United States Senate

COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510-6275

May 2, 2003

The Honorable Donald H. Rumsfeld
Secretary of Defense
1000 Defense Pentagon
Washington, DC 20301-1000

Dear Secretary Rumsfeld:

It has come to our attention that the Department of Defense is currently seeking a contract with a hospital group purchasing organization (GPO) for the use of negotiated medical and surgical supply contracts. We know you share our belief that it is critical that the Department of Defense medical facilities always have access to the best and most advanced products to treat our men and women in uniform. Accordingly, as you consider how to best procure these items, we urge you to consider carefully what we have learned about this issue.

During the past year, the Senate Antitrust Subcommittee has engaged in a thorough investigation of the hospital group purchasing industry. We have examined allegations that the industry was plagued with anticompetitive business practices and unethical conflicts of interest, as well as the claims that GPOs save money. We hope the results of our extensive investigation into the business practices of GPOs will aid the Department in understanding the benefits and drawbacks of hospital group purchasing.

The main benefit offered by GPOs to hospitals is that contracts negotiated by GPOs should gain the lowest prices for their members. By aggregating purchasing of numerous hospitals around the nation, GPOs gain volume discounts for their members. However, our investigation revealed that the purported benefits of GPO purchasing are not always realized, and that GPO purchasing carries risks for competition in the medical device industry.

Specifically, we advise you to consider the following:

> The existence of GPO cost savings are in dispute. We can all agree that there is a public good in holding down health care costs and there is no question that GPOs simplify purchasing for member hospitals. However, in a pilot study performed by the General Accounting Office (GAO) last year, it became clear that GPOs do not always save hospitals money. In fact, the GAO found that hospital systems and large individual hospitals were able to achieve the same or greater price savings in certain circumstances by buying directly from manufacturers. The analysis is complicated by the fact that the savings figures that GPOs frequently

cite as benchmarks to demonstrate savings are based on a manufacturer's list price that hospitals rarely, if ever, pay. Accordingly, while it appears likely that the volume discounts organized by GPOs generate savings when compared to a manufacturer's list price, it is unclear whether and to what extent the GPOs generate further savings.

Not all GPOs rebate savings (or administrative fees) to all hospitals or systems which buy through their contracts. Different GPOs have different membership structures, and it is important to understand how they function in order to determine the benefits they would deliver to the Department of Defense. For example, some GPOs return administrative fees collected through use of GPO negotiated contracts to all member hospitals, while others return fees only to owner-members. Others retain a significant portion of administrative fees collected to engage in other business activities before returning the remaining balance to member institutions. Because GPOs often tout administrative fees as a way to create additional savings, it is important to track a group purchasing organization's use of these fees and ensure that any organization-level use of these fees will substantially benefit the Department given that it is unlikely to be an owner-member of a GPO.

GPOs often rely on contracting tools which limit choice and flexibility for participating hospitals and hospital systems. GPOs use various contracting tools to negotiate pricing with suppliers. While their cost-saving effects are important, these tools can also serve to limit choice and flexibility for participating hospitals. Among the contracting tools that may limit choice and flexibility are high commitment levels, sole-sourcing, long term contracts, and bundling.

Some contracts utilize high commitment levels, in which hospitals are required to purchase 80-95% of their needs for a certain product from the designated manufacturer. Commitment can be an effective cost-saving tool in a product category in which a hospital or system wants to standardize. However, in the case of high-technology items about which physicians tend to have differing preferences, commitment can limit a hospital to the purchase of a single device when better care could possibly be delivered if physicians had a choice.

Similarly, in certain instances GPOs contract with only one supplier for a given product, leaving hospitals and physicians with little choice for those medical products and devices.

GPO negotiated contracts have varying terms, and our investigation revealed that some last as long as seven years. In fields of emerging or rapidly developing technology, a seven year contract could, depending on its terms, inhibit a hospital from purchasing a new device made by another manufacturer until the GPO is able to negotiate a contract for the new product at the end of the old contract term. If a hospital or system is locked into a long term contract, it could find it difficult to purchase the new technology.

Finally, GPOs often engage in the bundling or tying of products. In some cases, this contracting tool offers discounts if the hospitals buys a group of products from a single manufacturer. In other cases, GPOs will create its own bundle with products from multiple manufacturers, again requiring a hospital to purchase all products in the bundle in order to get a discount on any one item. When unrelated products are tied together in this way, hospitals are forced to make sometimes undesirable purchasing decisions, choosing either a discount or purchasing flexibility. This dilemma is highlighted, for example, when high-technology medical/surgical tools are bundled with commodity products such as exam gloves.

In conclusion, we recommend that you consider these results of our investigation during your decision-making process. It may be helpful to note that as part of our ongoing investigation, several GPOs have agreed to adopt a series of best practices. These practices include prohibiting sole source contracts for clinical preference items; prohibiting bundling of clinical preference products with any other unrelated product; limiting vendor contracts to three year terms; and limiting commitment levels for clinical preference items (in no cases higher than 75%). It is our belief that in many instances the practices that the GPOs agreed to abandon diminish choice and innovation, often to an extent not justified by any potential cost savings. Accordingly, we ask that the Defense Department consider this information as it works to assure the best possible medical care for our men and women in uniform.

Thank you for your attention to this matter.

Very Respectfully Yours,

MIKE DeWINE
Chairman, Subcommittee on
Antitrust, Competition Policy, and
Consumer Rights

HERB KOHL
Ranking Member, Subcommittee on
Antitrust, Competition Policy, and
Consumer Rights