U.S. Office of Personnel Management

Office of the Inspector General

Office of Audits

Final Audit Report

Audit of Group Health Incorporated's Federal Employees Health Benefits Program Pharmacy Operations as Administered by Express Scripts, Inc. for Contract Years 2015 through 2019

Report Number 1H-08-00-21-015
February 16, 2023

Executive Summary

Audit of Group Health Incorporated's Federal Employees Health Benefits Pharmacy Operations as Administered by Express Scripts, Inc. for Contract Years 2015 through 2019

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Why Did We Conduct the Audit?

The objective of the audit was to determine whether costs charged to the Federal Employees Health Benefits Program (FEHBP) and services provided to its members were in accordance with the U.S. Office of Personnel Management (OPM) Contract Number CS 1056 and applicable Federal regulations.

What Did We Audit?

The Office of the Inspector General has completed a performance audit of Group Health Incorporated's ("Carrier" and subsidiary of EmblemHealth) FEHBP pharmacy operations as administered by Express Scripts, Inc. (the Pharmacy Benefit Manager or PBM). Our audit consisted of reviewing the administrative fees, annual accounting statements, claims eligibility and pricing, drug manufacturer rebates, performance guarantees, and fraud and abuse program for pharmacy operations during contract years 2015 through 2019. Audit work was completed remotely from our offices in Jacksonville, Florida and Cranberry Township, Pennsylvania due to COVID-19 restrictions.

Michael R. Esser
Assistant Inspector General
for Audits

What Did We Find?

We found that the Carrier and the PBM overcharged the FEHBP $15,086,272 (including lost investment income) by not passing-through all discounts and credits related to prescription drug pricing that were required under the PBM Transparency Standards found in the Carrier's contract with OPM.

Specifically, our audit identified the following six findings during the scope of our audit that require corrective action. The findings occurred across all years of the audit scope and each amount includes lost investment income.

- The FEHBP did not receive pass-through transparent drug pricing from the PBM, resulting in a $12,480,345 overcharge to the program.
- The FEHBP did not receive any of the drug purchasing discounts collected by the PBM for drugs filled at its own specialty and mail order pharmacies, resulting in a $917,373 overcharge to the program.
- The Carrier failed to return $588,565 to the FEHBP for its portion of the PBM's generic drug pricing guarantees that were paid to the Carrier.
- The FEHBP did not receive all drug manufacturer rebates and corresponding administrative fees collected by the PBM, resulting in a $1,048,407 overcharge to the program.
- The Carrier failed to return $51,581 for the FEHBP's portion of the PBM's performance guarantee penalties that were credited back to the Carrier.
- The Carrier did not refer pharmacy specific fraud and abuse cases to OPM because there was no process in place to identify which cases from the PBM had FEHBP exposure.

No exceptions were identified from our reviews of the administrative fees, annual accounting statements, and claims eligibility.

Abbreviations

5 CFR 890	**Title 5, Code of Federal Regulations, Part 890**
AAC	**Actual Acquisition Cost**
Act	**Federal Employees Health Benefits Act**
Agreement	**The Pharmacy Benefit Management Agreement between the Carrier and the PBM**
Carrier	**Group Health Incorporated, a Subsidiary of EmblemHealth**
Contract	**OPM Contract CS 1056**
CY	**Contract Year**
FEHBP	**Federal Employees Health Benefits Program**
FWA	**Fraud, Waste, and Abuse**
HIO	**Healthcare and Insurance Office**
LII	**Lost Investment Income**
LOCA	**Letter of Credit Account**
NDC	**National Drug Code**
NFR	**Notification of Finding and Recommendation**
OED	**Overall Effective Discount**
OIG	**Office of the Inspector General**
OPM	**U.S. Office of Personnel Management**
PBM	**Express Scripts, Inc (Pharmacy Benefit Manager)**

Table of Contents

I. Background

This report details the results of our audit of Group Health Incorporated's ("Carrier" and subsidiary of EmblemHealth) Federal Employees Health Benefits Program (FEHBP) pharmacy operations as administered by Express Scripts, Inc. (Pharmacy Benefit Manager or PBM) for contract years (CY) 2015 through 2019. The audit was conducted pursuant to the provisions of Contract CS 1056 (Contract) between the U.S. Office of Personnel Management (OPM) and the Carrier; the Pharmacy Benefit Management Agreement between the Carrier and the PBM (Agreement); and Title 5, Code of Federal Regulations, Part 890 (5 CFR 890). The audit was performed by OPM's Office of the Inspector General (OIG), as established by the Inspector General Act of 1978, as amended.

The FEHBP was established by the Federal Employees Health Benefits Act (Act), Public Law 86-382, enacted on September 28, 1959. The FEHBP was created to provide health insurance benefits for Federal employees, annuitants, and dependents. OPM's Healthcare and Insurance Office (HIO) has the overall responsibility for the administration of the FEHBP, including the publication of program regulations and agency guidance. As part of its administrative responsibilities, the HIO contracts with various health insurance carriers that provide service benefits, indemnity benefits, and/or comprehensive medical services. The provisions of the Act are implemented by OPM through regulations codified in 5 CFR 890 and the Contract.

The PBM is primarily responsible for processing and paying prescription drug claims. The services provided typically include retail pharmacy, mail order, and specialty drug benefits. For drugs acquired through retail, the PBM contracts directly with approximately 50,000 retail pharmacies located throughout the United States. For maintenance prescriptions that typically do not need to be filled immediately, the PBM offers the option of a mail order pharmacy benefit. The PBM also provides specialty pharmacy services for members with rare and/or chronic medical conditions. The PBM is used to develop, allocate, and control costs related to the pharmacy claims program.

The Carrier contracted with the PBM, located in St. Louis, Missouri, to provide pharmacy benefits and services to FEHBP members for CYs 2015 through 2019. Section 1.11 of the Contract includes a provision that allows for audits of the program's operations. Additionally, section 1.28(a) of the Contract outlines transparency standards that require the PBM to provide pass-through pricing based on its cost for drugs. Our responsibility is to review the performance of the PBM and the Carrier to ensure that costs charged to the FEHBP, and services provided to its members, are in accordance with the Contract, the Agreement, and Federal regulations.

This is the first audit of the Carrier's pharmacy operations as administered by the PBM. The results of our audit were discussed with the Carrier and PBM officials at an exit conference on August 3, 2022. In addition, a draft audit report, dated September 15, 2022, was provided to the Carrier and PBM for review and comment. The Carrier's and PBM's responses to the draft report were considered in preparing the final report and are included as Appendices to this report.

II. Objectives, Scope, and Methodology

Objectives

The main objective of the audit was to determine whether costs charged to the FEHBP, and services provided to its members, were in accordance with the terms of the Contract, the Agreement, and applicable Federal regulations.

Our specific audit objectives were to determine if:

Administrative Fees Review

- The Carrier paid the PBM's administrative fees in accordance with the Agreement.

Annual Accounting Statements Review

- The Carrier accurately reported to OPM the prescription drug charges and drug manufacturer rebates for FEHBP operations.

Claims Eligibility Review

- Any claims were paid for ineligible dependents age 26 and older, excluded drugs, or members enrolled in another group.

Claims Pricing Review

- The pricing elements for retail, mail order, specialty, and other drug claims were transparent and priced correctly in accordance with the Contract and the Agreement.
- The financial pricing guarantees were met, and if any penalties were accurately returned/credited to the FEHBP.

Drug Manufacturer Rebates Review

- All drug manufacturer rebates and corresponding administrative fees were properly credited to the FEHBP.

Performance Guarantees Review

- The PBM performance guarantees were met, and if any penalties were accurately returned/credited to the FEHBP.

Fraud and Abuse Program Review

- The Carrier and the PBM complied with the FEHBP's fraud and abuse program requirements.

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives.

This performance audit included a review of the administrative fees, annual accounting statements, claims pricing and eligibility, drug manufacturer rebates, performance guarantees, and fraud and abuse program related to FEHBP pharmacy operations for CYs 2015 through 2019. As part of our survey work, we conducted informational meetings with the PBM from August 2 through August 4, 2021. The audit fieldwork was completed remotely from our offices in Jacksonville, Florida and Cranberry Township, Pennsylvania from September 14, 2021, through August 3, 2022.

The Carrier is responsible for providing FEHBP members with medical and prescription drug benefits. To meet this responsibility, the Carrier collected healthcare premium payments of approximately $1.1 billion from CYs 2015 through 2019, of which approximately two-thirds was paid for by the Federal government on behalf of Federal subscribers. The Carrier's annual accounting statements reported total pharmacy claims paid of approximately $264 million for CYs 2015 through 2019 (See net amounts below).

Contract Year	Earned Healthcare Premiums	Number of Pharmacy Claims	Amount of Pharmacy Claims Paid	Amount of Medical Claims Paid
2015	$275,137,339	469,213	$63,579,804	$190,056,511
2016	$257,737,465	447,861	$61,656,734	$174,500,840
2017	$207,922,804	371,133	$53,209,163	$150,763,034
2018	$204,537,356	191,026	$49,229,862	$138,188,547
2019	$131,808,239	159,726	$36,306,320	$95,089,003
Total	**$1,077,143,203**	**1,638,959**	**$263,981,883**	**$748,597,935**

In planning and conducting the audit, we obtained an understanding of the Carrier's and the PBM's internal control structures to help determine the nature, timing, and extent of our auditing procedures. This was determined to be the most effective approach to select areas for audit. For those areas selected, we primarily relied on substantive tests of transactions and not tests of controls. Additionally, since our audit would not necessarily disclose all significant matters in the internal control structure, we do not express an opinion on the Carrier's and the PBM's systems of internal controls taken as a whole.

We also conducted tests of accounting records and other auditing procedures as we considered necessary to determine compliance with the Contract, the Agreement, and Federal regulations. Exceptions noted in the areas reviewed are set forth in the "Audit Findings and Recommendations" section of this report. With respect to the items not tested, nothing came to our attention that caused us to believe that the Carrier and the PBM had not complied, in all material respects, with those provisions.

In conducting the audit, we relied to varying degrees on computer-generated data provided by the Carrier and the PBM. Due to time constraints, we did not verify the reliability of the data generated by the various information systems involved. However, while utilizing the computer-generated data during our audit, nothing came to our attention to cause us to doubt its reliability. We believe that the data was sufficient to achieve our audit objectives.

To determine whether costs charged to the FEHBP, and services provided to its members, were in accordance with the terms of the Contract, Agreement, and applicable Federal regulations for CYs 2015 through 2019, we performed the following audit steps:

Administrative Fees Review

- For each CY, we reviewed the monthly administrative fee invoices and line items to determine if the PBM's fees were properly calculated and supported in accordance with the terms of the Agreement.

Annual Accounting Statements Review

- For each CY, we reviewed the annual accounting statements to determine if the prescription drug charges and drug manufacturer rebates were properly reported based on a reconciliation with the claims data and the Letter of Credit Account (LOCA).

Claims Eligibility Review

- We identified and reviewed all dependents 26 years of age or older from the 2019 paid claims data, the most recent year of our audit scope, to determine if the members were eligible for coverage due to a disability and incapable of self-support.
- We identified and reviewed the Carrier's non-covered drugs list to determine if any claims were paid for excluded drugs during the scope of our audit.
- We reviewed all claims to determine if any were paid for non-FEHBP members or members enrolled in another FEHBP plan in which the Carrier participates.

Claims Pricing Review

- For each CY, we reviewed the retail, mail, and specialty pharmacy claims pricing to ensure that the FEHBP was charged accurate amounts in accordance with OPM's pass-through transparent pricing requirement.

- We reviewed all financial pricing guarantees that were paid to the Carrier from the PBM to determine if the amounts were accurate and if the credits were passed through to the FEHBP.

Drug Manufacturer Rebates Review

- From a universe of 1,034 different drug manufacturer rebates invoiced by National Drug Code (NDC), totaling $51,964,119 for CYs 2015 through 2019, we judgmentally selected a sample of the top 10 NDCs from each year with the highest dollar amount invoiced, totaling $18,326,222 over all five years. We then reviewed the collections from our sample to determine if the drug manufacturer rebates were properly supported, accurately calculated, and fully remitted to the Carrier and the FEHBP.

Performance Guarantees Review

- For each CY, we reviewed the PBM's actual performance and compared it to the guarantees to determine if the results were accurately reported and if any penalties were properly credited to the FEHBP.

Fraud and Abuse Program Review

- We reviewed all potential fraud and abuse cases that were reported by the PBM to the Carrier during the scope of our audit to determine if those cases were referred to the OPM-OIG.
- We reviewed the Carrier and PBM's policies and procedures for fraud and abuse to ensure that they complied with the most recent carrier letter guidelines published by OPM.

The samples that we selected and reviewed in performing the audit were not statistically based. Consequently, the results were not projected to the universe since it is unlikely that the results are representative of the universe taken as a whole.

III. Audit Findings and Recommendations

Throughout this engagement, the OIG audit team experienced significant delays caused by the Carrier's resistance to provide much of the requested information. Due to the nature and degree of these delays, it was necessary for the OIG to seek assistance from OPM's Contracting Officer to enforce the Contract by reminding the Carrier that it is legally obligated to cooperate with the audit team in providing the necessary audit support and documentation. We appreciate OPM's efforts to support the OIG during this extensive and lengthy audit.

A. Administrative Fee Review

The results of our review showed that the administrative fees charged by the PBM and paid by the Carrier were in accordance with the Agreement.

B. Annual Accounting Statements Review

The results of our review showed that the amounts reported in the 2015 through 2019 annual accounting statements for FEHBP pharmacy operations were accurate.

C. Claims Eligibility Review

The results of our review showed that the Carrier and the PBM had sufficient policies and procedures in place to help prevent ineligible pharmacy claims from being processed.

D. Claims Pricing Review

1. Pass-through Transparent Drug Pricing Not Received: $12,480,345

The PBM did not provide pass-through transparent pricing for the FEHBP's retail, mail order, and specialty drugs charged to the Carrier during CYs 2015 through 2019, resulting in an $11,251,490 overcharge. Additionally, $1,228,855 is due to the FEHBP ($12,480,345 in total) for lost investment income (LII).

Section 1.28 of the Contract between OPM and the Carrier requires PBM transparency standards for the FEHBP, effective no later than January 1, 2013. This section states "The PBM agrees to provide pass-through transparent pricing based on the PBM's cost for drugs (as described below) in which the Carrier receives the value of the PBM's negotiated discounts, rebates, credits or other financial benefits. (i) The PBM shall charge the Carrier no more than the amount it pays the pharmacies in its retail network for brand and generic drugs plus a dispensing fee. (ii) The PBM shall charge the Carrier the cost of drugs at mail order pharmacies based on the actual cost, plus a dispensing fee. Costs shall not be based on industry benchmarks … ." In return for pass-through pricing of the drug costs, the PBM is paid set administrative fees for processing claims and mail/specialty dispensing fees that account for all its profit and overhead in providing and processing drug benefits. This is known as a transparent arrangement since there are no hidden profits and the Carrier receives the value of the PBM's negotiated discounts, rebates, credits, or other financial benefits.

The FEHBP did not receive pass-through drug pricing required by the Contract's PBM Transparency Standards.

Additionally, the Agreement lists the administrative fee for processing claims outside of the PBM's network as $[redacted] since there are pre-negotiated discounts in place with out-of-network pharmacies.

Finally, sections 3.4(d) and (f) of the Contract state that "Investment income lost as a result of unallowable, unallocable, or unreasonable charges against the contract shall be paid from the first day of the contract term following the contract term in which the unallowable charge was made and shall end on the earlier of: (1) the date the amounts are returned to the Special Reserve (or the Office of Personnel Management); (2) the date specified by the Contracting Officer; or (3) the date of the Contracting Officer's Final Decision. … The Carrier shall credit the Special Reserve for income due in accordance with this clause. All lost investment income payable shall bear simple interest at the quarterly rate determined by the Secretary of the Treasury under the authority of 26 U.S.C. 6621(a)(2) applicable to the periods in which the amount becomes due … ."

During pre-audit, we requested from the PBM copies of any cost settlements, prior period adjustments, or reconciliations for the scope of our audit to ensure that pass-through transparent drug pricing was given to the Carrier for the FEHBP group. While holding our survey meetings, the PBM's personnel stated that transparent pricing was not specified for the FEHBP in the Agreement between the Carrier and the PBM, and that the FEHBP did not receive transparent pricing for any of the drug claims processed and filled during the scope of our audit. The OIG requested that the PBM reprice the FEHBP drug claims under a pass-through transparent pricing arrangement. The PBM provided repricing data showing the difference between the traditional spread pricing[1] methodology used and the pass-through transparent pricing methodology required by the FEHBP. The PBM used an $8 mail and $200 specialty dispensing fee based on the average of all client agreements that had a transparent pricing arrangement with the PBM during the scope of our audit. Additionally, we agreed to use the $[redacted] claims processing fee that was listed in the Agreement for claims processed outside of the PBM's network since that fee represented the required profit and overhead costs needed to process a claim that did not have a pre-negotiated pricing agreement in place (out-of-network). The difference between traditional and transparent drug pricing methods resulted in an overcharge of $11,251,490 to the FEHBP for CYs 2015 through 2019 using the PBM's data provided during the audit (See gross amounts below).

[1] Spread pricing occurs when PBMs charge health plans and payers more for a prescription drug than what they reimburse to the pharmacy and then keep the difference as profit.

Type of Drug Pricing Arrangement with PBM	2015 Total Rx Cost	2016 Total Rx Cost	2017 Total Rx Cost	2018 Total Rx Cost	2019 Total Rx Cost
Traditional Spread Pricing	$71,746,582	$68,706,691	$58,893,147	$54,375,287	$38,389,327
Pass-through Transparent Pricing	$69,317,003	$66,722,506	$57,001,946	$51,947,974	$35,870,115
Overcharge per Year	**$2,429,579**	**$1,984,185**	**$1,891,201**	**$2,427,313**	**$2,519,212**

Because the Carrier failed to change the FEHBP group to a transparent pass-through pricing arrangement with the PBM in 2013 (as required by OPM), the FEHBP was overcharged $11,251,490 for spread pricing on drugs filled and processed by the PBM during CYs 2015 through 2019. Additionally, the FEHBP is due $1,228,855 for LII (totaling $12,480,345 for this finding).

Recommendation 1:

We recommend that OPM's Contracting Officer require the Carrier to return $11,251,490 to the FEHBP for pass-through transparent drug pricing that was not received from the PBM for CYs 2015 through 2019.

Recommendation 2:

We recommend that OPM's Contracting Officer assess the Carrier $1,228,855 for LII on the questioned costs due back to the FEHBP for this finding, calculated through December 31, 2022. The LII should be adjusted to account for the date the questioned costs are returned to the program.

Carrier's Response to Finding # 1:

"The Draft Report concludes GHI should pay OPM $10,620,988[2], plus interest, because ESI charged GHI more than the amount ESI paid for all drugs dispensed to GHI health plan participants. Emblem disagrees. The Draft Report is incorrect in two respects. First, unlike the current OPM contract, the contract version in effect for 2015-2019 did not require full pass- through pricing. Second, where drug charges are 100% pass-through, an additional rate component is added to cover compensation to the PBM. The contract between GHI and OPM (the 'OPM Contract') contemplates such

[2] The draft report did not include $630,502 in retail drug dispensing fees under traditional pricing. The total overcharge for the final report is $11,251,490, not including lost investment income.

additional charges. But the Draft Report substantially understates those charges, and in doing so disregards the charges as reported by ESI.

The Draft Report premises Finding #1 on Section 1.28 of the OPM Contract. But Section 1.28 does not require full pass-through pricing, which would require the commercially unlikely outcome of no compensation whatsoever to the PBM. Rather, Section 1.28 requires only that the Carrier 'receives the value of the PBM's negotiated discounts, rebates, credits or other financial benefits.' OPM Contract § 1.28(a)(2). Based upon a plain language reading of Section 1.28, it is clear the OPM Contract did not in fact require the actual pass-through of the negotiated discounts, rebates, credits and other financial benefits – but merely the delivery of the value of those items. Notably, and seemingly in recognition of this fact, OPM subsequently revised this language for the 2022 contract version of Section 1.28 to require the actual pass-through of such discounts, rebates, credits and other financial benefits. The version of the contract applicable in 2015-2019 lacks that requirement.

As stated in the Draft Report, Section 1.28 provides with respect to drugs dispensed through retail pharmacies that the PBM 'shall charge the Carrier no more than the amount it pays pharmacies in its retail network for brand and generic drugs plus a dispensing fee.' OPM Contract, Section 1.28(a)(1)(ii). This provision expressly contemplates a dispensing fee, through which the PBM may be compensated. In addition, despite this reference to pass-through pricing, two additional subsections of Section 1.28(a) expressly contemplate other forms of compensation to a PBM, including administrative fees, as well as other 'sources of profit' to the PBM. See OPM Contract, §§1.28(a)(3) and (4).

Section 1.28(a)(2)(ii) of the OPM Contract, applicable to mail order claims, establishes a different requirement than subsection (i), applicable to retail claims. Subsection (ii) provides: 'The PBM shall charge the carrier the cost of drugs at mail order based on the actual cost, plus a dispensing fee (emphasis added).' OPM Contract § 1.28(a)(2)(ii). The requirement that charges be 'based on the actual cost,' is clearly different from and less limiting than the language applicable to retail claims, yet the Draft Report fails to note or apply the distinction. Instead, the Draft Report states that full pass-through is required for all claims – an approach contradicted by the Contract's plain language.

The auditors' recommendation with respect to Finding #1 should also be rejected because the Draft Report fails to specify accurately the fees payable to ESI. Pass-through pricing and spread pricing differ in terms of how they compensate a PBM for its overhead and profit margin. These costs are not eliminated in pass-through pricing; they are just paid differently. In spread pricing, a PBM's overhead and profit are covered by the difference between what the PBM pays the pharmacy for drugs versus what the customer pays the PBM, as well as by any share of rebates retained by the

PBM. The actual amount above the PBM's net drug cost is not apparent to the customer. With pass-through pricing, a PBM's total charge for overhead and margin is more apparent: it is separately stated, typically in the form of per-claim fees and other charges.

Section 1.28 of the OPM Contract expressly contemplates that PBMs will receive a profit for providing services. See, e.g., Section 1.28(a)(3)(requiring the PBM to 'identify sources of profit to the carrier and OPM as it relates to the Federal Employees Health Benefits Program ("FEHBP" contract). This subsection also contemplates that a PBM may have multiple sources of profit in connection with its services for FEHBP.

The Draft Report's $10.6 million figure is a gross number, which fails to take into account all the additional charges, including per-claim charges, that apply with transparent pricing, as well as the permissible additional charges that are contemplated under the OPM Contract. Transparent pricing is untenable absent a means to compensate a PBM for its overhead and margin. And, thus, in considering whether the government failed to receive the value of pass-through pricing, it is imperative that OPM also consider the fulsome additional charges that would have been applied had transparent pricing been utilized.

Emblem elected traditional, spread pricing for its own business at the same time it adopted that pricing model for its FEHBP business. Emblem determined spread pricing was best when it was at risk for its commercial business, and treated its FEHBP business in exactly the same way. Emblem believes the FEHBP was not disadvantaged by this choice.

ESI agrees with Emblem that the special audit group's $10.6 million estimate for this NFR [Notification of Finding and Recommendation] is substantially overstated. Using its best estimates and based upon the specific characteristics of GHI's utilization, volume, and other client-specific characteristics, ESI performed a calculation for the applicable administrative fees that would have been applied had pass-through pricing been utilized for 2015-2019. ESI concluded that when these costs are taken into account, the aggregate difference during the audit period between the two approaches is around $2.75 million.'

The Draft Report's conclusion of a $10.6 million overcharge is premised on the auditors' rejection of the analysis and conclusions of ESI that are attached to this response. The Draft Report does not address or even acknowledge the conclusions of ESI and provides no grounds whatsoever for the Contract Officer to accept the figures in the Draft Report over those presented by ESI.

While Emblem appreciates that ESI's own analysis indicates the amount at issue to be materially less than the audit group determined, Emblem continues to believe ESI's calculations may in fact understate the extent of fees that would have applied had the contract been performed on a transparent pricing basis – and that, in fact, the government received a net benefit from Emblem's decision to utilize traditional pricing. Regardless, in any event, the amount at issue is far less than the figures reflected in Finding #1."

PBM's Response to Finding # 1:

"Please accept this response by Express Scripts, Inc. ('ESI') on behalf of Group Health Inc. to OIG's Notification and Finding regarding Pass-Through Transparent Drug Pricing in the amount of $10,620,988 in connection with the Audit of Group Health Incorporated's Federal Employees Health Benefits Program pharmacy operations administered by Express Scripts. We welcome the opportunity to provide the following response.

We partially agree with OIG's Finding and Recommendation that ESI did not provide pass-through transparent pricing for all retail, mail order, and specialty drugs processed and filled for the Group Health Inc.'s FEHBP group during CYs 2015 through 2019, resulting in a $10,620,988 overcharge. ESI agrees that ESI did not provide pass-through transparent pricing for all retail, mail order, and specialty drugs processed and filled for the Group Health Inc.'s FEHBP group during CYs 2015 through 2019. ESI, however, does not agree with the impact calculation.

The impact calculation used Administrative and Dispensing Fee amounts that were estimates based on lines of business comparable to Group Health Inc., as opposed to using Administrative and Dispensing Fee amounts that were specifically based on Group Health Inc.'s demographics, drug utilization, pharmacy mix, etc. ('GHI Specific Data'). ESI and Group Health Inc. recently negotiated the 2022 and beyond pricing for the FEHBP lives for Group Health Inc. under a pass-through transparent pricing arrangement. During this process, GHI Specific Data was analyzed to evaluate and more accurately and appropriately calculate the applicable Administrative and Dispensing Fee amounts that would have applied to Group Health Inc. from 2015 forward. Specifically, Group Health Inc. has a higher non-specialty mail penetration and a higher generic fill rate for specialty drugs. Those Administrative and Dispensing Fee amounts are set forth in the Pharmacy Claims Pricing Traditional to Transparent Pricing spreadsheet attached hereto.

It is important to understand that specific analysis of the GHI Specific Data was performed for the 2022 and that a true pass-through transparent pricing arrangement cannot be re-created for the past. Notwithstanding, pricing offers improve over time, so

the Administrative and Dispensing Fee amounts would have been higher in the years leading up to 2022. As such, it is more accurate to take a tiering approach to the Administrative and Dispensing Fees utilized in the impact calculation versus an average.

Thus, we respectfully assert that for the 2015 through 2019 audit period at issue here, the impact calculation should be based on the Administrative and Dispensing Fees set forth in the Pharmacy Claims Pricing Traditional to Transparent Pricing spreadsheet attached hereto."

OIG Comments:

FEHBP experience-rated carriers were required to implement PBM transparency standards no later than January 1, 2013. The Carrier failed to comply with the Contract and did not transition the FEHBP group to a pass-through transparent pricing arrangement until 2022, after we conducted this audit. The Carrier incorrectly argues that the value of the PBM's negotiated discounts, rebates, credits, or other financial benefits were not required to be passed through to the FEHBP until 2020. The Carrier asserts that because OPM added a definition of pass-through transparent pricing that included the word "full" before "value" in the 2020 FEHBP contract, that less than 100 percent pass-through was required during contract years 2013 to 2019. OPM added the word "full" in the 2020 FEHBP contract for clarification purposes only in response to closing a loophole with retail pharmacy contracts that use an overall effective discount (OED) and allow the PBM to apply variable pricing among clients. The purpose of a clarification is to take a prior statement or contract clause and make it easier to understand. This was not an alteration, modification, or amendment to the contract's pass-through transparent pricing requirements, it was simply a clarification to assist the reader in understanding OPM's intentions. The Carrier failed to recognize the fact that the 2013 through 2019 FEHBP contracts accurately stated "the value of the PBM's negotiated discounts, rebates, credits, or other financial benefits" were to be passed through to the Carrier and the FEHBP. The word "partial" value was never used prior to 2020, nor was the definition for pass-through transparent pricing ever listed. Instead, OPM simply required all experience-rated carriers to implement the FEHBP transparency standards no later than 2013, where "the value of the PBM's negotiated discounts, rebates, credits or other financial benefits" are required to be passed through to the FEHBP. In addition, OPM has explained transparent pricing to the FEHBP carriers multiple times since 2013, both in meetings and carrier letters, making it clear that the requirement means 100 percent pass through of the PBM's negotiated discounts, rebates, credits, or other financial benefits. The Carrier's actions were in disregard to the FEHBP transparency standards. Even the PBM agreed that it should have provided pass-through transparent pricing to the FEHBP during the years in question. In the PBM's response, it states "*ESI agrees that ESI did not provide pass-through transparent pricing for all retail, mail order, and specialty drugs processed and filled for the Group Health Inc.'s FEHBP group during CYs 2015 through 2019. ESI, however, does not agree with the impact calculation."*

The Carrier's second argument is that the OIG used understated administrative fees (claims processing fees) and dispensing fees to calculate the audit finding amount. The questioned costs calculated by the OIG used the PBM's average administrative fees and dispensing fees derived from all the PBM's clients that have a transparent arrangement with the PBM. **The average administrative fees and dispensing fees, provided by the PBM during the audit and used by the OIG, are the only numbers that differ between the $11,251,490 overcharge calculated by the OIG compared to the $2,750,000 overcharge calculated by the Carrier**. The Carrier is not using the PBM's average administrative fees and dispensing fees for the PBM's book of business for transparent pricing arrangements. Instead, the Carrier requested to drop out of the FEHBP after 2022, and in doing so, the Carrier signed a new agreement with the PBM using inflated administrative fees and dispensing fees that are high enough to absorb most of the questioned costs identified by the audit. These fees were calculated in 2022, after the OIG audit in which the Carrier and the PBM were already found to be responsible for paying back over $10 million. The Carriers inflated administrative and dispensing fees will only be in place for one full year before it withdraws its health plan from participating in the FEHBP. The OIG reviewed the Carrier and PBM's new administrative fees and dispensing fees listed in the 2022 agreement, along with the retroactive fees calculated back to 2015, and found that some fees were higher than any other Carrier and PBM agreement for participants in the FEHBP. The difference between the average administrative fees used by the OIG (derived from the average transparent group with the PBM) and the newly agreed upon fees developed after the audit by the Carrier and the PBM (only for the last year participating in the FEHBP and after they were found responsible for repaying over $10 million) are as follows:

Claim Type	PBM's Average Transparent Dispensing and Out-of-Network Processing Fees used by Auditors	New 2022 PBM Agreement and Retroactive Fees used by Carrier after Announcing FEHBP Termination
Retail, Mail, and Specialty Claims Processing Fee	[redacted]	[redacted]
Mail Dispensing Fee	[redacted]	[redacted]
Specialty Dispensing Fee	[redacted]	[redacted]

We maintain that our calculation, using both the PBM's average transparent dispensing fees provided during the audit to develop the questioned costs and the out-of-network claims processing fee found in the Agreement, should be used to determine the overcharge. Any short-term retrospective fee structure developed in collaboration between the Carrier and the PBM after the audit identified over $10 million in overcharges should not be used. These new fees are some of the highest in the FEHBP and will not affect the Carrier for more than one year since it is no longer participating in the program.

2. Specialty and Mail Order Drug Purchasing Discounts Not Received: $917,373

The PBM did not pass-through to the Carrier and credit the FEHBP for non-specific drug purchasing discounts that it received related to FEHBP drugs processed and filled at its own specialty pharmacies and mail-order warehouses for CYs 2015 through 2019, resulting in an $816,814 overcharge. Additionally, $100,559 is due to the FEHBP for LII ($917,373 in total).

Section 1.28(a) of the Contract between OPM and the Carrier lists PBM transparency standards that the PBM and Carrier must follow no later than January 1, 2013. Section 1.28(a)(2) states that the PBM agrees to provide pass-through transparent pricing based on the PBM's cost for drugs in which the Carrier receives the "**value of the PBM's negotiated discounts, rebates, credits or other financial benefits**." Non-specific drug purchasing discounts represent credits that should be passed through to the Carrier and FEHBP under a transparent PBM arrangement.

The FEHBP did not receive any of the PBM's non-specific drug purchasing discounts.

Additionally, sections 3.4(e) and (f) of the Contract state that "Investment income lost as a result of failure to credit income due the contract or failure to place excess funds in income producing investments and accounts shall be paid from the date the funds should have been invested or appropriate income was not credited and shall end on the earlier of: (1) the date the amounts are returned to the Special Reserve (or the Office of Personnel Management); (2) the date specified by the Contracting Officer; or (3) the date of the Contracting Officer's Final Decision. … The Carrier shall credit the Special Reserve for income due in accordance with this clause. All lost investment income payable shall bear simple interest at the quarterly rate determined by the Secretary of the Treasury under the authority of 26 U.S.C. 6621(a)(2) applicable to the periods in which the amount becomes due ....."

During our review of the pass-through pricing requirement at the Carrier and PBM level, we found that the FEHBP group was receiving pharmacy benefits under a traditional spread pricing arrangement with the PBM and not the transparent pass-through pricing arrangement required for the FEHBP since 2013. To assist us in identifying the overcharges to the FEHBP, the PBM provided data showing what the pass-through transparent pricing would have been from CY 2015 through 2019. At a repricing narrative meeting held on March 10, 2022, the OIG inquired if all purchasing discounts associated with the FEHBP claims were credited in the amounts disclosed by the PBM. Although the PBM previously stated that the repricing spreadsheet contained all drug specific discounts, credits, and actual acquisition costs required under the FEHBP's pass-through transparent standards, the PBM disclosed additional discounts that it had originally excluded known as "non-specific" drug purchasing discounts. These discounts include [redacted] and other direct and indirect credits from drug wholesalers and manufacturers. The OIG requested that the PBM determine the full amount of non-specific drug discounts allocable to the FEHBP for CYs 2015 through 2019. The PBM identified $816,814 as being directly attributed to FEHBP claims.

As stated previously because the Carrier never moved the FEHBP group to a transparent PBM arrangement, the PBM did not pass-through the non-specific drug purchasing discounts to the FEHBP, resulting in an $816,814 overcharge for CYs 2015 through 2019. Additionally, the FEHBP is due $100,559 for LII (totaling $917,373 for this finding).

Recommendation 3:

We recommend that OPM's Contracting Officer require the Carrier to return $816,814 to the FEHBP for its portion of the PBM's non-specific drug discounts that were not received due to the Carrier's failure to move its FEHBP experience-rated group to a transparent PBM arrangement with pass-through pricing for CYs 2015 through 2019.

Recommendation 4:

We recommend that OPM's Contracting Officer assess the Carrier $100,559 for LII on the questioned costs due back to the FEHBP for this finding, calculated through December 31, 2022. The LII should be adjusted to account for the date the questioned costs are returned to the program.

Carrier's Response to Finding # 2:

"The Draft Report states: 'Because the Carrier never moved the FEHBP Group to a transparent PBM Arrangement, the PBM did not pass-through the non-specific drug purchasing discounts to the FEHBP, resulting in a $816,814 overcharge for CYs 2015-2019.' This statement is incorrect. The auditors failed to analyze the actual credits at issue in the context of the applicable contract language and, accordingly, misconstrued how those credits should be treated.

The attached letter from ESI explains the reason these credits were not treated by ESI as being pass-through amounts during the years at issue. ESI is strongly of the view that, under the requirements applicable to pass-through pricing during the audit period, the credits were not required to be passed through. Instead, they were retained

by ESI in consideration of specific services performed by ESI – or, in the case of [redacted] discounts, ESI earned those amounts by choosing to pay certain bills early.

As in the case of Finding #1, the Draft Report requests payment of a gross amount without giving effect to other charges ESI would have imposed were this revenue source unavailable. ESI and Emblem did not transact during the years at issue under a pass-through pricing model. When ESI is required to forgo certain revenue sources in order to meet pass-through requirements, typically it identifies and requires alternative sources of revenue. This is entirely permissible in that transparent pricing does not require PBMs to operate at a loss. Instead, it requires them to cover their costs and margin in a way that reveals those amounts.

Had ESI been required, over its objections, to credit GHI for the discounts involved, ESI would have made up for those credits by claiming an equal amount in administrative fees, as is typical in pass-through scenarios. Accordingly, there is no recovery amount to be had under this finding. OPM was not damaged at all by the parties' use of traditional pricing to set the amounts payable by OPM. Pass-through pricing does not require private businesses to cover their own overhead or to forego their margins in order to provide services for federal employees.

In addition, Section 1.28 of the OPM Contract as in effect during the audit period did not require the PBM to pass through the full value of all credits it may have received. The retention by the PBM of certain credits is consistent with the applicable contractual requirements. As ESI notes in its attached correspondence, OPM has changed the contractual requirements effective for the 2022 contract year. This change demonstrates that the 2015-2019 contracts did not require full pass-through pricing."

PBM's Response to Finding # 2:

"Please accept this response by ESI on behalf of Group Health Inc. to OIG's Notification and Finding Regarding Non-Specific Drug Purchasing Discounts in the amount of $816,814.00 in connection with the Audit of Group Health Incorporated's Federal Employees Health Benefits Program pharmacy operations administered by Express Scripts. We welcome the opportunity to provide the following response.

We respectfully disagree with OIG's finding that under the then-existing OPM requirements, non-direct drug costs were required to be passed through to the Carrier.

The Audit Finding describes the general OPM Requirement as follows: '*Section 1.28(a)(2) states that the PBM agrees to provide pass through transparent pricing based on the PBM's cost for drugs in which the Carrier receives the value of the PBM's negotiated discounts, rebates, credits or other financial benefits* (original emphasis).' But this

reference of the general requirement for pass through pricing omits a key phrase of the requirement, and the Finding itself fails to reference and omits altogether the more detailed and specific provision setting forth [in] the transparent requirement for mail order pharmacy claims.

The general OPM Requirement in its entirety provides: '*Section 1.28(a)(2) states that the PBM agrees to provide pass through transparent pricing based on the PBM's cost for drugs (as described below) in which the Carrier receives the value of the PBM's negotiated discounts, rebates, credits or other financial benefits* (emphasis added).' The omission of the phrase 'as described below' is significant. In order for a party to comply with the OPM Requirement it must provide the value of the PBM's negotiated discounts, rebates, credits or other financial benefits 'as described below.' And, that is significant, because there are different standards for different elements as to what constitutes 'pass through' or 'transparent' pricing. The standard for retail pharmacy claims is different from the standard for mail order pharmacy claims and each of those standards is different from the standard for rebates. It is axiomatic that when interpreting written provisions the specific takes precedence to the general.

Here, regarding mail order pharmacy claims, Section 1.28, Section (a)(2)(ii)), provides that the PBM is to provide pass through pricing as follows: '*The PBM shall charge the Carrier the cost of drugs at mail order pharmacies based on the actual cost, plus a dispensing fee (emphasis added). Costs shall not be based on industry benchmarks; for example, Average Acquisition Cost (AAC) or Wholesale Acquisition Cost.*' This is the specific OPM Requirement that governs pass through pricing for mail order claims.

As such, the OPM requirement for claims dispensed at a mail pharmacy is to be the cost of drugs '*based on the actual cost.*' The standard does not state, nor does it require, that the cost of drugs 'be the actual cost' or be 'the actual net cost' or be 'the lowest actual net acquisition cost,' only that the price be based on actual cost.

More specifically, for purposes of applying pass through pricing based on an actual cost, ESI provides the following standard: ESI uses the actual purchase price for the ingredient(s) dispensed for each covered drug dispensed to a FEHBP member by a mail order or specialty pharmacy. ESI uses an actual acquisition cost reconciliation methodology that reflects drug specific procurement pre and post invoice discounts for all products dispensed from an ESI facility. The costs are maintained by ESI's [redacted] group. The acquisition costs are calculated monthly and are loaded monthly to a table to support reconciliation and analytic activities. The acquisition cost, inclusive of post purchase discounts, applicable to the date of service of the claim is then applied to each claim incurred.

As such, ESI applies a pass through pricing methodology that is 'based on the actual cost' of claims dispensed to and specifically attributable to OPM members. As noted above, this methodology results in pricing that represents approximately 99% of actual net acquisition cost depending on client utilization. Non-specific drug discounts, which include [redacted] for brand drugs and [redacted] for generic drugs, account for less than 1% of total mail and specialty aggregated acquisition cost. Stated differently, the less than 1% value is directly related only to the total aggregated drug cost attributable to claims dispensed by a mail and specialty pharmacy. Moreover, this value is not attributable to a specific drug claim basis and thus does not directly correlate to a particular dispensing event for a FEHBP member. And, the OPM Standards expressly provide that an average acquisition cost methodology is not to be used, thus indicating that pass through pricing is to be predicated on drug specific costs.

In further support of our position, we reference that OPM has recently revised its OPM Standards, effective as of January 1, 2022. In these recently revised standards, OPM added a new and express definition for Pass-Through Transparent Pricing. This newly added definition states: '*Pass-Through Transparent Pricing' means drug pricing in which the Carrier receives the full value of all discounts, rebates, credits or other financial guarantees or adjustments including any true up or reconciliation*' (emphasis added). Under the revised standard, pass through pricing will now include 'the full value of all discounts, rebates, credits or other financial guarantees or adjustments, including any true up or reconciliation.' This represents a difference from the prior standard. Indeed, in light of this new standard, ESI acknowledges that it has changed its methodology in how it calculates pass through pricing based on actual cost for drugs dispensed at mail pharmacies, so that the value of non-specific drug credit value will be included.
Thus, we respectfully assert that for the 2015 through 2019 audit period at issue here, ESI's calculation of pass through pricing based on actual drug cost for drugs dispensed at mail order pharmacies was correct and in compliance with OPM's requirements."

OIG Comments:

The FEHBP Contract's Transparency Standards historically stated that the "value of the PBM's negotiated discounts, rebates, credits or other financial benefits" were to be passed through to the Carrier and the FEHBP. In 2020, OPM added definitions for several terms including Pass-through Transparent Pricing, which included the word "full" before "the value of the PBM's negotiated discounts, rebates, credits, or other financial benefits." The additional word "full" was for clarification purposes only to ensure that retail pharmacy agreements containing an OED were properly accounted for when the PBM applied variable discretionary pricing to retail pharmacy claims. At no time was the pass-through value of the

PBM's negotiated discounts, rebates, credits or other financial benefits to be interpretated as "partial value," yet the PBM stated that it only gave 99 percent of its financial benefits to the FEHBP. The PBM also stated that once the word "full" was included in the 2020 definition for pass-through transparent pricing, then it agreed to provide 100 percent of its financial benefits including non-specific drug discounts. Using the same logic as the PBM focusing on the term "full" value, never once has the historical Transparency Standard language stated that only the "partial" value should be passed through to the Carrier and FEHBP under transparent PBM arrangement. Therefore, a change from partial to full value never occurred as suggested by the Carrier and PBM. The finding and questioned costs stand under the definition that the PBM was to pass-through the <u>value</u> of its negotiated discounts, rebates, credits or other financial benefits. The term "full" is not needed in this situation just as the term "partial" was never included.

3. Drug Pricing Guarantees Retained by the Carrier: $588,565

The Carrier did not return $531,868 in generic drug pricing guarantees that were paid by the PBM to the Carrier for FEHBP pharmacy claims from CYs 2015 through 2019. Additionally, $56,697 is due to the FEHBP for LII ($588,565 in total).

Section 1.28 of the Contract between OPM and the Carrier lists transparency standards that the PBM and Carrier must follow, to include pass-through pricing of all negotiated discounts, rebates, credits, and other financial benefits. The transparency standards must be implemented in all PBM agreements by January 1, 2013. Section 2.3(i) of the Contract also states, "All health benefit refunds and recoveries, including erroneous payment recoveries, must be deposited into the working capital or investment account within 30 days and returned to or accounted for in the FEHBP [Letter of Credit Account (LOCA)] within 60 days after receipt by the Carrier." Benefit costs are defined as payments made and liabilities incurred for covered health care services on behalf of FEHBP subscribers less any refunds, rebates, allowances or other credits received.

The Carrier did not credit the FEHBP for pricing guarantees that were paid by the PBM to the Carrier.

Additonally, the Agreement between the Carrier and the PBM provided a series of drug pricing guarantees that were payable to the Carrier for its pharmacy claims. When the aggregate for each category of the pharmacy claims is paid at a lesser discount than the guarantee, the PBM pays the Carrier a true-up amount to meet the guaranteed pricing.

Finally, sections 3.4(e) and (f) of the Contract state that "Investment income lost as a result of failure to credit income due the contract or failure to place excess funds in income producing investments and accounts shall be paid from the date the funds should have been invested or appropriate income was not credited and shall end on the earlier of: (1) the date the amounts are returned to the Special Reserve (or the Office of Personnel Management);

(2) the date specified by the Contracting Officer; or (3) the date of the Contracting Officer's Final Decision. … The Carrier shall credit the Special Reserve for income due in accordance with this clause. All lost investment income payable shall bear simple interest at the quarterly rate determined by the Secretary of the Treasury under the authority of 26 U.S.C. 6621(a)(2) applicable to the periods in which the amount becomes due..... ”

As part of our audit, we reviewed the PBM’s pricing guarantees and true-ups at the end of the year to ensure that any amounts received by the Carrier were properly credited to the FEHBP. The PBM provided its end of the year pricing guarantees that were paid to the Carrier for all the client’s business, including the FEHBP, from CYs 2015 through 2019 ($320,766, $5,944,630, $1,694,778, $625,395, and $1,173,945, respectively). Using the FEHBP’s allocation percentages provided by the Carrier, we calculated the annual amount due to the FEHBP for its portion of the penalty payments from CYs 2015 through 2019 ($23,373, $370,104, $82,741, $23,780, and $31,869, respectively). We then traced these pricing guarantee credits back to the LOCA and found that the Carrier never returned the FEHBP’s portion of the pricing guarantees. The Carrier reported that the error occurred because the FEHBP was never moved to a transparent pricing arrangement with the PBM, so it did not transfer the credits back to the FEHBP’s LOCA.

As a result of the Carrier failing to return the generic pricing guarantees back to the LOCA for CYs 2015 through 2019, the FEHBP was overcharged $531,868. Additionally, the FEHBP is due $56,697 for LII (totaling $588,565 for this finding).

Recommendation 5:

We recommend that OPM’s Contracting Officer require the Carrier to return $531,868 to the LOCA for drug pricing guarantees that were paid by the PBM to the Carrier for the FEHBP’s portion of pharmacy claims from CYs 2015 through 2019.

Recommendation 6:

We recommend that OPM’s Contracting Officer assess the Carrier $56,697 for LII on the questioned costs due back to the FEHBP for this finding, calculated through December 31, 2022. The LII should be adjusted to account for the date the questioned costs are returned to the program.

Carrier’s Response to Finding # 3:

“This finding is predicated on the guarantees that apply when spread pricing is used in a PBM Agreement. But many of the other findings are based on pass-through pricing. The pricing approaches are mutually exclusive and, accordingly, so are the corresponding findings. If the relevant charges are adjusted retroactively to reflect

pass-through pricing, the ingredient cost guarantees that underlie this finding would be inapplicable. Moreover, any payment by Emblem on the other NFRs would effectively lower the net cost of the pharmacy program to the FEHBP, and with the costs thus reduced, any applicable ingredient cost guarantee would be satisfied.

An unspoken premise of this finding is that GHI's FEHBP population is analogous to the balance of its covered population for purposes of drug utilization and guarantee performance. The Draft Report presents no evidence that this is correct. Instead, it ignores the issue and maintains without support that the overall guarantees can be applied to the FEHBP slice of the business with no adjustments. This approach requires empirical support.

Finally, the Draft Report bases this finding on Section 1.28 of the OPM Contract. The Draft Report states that this section requires certain payments from the carrier to OPM. This is incorrect. Section 1.28 pertains to arrangements between a PBM and a carrier, rather than between a carrier and OPM. Moreover, this section simply does not apply to the allocation of ingredient cost guarantees by a carrier, nor does it require OPM to receive the full value of ingredient cost guarantees based on an allocation of a carrier's FEHBP population to its total population."

OIG Comments:

Health benefit refunds and recoveries passed through to the Carrier are required to be returned to the FEHBP within 30 days. This finding is different from the pass-through transparent pricing finding because the Carrier is the one who withheld the money, not the PBM. We agree that there is likely an inverse relationship between the pricing guarantees paid and the overcharge for not providing pass-through transparent pricing, but all categories of prescription drug pricing (retail generic, retail brand, mail generic, mail brand, specialty generic, specialty brand) stand alone and need to be analyzed to ensure that the guarantee paid to the Carrier was not already considered in the pass-through transparent pricing overcharge calculated by the PBM. The PBM would have to verify that the pricing guarantees already paid to the Carrier were not reflected in the PBM's calculation of overcharges to the FEHBP under the amount for billed charges to the Carrier. We have not been provided that level of detail from the PBM, but we would encourage OPM's Audit Resolution office to consider the offset if evidence is provided.

As for the Carrier's argument that the pricing guarantee was not specific to FEHBP claims, we need to review the FEHBP contract and the PBM agreement to see that allocation methods are used when the Carrier is assessed or credited costs based on its book of business. The pricing guarantees are measured based on the Carrier's total business and therefore should be allocated similarly to any other cost element charged by the Carrier or PBM when a direct relationship to the FEHBP group is not being measured.

E. Drug Manufacturer Rebates Review

1. Underpayment of Rebates and Corresponding Administrative Fees: $1,048,407

The FEHBP did not receive all drug manufacturer payments collected by the PBM for the Carrier's FEHBP group during CYs 2015 through 2019, resulting in a $957,512 overcharge. Additionally, $90,895 is due to the FEHBP for LII ($1,048,407 in total).

The FEHBP did not receive all the drug manufacturer payments received by the PBM.

Section 1.28 of the Contract between OPM and the Carrier required PBM transparency standards for the FEHBP, effective no later than January 1, 2013. This section states "The PBM agrees to provide pass-through transparent pricing based on the PBM's cost for drugs (as described below) … (iii) The PBM, or any other entity that negotiates and collects Manufacturer Payments allocable to the Carrier agrees to credit to the Carrier either as a price reduction or by cash refund the value of all Manufacturer Payments properly allocated to the Carrier. Manufacturer Payments are any and all compensation, financial benefits, or remuneration the PBM receives from a pharmaceutical manufacturer, including but not limited to, discounts; credits; rebates, regardless of how categorized; market share incentives, chargebacks, commissions, and administrative or management fees."

Additionally, sections 3.4(e) and (f) of the Contract state that "Investment income lost as a result of failure to credit income due the contract or failure to place excess funds in income producing investments and accounts shall be paid from the date the funds should have been invested or appropriate income was not credited and shall end on the earlier of: (1) the date the amounts are returned to the Special Reserve (or the Office of Personnel Management); (2) the date specified by the Contracting Officer; or (3) the date of the Contracting Officer's Final Decision. … The Carrier shall credit the Special Reserve for income due in accordance with this clause. All lost investment income payable shall bear simple interest at the quarterly rate determined by the Secretary of the Treasury under the authority of 26 U.S.C. 6621(a)(2) applicable to the periods in which the amount becomes due..... "

To ensure that all drug manufacturer payments were properly returned to the FEHBP in accordance with Federal rules and regulations, we requested that the PBM provide us with the total drug manufacturer rebates and their corresponding administrative fees that were invoiced and received for the FEHBP group from CYs 2015 through 2019. While holding our survey meetings, the PBM's personnel stated that pass-through transparent pricing for the FEHBP was not specified in the Agreement between the Carrier and the PBM. Instead, under the Carrier's traditional spread pricing arrangement, the PBM kept approximately three percent of the FEHBP's total rebates ($957,512 of $31,916,419). This practice is unauthorized under Federal regulations since the FEHBP is always due back its drug rebates for experience-rated carriers.

Because the Carrier failed to move the FEHBP group to a pass-through transparent pricing arrangement with the PBM in 2013 (as required by OPM), the PBM retained three percent of the rebates that were due back to the FEHBP, resulting in an underpayment of $957,512 in drug manufacturer payments for CYs 2015 through 2019. Additionally, the FEHBP is due $90,895 for LII (totaling $1,048,407 for this finding).

Recommendation 7:

We recommend that OPM's Contracting Officer require the Carrier to return $957,512 to the FEHBP for the underpayment of drug manufacturer rebates and corresponding administrative fees that were withheld by the PBM for CYs 2015 through 2019.

Recommendation 8:

We recommend that OPM's Contracting Officer assess the Carrier $90,895 for LII on the questioned costs due back to the FEHBP for this finding, calculated through December 31, 2022. The LII should be adjusted to account for the date the questioned costs are returned to the program.

Carrier's Response to Finding # 4:

"This is another finding that states GHI must pass through to OPM amounts GHI never received. The rebates and related fees at issue were earned by ESI under the parties' contract and retained by ESI.

This finding pertains to the retention by ESI of approximately 3% of the rebate revenue payable for drugs utilized by the individuals covered by GHI for drug benefits, which included commercial and Medicaid members, as well as FEHBP members. The Draft Report alleges that had pricing been pass-through rather than spread, the full amount would have accrued to OPM. This is incorrect. In fact, none of this amount would have accrued to OPM. Moreover, the amount at issue is totally transparent and, as such, meets the requirement for price transparency.

Transparent pricing does not require free services or even not-for-profit services. In the PBM context, it simply means having financial terms that distinguish PBM fees from drug costs.

Under the traditional approach to pricing, those amounts are mixed together. The PBM pays the pharmacy one price, and the customer pays the PBM a higher price. It is

largely impossible without an audit to see where the claim costs end and the fees to the PBM begin.

This is not that situation. Here, it is totally clear how the rebates are allocated: 97% go to Emblem, and 3% go to ESI. The pass-through pricing model allows administrative fees to be charged by the PBM, and there is no difference, on a net cost basis, between an administrative fee in the form of a per-claim charge and one in the form of a small deduction from the total rebates. In fact, both are volume-dependent. Having both types of transparent fees as part of a PBM pricing arrangement gives the PBM a direct financial incentive to process any increase in claims as well as to work to maximize rebate collections for the benefit of the customer.

Section 1.28 of the OPM Contract requires that the carrier receive the value of the financial terms negotiated by the PBM, not the entire value of those terms. OPM has changed the requirement for 2022 by requiring that the full value of such pricing terms be passed through by the PBM, but that is not the requirement under the version of the OPM Contract in effect during the audit period. Moreover, the OPM Contract does not address the allocation of any rebate payments between the carrier and OPM.

The FEHBP incurred no damages by reason of the parties' decision to denominate certain administrative fees as a percentage of rebates. Had this method been unavailable, the parties would have calculated the fees differently, but Emblem would still have had to compensate ESI for its services to FEHBP members.

Price transparency does not require the elimination of fees or, indeed, the imposition of a fee cap. Rather, fees are an essential component of the private contractor model. While Emblem will certainly use an alternative fee structure for any future PBM services for the FEHBP program, its failure to do so during the years at issue did not damage OPM nor did it violate any requirements of the OPM Contract.

This NFR is also premised on the assumption that the FEHBP group should be treated as equivalent for utilization and guarantee purposes as the remainder of Emblem's covered population. This is an unreasonable assumption. Utilization in general and of rebatable drugs in particular varies widely from group to group. The Draft Report does not provide any evidence that it is reasonable to allocate fees based on rebates absent any assessment of the extent to which FEHBP members utilized rebatable drugs during the period at issue."

OIG Comments:

All manufacturer payments (100 percent of the rebates) are to be passed through to the FEHBP in accordance with the Contract's PBM Transparency Standards. For the pass-through transparent pricing findings identified in this report, we used an average administrative fee for claims processing that already included the PBM's cost for collecting rebates. Rebates are based on individual drug claims and the amount questioned is 100 percent attributable to the FEHBP's drug claims, which needs to be returned to the FEHBP since they are offsets to health benefit charges.

F. Performance Guarantees Review

1. Performance Penalties Due to the FEHBP: $51,581

During our review of the PBM's performance guarantees for CYs 2015 through 2019, we found that the Carrier did not allocate or credit $45,986 to the FEHBP for its portion of the performance penalties paid by the PBM to the Carrier. Additionally, $5,595 is due to the FEHBP for LII ($51,581 in total).

Section 1.28 of the Contract between OPM and the Carrier lists transparency standards that the PBM and Carrier must follow, to include pass-through pricing of all negotiated discounts, rebates, credits, and other financial benefits. The transparency standards must be implemented in all PBM agreements by January 1, 2013. Section 2.3(i) of the Contract also states, "All health benefit refunds and recoveries, including erroneous payment recoveries, must be deposited into the working capital or investment account within 30 days and returned to or accounted for in the FEHBP Letter of Credit Account (LOCA) within 60 days after receipt by the Carrier." Benefit costs are defined as payments made and liabilities incurred for covered health care services on behalf of FEHBP subscribers less any refunds, rebates, allowances or other credits received.

Additionally, Exhibit D of the 2012 PBM Agreement and Exhibit E of the 2017 PBM Agreement contain performance standards that are guaranteed by the PBM or it will credit back a portion of its fees to the Carrier as a performance penalty. These sections state that the PBM will include data associated with all groups (including FEHBP members) in the calculation of the performance guarantees, penalties, and minimum performance requirements.

Finally, sections 3.4(e) and (f) of the Contract state that "Investment income lost as a result of failure to credit income due the contract or failure to place excess funds in income producing investments and accounts shall be paid from the date the funds should have been invested or appropriate income was not credited and shall end on the earlier of: (1) the date the amounts are returned to the Special Reserve (or the Office of Personnel Management); (2) the date specified by the Contracting Officer; or (3) the date of the Contracting Officer's Final Decision. … The Carrier shall credit the Special Reserve for income due in accordance with this clause. All lost investment income payable shall bear simple interest at the quarterly rate determined by the Secretary of the Treasury under the authority of 26 U.S.C. 6621(a)(2) applicable to the periods in which the amount becomes due..... ”

The FEHBP did not receive its portion of the PBM’s performance penalties that were paid to the Carrier.

To determine if the PBM accurately calculated, reported, and paid any performance guarantees and penalties required by the Agreements with the Carrier, we compared the metrics and penalties reported by the PBM in its Performance Guarantee Reports to the performance guarantees and penalties listed in the PBM Agreements for CYs 2015 through 2019. Our review showed that the PBM missed several performance guarantees for CYs 2015 through 2019. The PBM provided documentation stating that it paid $750,000 in performance penalties to the Carrier for the scope of the audit. Since the PBM assessed performance results and paid penalties at the commercial level for the Carrier’s book of business, we obtained a breakout of the FEHBP membership and compared it to the Carriers total membership to determine the percentage for how the Carrier would generally allocate PBM credits back to the FEHBP. We then calculated the FEHBP’s share of the PBM’s performance penalties that were paid to the Carrier and never passed through to the FEHBP. Based on our calculations, we determined that the Carrier should have allocated and credited $45,986 in performance penalties to the FEHBP for CYs 2015 through 2019 since the penalty payments represent a portion of the PBM’s administrative fees being returned. The Carrier stated that it did not pass-through the FEHBP’s portion of the PBM’s performance penalties because it was not under a transparent PBM arrangement at that time.

As a result of the Carrier not transitioning its FEHBP group to a transparent PBM arrangement in 2013 (as required by the OPM Contract), the FEHBP was overcharged $45,986 by not receiving its portion of the performance penalty credits for CYs 2015 through 2019. Additionally, the FEHBP is due $5,595 for LII (totaling $51,581 for this finding).

Recommendation 9:

We recommend that the Carrier return $45,986 to the FEHBP for the Federal group’s portion of the penalties that were paid by the PBM to the Carrier for missed performance guarantees from CYs 2015 through 2019.

Recommendation 10:

We recommend that OPM’s Contracting Officer assess the Carrier $5,595 for LII on the questioned costs due back to the FEHBP for this finding, calculated through December 31, 2022. The LII should be adjusted to account for the date the questioned costs are returned to the program.

Carrier's Response to Finding # 5:

"This finding cites Section 1.28 of the OPM contract, 'Standards for Pharmacy Benefit Management (PBM) Company Arrangements,' as a basis for concluding that GHI was required to pay OPM a portion of performance penalties paid by ESI. Section 1.28 contains no such requirement. Rather, the transparency requirements in Section 1.28 apply to the contract between the carrier and the PBM. Transparency is required with respect to certain pricing terms, but no such requirements are imposed with respect to performance penalties. Moreover, Section 1.28 does not address the scope of any pass-through obligations imposed on Emblem with respect to OPM. No payment obligation should be imposed on Emblem where the governing contract does not clearly state it.

Notably, the OPM contract itself contains a section governing performance standards, Section 1.9(g), which does not impose financial penalties for any shortcomings in performance. These standards are also less demanding in some instances than the ESI standards. There is no claim that Emblem failed to meet the OPM performance standards, and consequently, Emblem should not be required to pay any performance penalty amounts – especially because the OPM standards do not impose penalties.

To the extent the FEHBP population was considered for purposes of the performance guarantees, the audit group failed to assess whether ESI's performance fell short specifically with respect to that group. Instead, this finding is based on a purely arithmetic allocation. Even assuming data about FEHBP members was considered for the performance measures, the assumption that ESI performed the same for every group is likely inconsistent with the facts. Groups receiving PBM services differ in manifold ways, including with respect to drug utilization and the use of PBM resources. It cannot be assumed that ESI's performance shortfall for Emblem in the aggregate applied equally to every Emblem group. The audit group's analysis fails to demonstrate any concrete connection between the performance penalties paid by ESI and the services provided to the FEHBP group."

OIG Comments:

The Carrier was credited back a portion of its PBM expenses. The Carrier charged the FEHBP its full PBM expense without allocating any of the credit that the Carrier received back from the PBM. The PBM's performance was measured based on the Carrier's book of business, which included the FEHBP utilization. As a result, there were no specific group performance measures, and an allocation method would be needed to distribute the return of any charges paid by the groups under pass-through transparent pricing. If the Carrier wants to implement performance measures in its PBM agreement that are specific to the FEHBP group, we would encourage the Contracting Officer to consider it. Because the PBM's performance guarantees included FEHBP data, the FEHBP is due an allocated portion of the credit. The Carrier should not keep the FEHBP's portion of the credit as additional profit since only net charges are billable to the FEHBP. This finding is based on the PBM's performance standards only, unrelated to OPM's performance standards cited by the Carrier.

G. Fraud and Abuse Program Review

1. Pharmacy Fraud, Waste, and Abuse Not Being Reported: Procedural

The Carrier did not notify the OPM-OIG of reportable pharmacy fraud, waste, and abuse (FWA) cases for CYs 2015 through 2019 as required by Carrier Letters (CL) 2014-29 and 2017-13.

CLs 2014-29 and 2017-13 for FWA state, "FEHB Carriers are required to submit a written notification to the OPM-OIG within 30 working days when there is reportable FWA that has occurred against the FEHB Program. Potential FWA issue becomes reportable to the OPM-OIG if, after a preliminary review of the allegation and/or complaint, the Carrier takes an affirmative step to expand, further investigate, develop and/or close an allegation/complaint."

FEHBP-specific fraud and abuse cases at the PBM were never reported to the OPM-OIG.

To determine if the Carrier properly notified the OPM-OIG of reportable pharmacy FWA, we requested that the PBM provide a list of all possible FWA cases forwarded to the Carrier for further review. We then requested that the Carrier provide supporting documentation for all the pharmacy FWA cases reported to the OPM-OIG as a comparison. During the November 17, 2021, audit status meeting, the Carrier stated that there were no pharmacy FWA cases reported to the OPM-OIG for CYs 2015 through 2019 because the PBM only provided FWA cases at a corporate level with no designation for FEHBP-specific cases. After further discussion between the investigation units for both the PBM and Carrier, it was agreed that some of the PBM's FWA cases should have been reported to the OPM-OIG within 30 days since FEHBP members were involved. Going forward, the Carrier verbally requested from the PBM that it specifically identify when FWA referrals contain FEHBP exposure.

Because the PBM and the Carrier did not break out or identify pharmacy FWA that contain FEHBP exposure, reportable FWA cases were not being referred to the OPM-OIG within the required 30 working days for further investigation. This is a patient safety issue that must be corrected immediately, in addition to the FEHBP being at further risk of overcharges due to FWA.

Recommendation 11:

We recommend that the Carrier formally require the PBM to identify which FWA cases contain FEHBP exposure so that the Carrier can properly report the cases to the OPM-OIG within 30 working days. If the PBM does not identify when there is FEHBP exposure, the Carrier should have its own protocol to review cases for FEHBP exposure since it is ultimately the Carrier's responsibility.

Recommendation 12:

We recommend that OPM's Contracting Officer verify that the Carrier is notifying the OPM-OIG of reportable pharmacy FWA from the PBM within 30 working days.

Carrier's Response to Finding # 6:

"Emblem accepts OPM's specific recommendations with respect to fraud, waste and abuse ('FWA') notifications. In response to discussions with the audit team, ESI has agreed to begin reporting FWA cases not just on a corporate level, as was the past practice, but separately with respect to FEHBP members. This separate reporting by ESI will allow Emblem to refer reportable FWA cases to OPM within the requisite period of thirty working days."

GROOM LAW GROUP

Lisa M. Campbell
(202) 861-6612

October 24, 2022

By Email to Jim.Tuel@opm.gov

James L. Tuel, Jr.
Chief, Special Audits Group
Office of the Inspector General
U.S. Office of Personnel Management

Re: Response of EmblemHealth to Audit of Group Health Incorporated's Federal Employees Health Benefits Program Pharmacy Operations, 2015-2019

Dear Mr. Tuel:

We are counsel to EmblemHealth ("Emblem"), and submit this letter on Emblem's behalf in response to the correspondence and draft audit report sent to Amy Syska of Emblem by letter dated September 15, 2022 ("Draft Report"). We appreciate the additional time, through today, which you gave Emblem to respond to the Draft Report. This letter addresses the five monetary findings and one procedural finding set forth in the Draft Report (each a "Finding").

Introduction

There are five contract years covered by the Draft Report, 2015 through 2019. The Draft Report states the total healthcare premium earned by Group Health Incorporated ("GHI") during this period is $1,077,143,203, of which $263,981,883 pertains to pharmacy claims, the subject of the audit. The audit's five monetary findings are as follows:

1. $10,620,988 – Value of pass-through pricing
2. 816,814 – Credits and discounts retained by PBM
3. 531,868 – Ingredient cost guarantees
4. 957,512 – Rebate reconciliation amounts
5. 45,986 – Performance guarantees

The Draft Report also states that an additional $1,258,624 is payable by GHI for lost investment income in connection with the above amounts, essentially an interest charge applied to each Finding.

Notably, the findings are generally not additive. Rather than summing to reach an aggregate claim amount, the findings instead overlap. For example, the $816,884 claim in the second finding, concerning an alleged failure by the pharmacy benefit manager ("PBM") to pass through certain credits and discounts, is subsumed entirely by the first finding about an alleged failure to provide pass-through pricing. Similarly, the third finding about an alleged failure to share the proceeds of an ingredient cost reconciliation is also duplicative of the first finding regarding pass-through pricing. Any payment by GHI with respect to the second or third finding would be an offset or credit to the amount claimed under the first finding.

Certain of the findings are also mutually exclusive. For example, Findings #1 and #3 are based on alternative methods of reconciling rate guarantees. Finding #3 is based on an ingredient cost discount guarantee, which sets the rates based on specified discounts off the average wholesale price ("AWP"). This is the methodology the parties actually used.

Finding #1 is based on an alternative methodology, full pass-through pricing, which bases rates on the amounts the PBM pays for certain drugs. If full pass-through pricing had been in place between the parties, the ingredient cost guarantees would not have been set at the levels assumed for Finding #1. These differing approaches to rates reflect choices made by the parties at the time of contracting. The specific guarantees that underlie Finding #3 would not have been applicable had full pass-through pricing been required, as assumed for Finding #1.

The first finding, at over $10.6 Million, is thirteen times greater than the next largest finding. The first finding is premised on the assertion that the parties were required to substitute full pass-through pricing for the more traditional alternative, spread pricing, which is what the parties actually used. However, the Draft Report's conclusions with respect to this crucial finding are incorrect because they underestimate the amount of the administrative fees that would have been payable had pass-through pricing been in effect.

With spread pricing, the ingredient costs may be less favorable to the customer than with full pass-through pricing, but there are no additional administrative fees. With pass-through pricing, the ingredient costs may be lower, but the PBM is necessarily compensated in another way – typically through the imposition of a per-claim administrative fee. Spread versus pass-through pricing is largely about how the PBM gets compensated – whether by a per-claim fee for pass-through or by an additional margin on drug costs via the traditional, spread approach.

The Draft Report underestimates the administrative fees the PBM would have charged had pass-through pricing been in effect. The alleged $10.6 million overcharge is not an amount actually paid or received by GHI. Instead, the figure is based in part on the auditors' estimate of the total fees GHI would have owed to the PBM had pass-through pricing been in effect.

Notably, the Draft Report estimates GHI would have paid its PBM, Express Scripts ("ESI"), over $8 million less than the amount ESI estimates GHI would have paid. The higher fee means pass-through pricing is less advantageous than is claimed in the Draft Report and, accordingly, the amount requested by the Office of Personnel Management ("OPM") should be lower. In the accompanying letter, ESI reports that the administrative fees payable with pass-through pricing would have been substantially more than the auditors' estimate, such that the difference between spread and pass-through pricing for the years at issue would have been only $2.75 million rather than $10.6 million. ESI also provides detailed calculations showing the higher fees and the corresponding impact on total costs.

The Draft Report presents the $10.6 million figure without acknowledging it is based on an assumed level of administrative fees or acknowledging that the Draft Report is projecting a level of administrative fees substantially below the fees as estimated by ESI. The auditors fail to acknowledge ESI's figures or to provide any basis for the Contracting Officer to choose the auditors' figures over ESI's own figures. This is a crucial shortcoming of the Draft Report, and with respect to its most consequential conclusion.

Before turning to the specific findings, we want to respond on Emblem's behalf to the paragraph in the Draft Report stating that Emblem was untimely in responding to the audit team and in furnishing requested data. It was never Emblem's intention to delay or otherwise forestall the audit process. Unfortunately, the audit fieldwork coincided with some of the most challenging times of the COVID-19 pandemic in which Emblem, and health insurance issuers in general, played a critical role in supporting members with healthcare needs during the height of the pandemic, particularly in New York. Emblem strives to comply with all contractual and legal requirements and takes very seriously its responsibility to work collaboratively with its customers as well as auditors and regulators. Emblem hopes the audit team's experience with Emblem improved as the audit fieldwork continued, and Emblem was able to provide more extensive support for the audit.

Finding # 1 – Pass-Through Transparent Drug Pricing – $10,620,988, plus interest

The Draft Report concludes GHI should pay OPM $10,620,988, plus interest, because ESI charged GHI more than the amount ESI paid for all drugs dispensed to GHI health plan participants. Emblem disagrees. The Draft Report is incorrect in two respects. First, unlike the current OPM contract, the contract version in effect for 2015-2019 did not require full pass-through pricing. Second, where drug charges are 100% pass-through, an additional rate component is added to cover compensation to the PBM. The contract between GHI and OPM (the "OPM Contract") contemplates such additional charges. But the Draft Report substantially understates those charges, and in doing so disregards the charges as reported by ESI.

The Draft Report premises Finding #1 on Section 1.28 of the OPM Contract. But Section 1.28 does not require full pass-through pricing, which would require the commercially unlikely outcome of no compensation whatsoever to the PBM. Rather, Section 1.28 requires only that the

Carrier “receives the value of the PBM’s negotiated discounts, rebates, credits or other financial benefits.” OPM Contract § 1.28(a)(2). Based upon a plain language reading of Section 1.28, it is clear the OPM Contract did not in fact require the actual pass-through of the negotiated discounts, rebates, credits and other financial benefits – but merely the delivery of the value of those items. Notably, and seemingly in recognition of this fact, OPM subsequently revised this language for the 2022 contract version of Section 1.28 to require the actual pass-through of such discounts, rebates, credits and other financial benefits. The version of the contract applicable in 2015-2019 lacks that requirement.

As stated in the Draft Report, Section 1.28 provides with respect to drugs dispensed through retail pharmacies that the PBM “shall charge the Carrier no more than the amount it pays pharmacies in its retail network for brand and generic drugs plus a dispensing fee.” OPM Contract, Section 1.28(a)(1)(ii). This provision expressly contemplates a dispensing fee, through which the PBM may be compensated. In addition, despite this reference to pass-through pricing, two additional subsections of Section 1.28(a) expressly contemplate other forms of compensation to a PBM, including administrative fees, as well as other “sources of profit” to the PBM. See OPM Contract, §§1.28(a)(3) and (4).

Section 1.28(a)(2)(ii) of the OPM Contract, applicable to mail order claims, establishes a different requirement than subsection (i), applicable to retail claims. Subsection (ii) provides: “The PBM shall charge the carrier the cost of drugs at mail order based on the actual cost, plus a dispensing fee (emphasis added).” OPM Contract § 1.28(a)(2)(ii). The requirement that charges be “based on the actual cost,” is clearly different from and less limiting than the language applicable to retail claims, yet the Draft Report fails to note or apply the distinction. Instead, the Draft Report states that full pass-through is required for all claims – an approach contradicted by the Contract’s plain language.

The auditors’ recommendation with respect to Finding #1 should also be rejected because the Draft Report fails to specify accurately the fees payable to ESI. Pass-through pricing and spread pricing differ in terms of how they compensate a PBM for its overhead and profit margin. These costs are not eliminated in pass-through pricing; they are just paid differently. In spread pricing, a PBM’s overhead and profit are covered by the difference between what the PBM pays the pharmacy for drugs versus what the customer pays the PBM, as well as by any share of rebates retained by the PBM. The actual amount above the PBM’s net drug cost is not apparent to the customer. With pass-through pricing, a PBM’s total charge for overhead and margin is more apparent: it is separately stated, typically in the form of per-claim fees and other charges.

Section 1.28 of the OPM Contract expressly contemplates that PBMs will receive a profit for providing services. See, e.g., Section 1.28(a)(3)(requiring the PBM to “identify sources of profit to the carrier and OPM as it relates to the Federal Employees Health Benefits Program (“FEHBP” contract). This subsection also contemplates that a PBM may have multiple sources of profit in connection with its services for FEHBP.

The Draft Report's $10.6 million figure is a gross number, which fails to take into account all the additional charges, including per-claim charges, that apply with transparent pricing, as well as the permissible additional charges that are contemplated under the OPM Contract. Transparent pricing is untenable absent a means to compensate a PBM for its overhead and margin. And, thus, in considering whether the government failed to receive the value of pass-through pricing, it is imperative that OPM also consider the fulsome additional charges that would have been applied had transparent pricing been utilized.

Emblem elected traditional, spread pricing for its own business at the same time it adopted that pricing model for its FEHBP business. Emblem determined spread pricing was best when it was at risk for its commercial business, and treated its FEHBP business in exactly the same way. Emblem believes the FEHBP was not disadvantaged by this choice.

ESI agrees with Emblem that the special audit group's $10.6 million estimate for this NFR is substantially overstated. Using its best estimates and based upon the specific characteristics of GHI's utilization, volume, and other client-specific characteristics, ESI performed a calculation for the applicable administrative fees that would have been applied had pass-through pricing been utilized for 2015-2019. ESI concluded that when these costs are taken into account, the aggregate difference during the audit period between the two approaches is around $2.75 million. See attached letter from ESI and the accompanying spreadsheet [see ESI response in Appendix B; spreadsheet deleted due to proprietary information].

The Draft Report's conclusion of a $10.6 million overcharge is premised on the auditors' rejection of the analysis and conclusions of ESI that are attached to this response. The Draft Report does not address or even acknowledge the conclusions of ESI, and provides no grounds whatsoever for the Contract Officer to accept the figures in the Draft Report over those presented by ESI.

While Emblem appreciates that ESI's own analysis indicates the amount at issue to be materially less than the audit group determined, Emblem continues to believe ESI's calculations may in fact understate the extent of fees that would have applied had the contract been performed on a transparent pricing basis – and that, in fact, the government received a net benefit from Emblem's decision to utilize traditional pricing. Regardless, in any event, the amount at issue is far less than the figures reflected in Finding #1.

<u>Finding # 2</u> – Specialty and Mail Order Credits – $816,814, plus interest

The Draft Report states: "Because the Carrier never moved the FEHBP Group to a transparent PBM Arrangement, the PBM did not pass-through the non-specific drug purchasing discounts to the FEHBP, resulting in a $816,814 overcharge for CYs 2015-2019." This statement is incorrect. The auditors failed to analyze the actual credits at issue in the context of the applicable contract language and, accordingly, misconstrued how those credits should be treated.

The attached letter from ESI explains the reason these credits were not treated by ESI as being pass-through amounts during the years at issue. ESI is strongly of the view that, under the requirements applicable to pass-through pricing during the audit period, the credits were not required to be passed through. Instead, they were retained by ESI in consideration of specific services performed by ESI – or, in the case of [redacted] discounts, ESI earned those amounts by choosing to pay certain bills early.

As in the case of Finding #1, the Draft Report requests payment of a gross amount without giving effect to other charges ESI would have imposed were this revenue source unavailable. ESI and Emblem did not transact during the years at issue under a pass-through pricing model. When ESI is required to forgo certain revenue sources in order to meet pass-through requirements, typically it identifies and requires alternative sources of revenue. This is entirely permissible in that transparent pricing does not require PBMs to operate at a loss. Instead, it requires them to cover their costs and margin in a way that reveals those amounts.

Had ESI been required, over its objections, to credit GHI for the discounts involved, ESI would have made up for those credits by claiming an equal amount in administrative fees, as is typical in pass-through scenarios. Accordingly, there is no recovery amount to be had under this finding. OPM was not damaged at all by the parties' use of traditional pricing to set the amounts payable by OPM. Pass-through pricing does not require private businesses to cover their own overhead or to forego their margins in order to provide services for federal employees.

In addition, Section 1.28 of the OPM Contract as in effect during the audit period did not require the PBM to pass through the full value of all credits it may have received. The retention by the PBM of certain credits is consistent with the applicable contractual requirements. As ESI notes in its attached correspondence, OPM has changed the contractual requirements effective for the 2022 contract year. This change demonstrates that the 2015-2019 contracts did not require full pass-through pricing.

The attached correspondence from ESI sets forth in detail ESI's rationale for not crediting the amount of these credits to GHI [see ESI response in Appendix B].

Finding # 3 – Pricing Guarantees Retained by Carrier – $531,868, plus interest

This finding is predicated on the guarantees that apply when spread pricing is used in a PBM Agreement. But many of the other findings are based on pass-through pricing. The pricing approaches are mutually exclusive and, accordingly, so are the corresponding findings. If the relevant charges are adjusted retroactively to reflect pass-through pricing, the ingredient cost guarantees that underlie this finding would be inapplicable. Moreover, any payment by Emblem on the other NFRs would effectively lower the net cost of the pharmacy program to the FEHBP, and with the costs thus reduced, any applicable ingredient cost guarantee would be satisfied.

An unspoken premise of this finding is that GHI's FEHBP population is analogous to the balance of its covered population for purposes of drug utilization and guarantee performance. The Draft Report presents no evidence that this is correct. Instead, it ignores the issue and maintains without support that the overall guarantees can be applied to the FEHBP slice of the business with no adjustments. This approach requires empirical support.

Finally, the Draft Report bases this finding on Section 1.28 of the OPM Contract. The Draft Report states that this section requires certain payments from the carrier to OPM. This is incorrect. Section 1.28 pertains to arrangements between a PBM and a carrier, rather than between a carrier and OPM. Moreover, this section simply does not apply to the allocation of ingredient cost guarantees by a carrier, nor does it require OPM to receive the full value of ingredient cost guarantees based on an allocation of a carrier's FEHBP population to its total population.

Finding # 4 – Underpayment of Drug Rebates and Fees – $957,512, plus interest

This is another finding that states GHI must pass through to OPM amounts GHI never received. The rebates and related fees at issue were earned by ESI under the parties' contract and retained by ESI.

This finding pertains to the retention by ESI of approximately 3% of the rebate revenue payable for drugs utilized by the individuals covered by GHI for drug benefits, which included commercial and Medicaid members, as well as FEHBP members. The Draft Report alleges that had pricing been pass-through rather than spread, the full amount would have accrued to OPM. This is incorrect. In fact, none of this amount would have accrued to OPM. Moreover, the amount at issue is totally transparent and, as such, meets the requirement for price transparency.

Transparent pricing does not require free services or even not-for-profit services. In the PBM context, it simply means having financial terms that distinguish PBM fees from drug costs. Under the traditional approach to pricing, those amounts are mixed together. The PBM pays the pharmacy one price, and the customer pays the PBM a higher price. It is largely impossible without an audit to see where the claim costs end and the fees to the PBM begin.
This is not that situation. Here, it is totally clear how the rebates are allocated: 97% go to Emblem, and 3% go to ESI. The pass-through pricing model allows administrative fees to be charged by the PBM, and there is no difference, on a net cost basis, between an administrative fee in the form of a per-claim charge and one in the form of a small deduction from the total rebates. In fact, both are volume-dependent. Having both types of transparent fees as part of a PBM pricing arrangement gives the PBM a direct financial incentive to process any increase in claims as well as to work to maximize rebate collections for the benefit of the customer.

Section 1.28 of the OPM Contract requires that the carrier receive the value of the financial terms negotiated by the PBM, not the entire value of those terms. OPM has changed the requirement for 2022 by requiring that the full value of such pricing terms be passed through by the PBM, but that is not the requirement under the version of the OPM Contract in effect during the audit period. Moreover, the OPM Contract does not address the allocation of any rebate payments between the carrier and OPM.

The FEHBP incurred no damages by reason of the parties' decision to denominate certain administrative fees as a percentage of rebates. Had this method been unavailable, the parties would have calculated the fees differently, but Emblem would still have had to compensate ESI for its services to FEHBP members.

Price transparency does not require the elimination of fees or, indeed, the imposition of a fee cap. Rather, fees are an essential component of the private contractor model. While Emblem will certainly use an alternative fee structure for any future PBM services for the FEHBP program, its failure to do so during the years at issue did not damage OPM nor did it violate any requirements of the OPM Contract.

This NFR is also premised on the assumption that the FEHBP group should be treated as equivalent for utilization and guarantee purposes as the remainder of Emblem's covered population. This is an unreasonable assumption. Utilization in general and of rebatable drugs in particular varies widely from group to group. The Draft Report does not provide any evidence that it is reasonable to allocate fees based on rebates absent any assessment of the extent to which FEHBP members utilized rebatable drugs during the period at issue.

Finding # 5 – Performance Penalties - $45,986, plus interest

This finding cites Section 1.28 of the OPM contract, "Standards for Pharmacy Benefit Management (PBM) Company Arrangements," as a basis for concluding that GHI was required to pay OPM a portion of performance penalties paid by ESI. Section 1.28 contains no such requirement. Rather, the transparency requirements in Section 1.28 apply to the contract between the carrier and the PBM. Transparency is required with respect to certain pricing terms, but no such requirements are imposed with respect to performance penalties. Moreover, Section 1.28 does not address the scope of any pass-through obligations imposed on Emblem with respect to OPM. No payment obligation should be imposed on Emblem where the governing contract does not clearly state it.

Notably, the OPM contract itself contains a section governing performance standards, Section 1.9(g), which does not impose financial penalties for any shortcomings in performance. These standards are also less demanding in some instances than the ESI standards. There is no claim that Emblem failed to meet the OPM performance standards, and consequently, Emblem should not be required to pay any performance penalty amounts – especially because the OPM standards do not impose penalties.

To the extent the FEHBP population was considered for purposes of the performance guarantees, the audit group failed to assess whether ESI's performance fell short specifically with respect to that group. Instead, this finding is based on a purely arithmetic allocation. Even assuming data about FEHBP members was considered for the performance measures, the assumption that ESI performed the same for every group is likely inconsistent with the facts. Groups receiving PBM services differ in manifold ways, including with respect to drug utilization and the use of PBM resources. It cannot be assumed that ESI's performance shortfall for Emblem in the aggregate applied equally to every Emblem group. The audit group's analysis fails to demonstrate any concrete connection between the performance penalties paid by ESI and the services provided to the FEHBP group.

<u>Finding # 6</u> – Fraud, Waste and Abuse – Non-Financial

Emblem accepts OPM's specific recommendations with respect to fraud, waste and abuse ("FWA") notifications. In response to discussions with the audit team, ESI has agreed to begin reporting FWA cases not just on a corporate level, as was the past practice, but separately with respect to FEHBP members. This separate reporting by ESI will allow Emblem to refer reportable FWA cases to OPM within the requisite period of thirty working days.

* * * * * * * *

We appreciate OPM's consideration of these responses on behalf of Emblem in connection with the Draft Report. Please do not hesitate to contact me if I can provide any additional information.

Very truly yours,

<u>/s/ Lisa M. Campbell</u>

Lisa M. Campbell
Principal, Groom Law Group, Chartered

October 24, 2022

ESI'S RESPONSE TO OIG REGARDING [FINDING # 1]
PASS-THROUGH TRANSPARENT DRUG PRICING

Please accept this response by Express Scripts, Inc. ("ESI") on behalf of Group Health Inc. to OIG's Notification and Finding regarding Pass-Through Transparent Drug Pricing in the amount of $10,620,988 in connection with the Audit of Group Health Incorporated's Federal Employees Health Benefits Program pharmacy operations administered by Express Scripts. We welcome the opportunity to provide the following response.

We partially agree with OIG's Finding and Recommendation that ESI did not provide pass-through transparent pricing for all retail, mail order, and specialty drugs processed and filled for the Group Health Inc.'s FEHBP group during CYs 2015 through 2019, resulting in a $10,620,988 overcharge. ESI agrees that ESI did not provide pass-through transparent pricing for all retail, mail order, and specialty drugs processed and filled for the Group Health Inc.'s FEHBP group during CYs 2015 through 2019. ESI, however, does not agree with the impact calculation.

The impact calculation used Administrative and Dispensing Fee amounts that were estimates based on lines of business comparable to Group Health Inc., as opposed to using Administrative and Dispensing Fee amounts that were specifically based on Group Health Inc.'s demographics, drug utilization, pharmacy mix, etc. ("GHI Specific Data"). ESI and Group Health Inc. recently negotiated the 2022 and beyond pricing for the FEHBP lives for Group Health Inc. under a pass-through transparent pricing arrangement. During this process, GHI Specific Data was analyzed to evaluate and more accurately and appropriately calculate the applicable Administrative and Dispensing Fee amounts that would have applied to Group Health Inc. from 2015 forward. Specifically, Group Health Inc. has a higher non-specialty mail penetration and a higher generic fill rate for specialty drugs. Those Administrative and Dispensing Fee amounts are set forth in the Pharmacy Claims Pricing Traditional to Transparent Pricing spreadsheet attached hereto.

It is important to understand that specific analysis of the GHI Specific Data was performed for the 2022 and that a true pass-through transparent pricing arrangement cannot be re-created for the past. Notwithstanding, pricing offers improve over time, so the Administrative and Dispensing Fee amounts would have been higher in the years leading up to 2022. As such, it is more accurate to take a tiering approach to the Administrative and Dispensing Fees utilized in the impact calculation versus an average.

Thus, we respectfully assert that for the 2015 through 2019 audit period at issue here, the impact calculation should be based on the Administrative and Dispensing Fees set forth in the Pharmacy Claims Pricing Traditional to Transparent Pricing spreadsheet attached hereto.

EXPRESS SCRIPTS®

ESI'S RESPONSE TO OIG REGARDING [FINDING # 2]
MAIL ACTUAL COST METHODOLOGY AND NON-DIRECT DRUG COSTS

Please accept this response by ESI on behalf of Group Health Inc. to OIG's Notification and Finding Regarding Non-Specific Drug Purchasing Discounts in the amount of $816,814.00 in connection with the Audit of Group Health Incorporated's Federal Employees Health Benefits Program pharmacy operations administered by Express Scripts. We welcome the opportunity to provide the following response.

We respectfully disagree with OIG's finding that under the then-existing OPM requirements, non-direct drug costs were required to be passed through to the Carrier.

The Audit Finding describes the general OPM Requirement as follows: "*Section 1.28(a)(2) states that the PBM agrees to provide pass through transparent pricing based on the PBM's cost for drugs in which the Carrier receives the "**value of the PBM's negotiated discounts, rebates, credits or other financial benefits*** (original emphasis)." But this reference of the general requirement for pass through pricing omits a key phrase of the requirement, and the Finding itself fails to reference and omits altogether the more detailed and specific provision setting forth the transparent requirement for mail order pharmacy claims.

The general OPM Requirement in its entirety provides: *Section 1.28(a)(2) states that the PBM agrees to provide pass through transparent pricing based on the PBM's cost for drugs* ***(as described below)*** *in which the Carrier receives the value of the PBM's negotiated discounts, rebates, credits or other financial benefits* (emphasis added)*."* The omission of the phrase "**as described below**" is significant. In order for a party to comply with the OPM Requirement it must provide the value of the PBM's negotiated discounts, rebates, credits or other financial benefits **"as described below**." And, that is significant, because there are different standards for different elements as to what constitutes "pass through" or "transparent" pricing. The standard for retail pharmacy claims is different from the standard for mail order pharmacy claims and each of those standards is different from the standard for rebates. It is axiomatic that when interpreting written provisions the specific takes precedence to the general.

Here, regarding mail order pharmacy claims, Section 1.28, Section (a)(2)(ii)), provides that the PBM is to provide pass through pricing as follows: "*The PBM shall charge the Carrier the cost of drugs at mail order pharmacies* ***<u>based on the actual cost</u>****, plus a dispensing fee (emphasis added). Costs shall not be based on industry benchmarks; for example, Average Acquisition Cost*

(AAC) or Wholesale Acquisition Cost." This is the specific OPM Requirement that governs pass through pricing for mail order claims.

As such, the OPM requirement for claims dispensed at a mail pharmacy is to be the cost of drugs "*based on the actual cost.*" The standard does not state, nor does it require, that the cost of drugs "be the actual cost" or be "the actual net cost" or be "the lowest actual net acquisition cost," only that the price be based on actual cost.

More specifically, for purposes of applying pass through pricing based on an actual cost, ESI provides the following standard: ESI uses the actual purchase price for the ingredient(s) dispensed for each covered drug dispensed to a FEHBP member by a mail order or specialty pharmacy. ESI uses an actual acquisition cost reconciliation methodology that reflects drug specific procurement pre and post invoice discounts for all products dispensed from an ESI facility. The costs are maintained by ESI's [redacted] group. The acquisition costs are calculated monthly and are loaded monthly to a table to support reconciliation and analytic activities. The acquisition cost, inclusive of post purchase discounts, applicable to the date of service of the claim is then applied to each claim incurred.

As such, ESI applies a pass through pricing methodology that is "based on the actual cost" of claims dispensed to and specifically attributable to OPM members. As noted above, this methodology results in pricing that represents approximately 99% of actual net acquisition cost depending on client utilization. Non-specific drug discounts, which include [redacted] for generic drugs, account for less than 1% of total mail and specialty aggregated acquisition cost. Stated differently, the less than 1% value is directly related only to the total aggregated drug cost attributable to claims dispensed by a mail and specialty pharmacy. Moreover, this value is not attributable to a specific drug claim basis and thus does not directly correlate to a particular dispensing event for a FEHBP member. And, the OPM Standards expressly provide that an average acquisition cost methodology is not to be used, thus indicating that pass through pricing is to be predicated on drug specific costs.

In further support of our position, we reference that OPM has recently revised its OPM Standards, effective as of January 1, 2022. In these recently revised standards, OPM added a new and express definition for Pass-Through Transparent Pricing. This newly added definition states: "***<u>Pass-Through Transparent Pricing</u>***" *means drug pricing in which the Carrier receives <u>the full value of all</u> discounts, rebates, credits or other financial guarantees or adjustments <u>including any true up or reconciliation</u>*" (emphasis added). Under the revised standard, pass through pricing will now include "the full value of all discounts, rebates, credits or other financial guarantees or adjustments, including any true up or reconciliation." This represents a difference from the prior standard. Indeed, in light of this new standard, ESI acknowledges that it has changed its methodology in how it calculates pass through pricing based on actual cost for drugs dispensed at mail pharmacies, so that the value of non-specific drug credit value will be included.

Thus, we respectfully assert that for the 2015 through 2019 audit period at issue here, ESI's calculation of pass through pricing based on actual drug cost for drugs dispensed at mail order pharmacies was correct and in compliance with OPM's requirements.

Deleted by the OIG - Exhibits Showed Change in Administrative and Dispensing Fees Only and Contained Significant Proprietary Information

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