the Safe Harbor owe a duty of care to the Congress for granting the Safe Harbor. It is my sincere hope that you will move to eliminate the Safe Harbor and require GPOs to be paid for their services by hospitals the way every other supplier is paid. But if you choose to leave the Safe Harbor in place, from this point forward any bad behavior that is given license by the Safe Harbor must become, at least in part, the responsibility of this Subcommittee and the personal responsibility of each Member. Bad behavior at Enron cost people their money. Bad behavior at GPOs and suppliers could be costing people their health and their very lives. If you leave the Safe Harbor in place I urge you in the strongest possible terms to fully investigate the alleged bad behavior of certain GPOs. And I plead with you to use people who know what to look for.

I believe that there are answers to the dilemma we now face but that they will require careful examination of GPO practices and the actual value they produce for hospitals. Then, with detailed planning and meticulous execution, we can create a new approach that places hospitals as the priority and creates a supply chain procurement model that supports high-quality, safe patient care and effective management of cost issues. As a health care supply chain expert I have given this area a great deal of thought and I am prepared to work with this body, the Department of Justice, and the Federal Trade Commission to create an effective solution.

Recently, two major GPOs announced plans to go public with a stock offering. Does it seem right that while their hospital members continue to struggle financially, Broadlane and

MedAssets will use the windfall granted to them by the Congress in the form of the Safe Harbor to enrich themselves by selling stock in their companies? Will this be the legacy of the Safe Harbor? Will this body demand a full accounting of GPO business practices and full disclosure of the supply chain money trail that alone will lead to a meaningful and useful Code of Conduct? Or is the goal to place a band-aid on a scratched arm while the patient continues to hemorrhage from a severed aorta?

I have never believed that the answers to all of the country's problems reside in Washington, D.C. I also do not believe that most of our problems lie here either. Rather, the answers to many of our greatest challenges lie in individuals and corporations. The answers to the ills of the health care supply chain lie in the ability and willingness of manufacturers, GPOs, distributors, and hospitals to do what is right, fair, and just so as to do the most good for patients, caregivers, and their families at the lowest reasonable total cost. The role of the government is to provide a watchful eye and ensure that the playing field is level so that the market of patients, caregivers, and hospitals, and not the government, determines the winners and losers. By eliminating the Safe Harbor, the playing field can be leveled. Thank you for inviting me to testify today.