

Testimony of

The Honorable Strom Thurmond

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Mr. Chairman:

Thank you for holding this important hearing today on hospital group purchasing and its effects on patient health and medical innovation. In particular, this committee should carefully examine the role that Group Purchasing Organizations (GPOs) play in bringing medical products to market. GPOs deserve antitrust scrutiny for two significant reasons. First, the organizations themselves are the result of hospitals banding together in order to increase buying power. Second, GPOs have merged and consolidated the industry significantly. The result is that two large corporations, Premier and Novation, control purchasing for approximately 60% of the Nation's hospitals. With these two concerns in mind, we must determine whether the consumers of medical care, the patients, are being well-served by GPOs.

The fundamental premise of a GPO is to allow hospitals to aggregate their purchases and thereby negotiate lower prices. GPOs are generally immune from antitrust scrutiny for an array of policy reasons. When hospitals band together, they are better able to counteract the significant market power of large manufacturers of medical supplies and equipment.

Additionally, the lower prices procured by the hospitals enable them to maintain financial stability in the Medicare prospective payment system. This prospective payment system replaced fee for service plans and essentially resulted in caps on Medicare payments, limiting what the Federal Government would pay hospitals for medical services.

In addition to the relaxed antitrust scrutiny, GPOs have another useful tool in procuring lower costs for hospitals. They are immune from anti-kickback laws. This allows the payments for services provided by the GPOs to be shifted from the hospitals, the buyers of the goods, to the manufacturers of the goods. Therefore, manufacturers of goods pay kickbacks, often called administrative fees, to the GPOs. Administrative fees are commonly 3% of the value of goods sold to the hospitals, and may be higher if disclosed in writing. These fees go the GPO itself, and portions are remitted to the hospitals. Due to this arrangement, hospitals realize lower costs.

At first glance, the lower costs attributed to group purchasing power may appear to benefit patients. Indeed, group purchasing keeps prices low, and that is certainly desirable in the medical marketplace. However, a closer look at current policies reveals some disturbing consequences.

Many smaller device manufacturers have voiced concerns that they cannot break into the marketplace due to the power of GPOs. For example, GPOs negotiate long term contracts, thereby making it more difficult to bring new and innovative products to market. Long-term contracts themselves would not generally be a cause for concern. Two business entities may enter into these contracts if they wish. However, due to the fact that hospitals have all joined together

in the GPOs, large numbers of hospitals are committed to these long-term contracts. This scenario warrants antitrust scrutiny.

Smaller manufacturers may also have a more difficult time paying the kickbacks, or administrative fees, required to sell their products to the GPOs. Furthermore, the anti-kickback exception invites the kind of abuse that anti-kickback laws were designed to stop. Larger manufacturers have an incentive to pay higher administrative fees in order to dissuade the GPOs from purchasing the products of smaller competitors.

It is my hope that this committee will closely examine the antitrust immunity and anti-kickback exception that GPOs enjoy. We should not support policies that inhibit the abilities of smaller manufacturers to introduce innovative products into the marketplace. If patients are not benefitting from current practices, we should seek to implement reforms that free the marketplace to function unhindered by anti-competitive practices.

Another concern associated with the GPO system is the consolidation of the industry. In many areas, one of the two dominant GPOs, Premier or Novation, serves all of the hospitals while the other is almost nonexistent. The result is a dominant buyer in the market, which has been referred to as a monopsony, or a buyer monopoly. For antitrust purposes, a monopsony may be just as troubling as a monopoly due to the distortions that it creates in the market.

The buying power of the GPOs raises questions about the common practice of "bundling" in contracts with medical manufacturers. A bundled contract provides for numerous products to be purchased in one order, benefitting the seller, who can sell more products, and allowing the GPO to negotiate lower prices. While this practice may lower hospital costs, it may also have the effect of keeping other manufacturers out of the market. Because hospitals must usually purchase a high percentage of their products through the GPO to take advantage of discounts, there is less of an incentive for hospitals to bypass the GPOs and negotiate with the manufacturers directly.

Additionally, recent media reports have indicated that Premier invested in medical supplier companies, and then made contracts with them to provide supplies to Premier hospitals. I am greatly concerned about these allegations, and this committee should thoroughly study these potential conflicts of interest. If Premier has engaged in such activity, it has leveraged its buyer monopoly to procure goods from a company in which it has an interest, effectively blocking out legitimate competitors.

Mr. Chairman, I appreciate your work on this matter, and I hope that we will learn more today about the role of GPOs in the health care industry. While GPOs have almost certainly led to decreased costs for hospitals, we should carefully examine whether patients benefit from the current system of group purchasing. If innovative and crucial technology is not reaching our Nation's hospitals, we should consider reforming current practices. We should ask whether GPO immunity from general principles of antitrust law and anti-kickback law best serves those in need of medical care. I hope that our witnesses will address these important questions, and I look forward to hearing from them today.