

GAO

Report to the Ranking Member,  
Committee on Energy and Commerce,  
House of Representatives

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January 2013

# PRESCRIPTION DRUGS

## The Number, Role, and Ownership of Pharmacy Services Administrative Organizations



G A O

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Highlights of [GAO-13-176](#), a report to the Ranking Member, Committee on Energy and Commerce, House of Representatives

## Why GAO Did This Study

Independent pharmacies dispensed about 17 percent of all prescription drugs in the United States in 2010. To obtain, distribute, and collect payment for drugs dispensed, pharmacies interact with a network of entities, including drug wholesalers and third-party payers. With limited time and resources, independent pharmacies may need assistance in interacting with these entities, particularly with third-party payers that include large private and public health plans. Most use a PSAO to interact on their behalf. PSAOs develop networks of pharmacies by signing contractual agreements with each pharmacy that authorizes them to interact with third-party payers on the pharmacy's behalf by, for example, negotiating contracts. While specific services provided by PSAOs may vary, PSAOs can be identified and distinguished from other entities in the pharmaceutical distribution and payment system by their provision of intermediary or other services to assist pharmacies with third-party payers.

GAO was asked to review the role of PSAOs. In this report, GAO describes: (1) how many PSAOs are in operation and how many pharmacies contract with PSAOs for services; (2) the services PSAOs offer and how they are paid for these services; and (3) entities that own PSAOs and the types of relationships that exists between owners and the pharmacies they represent. GAO analyzed data on PSAOs in operation in 2011 and 2012, reviewed literature on PSAOs and model agreements from 8 PSAOs, and interviewed federal agencies and entities in the pharmaceutical industry.

View [GAO-13-176](#). For more information, contact John Dicken at (202) 512-7114 or [dickenj@gao.gov](mailto:dickenj@gao.gov).

January 2013

## PRESCRIPTION DRUGS

### The Number, Role, and Ownership of Pharmacy Services Administrative Organizations

## What GAO Found

At least 22 pharmacy services administrative organizations (PSAO), which varied in the number and location of the pharmacies to which they provided services, were in operation in 2011 or 2012. In total, depending on different data sources, these PSAOs represented or provided other services to between 20,275 and 28,343 pharmacies in 2011 or 2012, most of which were independent pharmacies. While the number of pharmacies with which each PSAO contracted ranged from 24 to 5,000 pharmacies, most PSAOs represented or provided other services to fewer than 1,000 pharmacies. Additionally, some PSAOs contracted with pharmacies primarily located in a particular region rather than contracting with pharmacies located across the United States.

While PSAOs provide a broad range of services to independent pharmacies, and vary in how they offer these services, PSAOs consistently provide contract negotiation, communication, and help-desk services. All of the model agreements between PSAOs and independent pharmacies that GAO reviewed stated that the PSAO will negotiate and enter into contracts with third-party payers on behalf of member pharmacies. PSAOs may also contract with pharmacy benefit managers (PBM), which many third-party payers use to manage their prescription drug benefit. In addition to contracting, PSAOs also communicate information to members regarding contractual and regulatory requirements, and provide general and claims-specific assistance to members by means of a help-desk or a dedicated staff person. They may also provide other services to help member pharmacies interact with third-party payers or their PBMs, such as managing and analyzing payment and drug-dispensing data to identify claims unpaid or incorrectly paid by a third-party payer. PSAO services are intended to achieve administrative efficiencies, including contract and payment efficiencies for both independent pharmacies and third-party payers or their PBMs. Most PSAOs charge a monthly fee for a bundle of services and may charge additional fees for other services provided to its member pharmacies. Virtually all of the fees paid for PSAO services are paid by member pharmacies, with PSAOs receiving no administrative fees from other entities such as third-party payers or their PBMs.

The majority of PSAOs in operation in 2011 or 2012 were owned by drug wholesalers and independent pharmacy cooperatives. Of the 22 PSAOs we identified, 9 PSAOs were owned by wholesalers, 6 were owned by independent pharmacy cooperatives, 4 were owned by group purchasing organizations, and 3 were stand-alone PSAOs owned by other private entities. These owners varied in their requirements for PSAO member pharmacies to also use services from their separate, non-PSAO line of business. Three PSAO owners GAO spoke with required PSAO members to also use their non-PSAO services. For example, one wholesaler-owned PSAO limited its offer of PSAO services to existing customers of its drug distribution line of business. All but one PSAO owner GAO spoke with reported that their PSAO line of business earned little to no profit. However, PSAO owners may operate PSAOs for a number of reasons, including helping pharmacies gain access to third-party payer contracts and to provide benefits to the owner's non-PSAO line of business.

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## Abbreviations

DOJ	Department of Justice
FEHBP	Federal Employees Health Benefits Program
FTC	Federal Trade Commission
HHS OIG	Department of Health and Human Services, Office of Inspector General
NCPA	National Community Pharmacists Association
NCPDP	National Council for Prescription Drug Programs
PBM	pharmacy benefit manager
PSAO	pharmacy services administrative organization

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**United States Government Accountability Office**  
Washington, DC 20548

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January 29, 2013

The Honorable Henry A. Waxman  
Ranking Member  
Committee on Energy and Commerce  
House of Representatives

Dear Mr. Waxman:

Independent pharmacies dispensed almost 20 percent of all prescription drugs in the United States in 2010, with chain pharmacies accounting for the majority of the remaining 80 percent.<sup>1</sup> To obtain, distribute, and collect payment for the drugs they dispense, independent pharmacies interact with a network of entities that offer a variety of services. These entities include drug wholesalers that purchase and distribute drugs to pharmacies, and third-party payers that pay for the dispensed drugs on behalf of enrollees. With limited time and resources, independent pharmacies may need assistance in interacting with these entities, particularly with third-party payers that include large private and public health plans such as those offered by large corporations and the federal government through Medicare and the Federal Employees Health Benefits Program (FEHBP).<sup>2</sup>

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<sup>1</sup>There are various definitions of independent pharmacies. In this report, we use the definition from the National Council for Prescription Drug Programs (NCPDP), which defines an independent pharmacy as one to three pharmacies under common ownership. Chain pharmacies and pharmacies operated by a mass merchant such as Wal-Mart or a supermarket accounted for nearly 73 percent of dispensed prescription drugs, and mail-order pharmacies accounted for the rest. A chain pharmacy is part of a group of four or more pharmacies under common ownership. Mail order pharmacies are highly automated facilities that fill prescriptions from a central location and deliver the prescription directly to the consumer.

National Association of Chain Drug Stores, *2011-2012 Chain Pharmacy Industry Profile*, (Alexandria, VA: 2011).

<sup>2</sup>Medicare is the federally financed health insurance program for persons age 65 or over, certain individuals with disabilities, and individuals with end-stage renal disease. Medicare beneficiaries may purchase coverage for outpatient prescription drugs under the Medicare Part D program. The FEHBP is the largest employer-sponsored insurance program in the United States. Most federal employees, retirees, and their dependents participate in the program.

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To address independent pharmacies' need for assistance with third-party payer interactions, both existing entities—such as drug wholesalers—as well as new entities began providing a variety of administrative services to independent pharmacies. These administrative services included, for example, managing pharmacies' claims payments from third-party payers. Entities that provide administrative services to independent pharmacies to assist such pharmacies in interacting with third-party payers are called pharmacy services administrative organizations (PSAO). While specific services provided by PSAOs may vary, PSAOs can be identified and distinguished from other entities in the pharmaceutical distribution and payment system by their provision of intermediary services to assist pharmacies with third-party payers.

PSAOs develop networks of member pharmacies by signing contractual agreements with individual pharmacies. These agreements set forth the duties and obligations of the PSAO to each pharmacy and vice versa, and generally authorize PSAOs to interact with third-party payers on behalf of the members in their network. Among the responsibilities established between the PSAO and the pharmacy, the PSAO is frequently given the responsibility to contract on behalf of the pharmacy with third-party payers.<sup>3</sup> Independent pharmacies may want the assistance of a PSAO due to the complexity of the contract terms and financial interactions with multiple third-party payers. As an intermediary, a PSAO may also provide other services that assist pharmacies in working with third-party payers. Because these other services may vary by PSAO, pharmacies may belong to multiple PSAOs' networks that provide complementary services. For example, a pharmacy may belong to one PSAO network that contracts with third-party payers on its behalf and belong to another PSAO network that assists the pharmacy with reconciling claim payments from third-party payers.<sup>4</sup> According to industry reports, 80 percent of

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<sup>3</sup>These agreements may also establish specific requirements for a PSAO's use and disclosure of personal health information created, maintained, received, or transmitted by the PSAO on behalf of the pharmacy, and provide for the security of such information. Information subject to such requirements may include but not be limited to protected health information under federal law. See, 45 C.F.R. Part 164, Subpart E (2011).

<sup>4</sup>While independent pharmacies may obtain complementary services from multiple PSAOs, according to model agreements we reviewed, some PSAOs require that a pharmacy use the PSAO's third-party contracting services exclusively. In these instances, a pharmacy cannot obtain third-party contracting services from more than one PSAO, although the pharmacy may obtain other services from another PSAO.

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independent pharmacies obtain services from a PSAO.<sup>5</sup> In addition, nearly 80 percent of the independent pharmacies surveyed by the Department of Health and Human Services, Office of Inspector General (HHS OIG) for its 2008 study reported obtaining PSAO services.<sup>6</sup>

Although PSAOs are focused on assisting independent pharmacies, their services may also benefit third-party payers. In addition, PSAO services may also benefit pharmacy benefit managers (PBMs), which many third-party payers use to help manage their prescription drug benefit, including developing contracts that set forth the terms and conditions for pharmacies to dispense prescriptions to health plan enrollees. According to PBMs, PSAOs make it easier for third-party payers or their PBMs to interact with multiple independent pharmacies by serving as a single point of contact. In addition, by providing access to multiple independent pharmacies, PSAOs enable third-party payers or their PBMs to expand and maintain networks in certain geographic areas—such as rural and underserved areas—where independent pharmacies are more likely to be located. Thus, PSAOs help third-party payers or their PBMs build networks of pharmacies to meet the needs of health plans and their enrollees and, in some cases, to satisfy federal requirements.<sup>7</sup>

You expressed interest in knowing more about the role of PSAOs in the network of entities that interact to distribute and pay for prescription drugs. In this report, we describe: (1) how many PSAOs are in operation and how many independent pharmacies contract with PSAOs for services; (2) the services PSAOs offer to independent pharmacies and how they are paid for these services; and (3) the entities that own PSAOs

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<sup>5</sup>Fein, Adam, Pembroke Consulting, Inc. *2011-12 Economic Report on Retail and Specialty Pharmacies*, (Philadelphia: January 2012). An unpublished report by a trade association also included this statistic.

<sup>6</sup>Department of Health and Human Services, Office of Inspector General, *Review of Medicare Part D Contracting For Contract Year 2006 (A-06-07-00082)*, (Washington, DC: 2008).

<sup>7</sup>For example, to participate as Medicare Part D sponsors, health plans are required to have a contracted pharmacy network sufficient to ensure that at least 70 percent of Medicare beneficiaries in the sponsor's rural service area, on average, live within 15 miles of a retail or other specified type of pharmacy participating in the sponsor's network. See 42 C.F.R. § 423.120(a) (2011). Consequently, it may be necessary for a sponsor to contract with independent pharmacies, which are more common in rural areas than chain pharmacies.

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and the types of relationships that exist between PSAO owners and the independent pharmacies with which they contract.

To determine how many PSAOs are in operation and how many independent pharmacies with which they contract, we reviewed literature on PSAOs, and conducted interviews with various entities including key entities in the pharmaceutical industry and federal agencies that have conducted work involving PSAOs. We also analyzed National Council for Prescription Drug Programs (NCPDP) data from February 2011. NCPDP collects and maintains a database of in-depth pharmacy information from both pharmacies and PSAOs.<sup>8</sup> Specifically, we conducted a comprehensive literature review that included materials published through October 2012.<sup>9</sup> We also obtained and reviewed published and unpublished reports we identified through Internet searches for information related to PSAOs and an interview with a pharmaceutical trade association. We conducted a total of 24 interviews with various entities including federal agencies—HHS OIG and the Federal Trade Commission (FTC)—trade associations, pharmaceutical industry experts, three independent pharmacy owners, and a sample of PSAOs and PBMs.<sup>10</sup>

- PSAO sample: Our sample of PSAOs to interview included the 5 largest PSAOs based on the number of pharmacies they contracted with according to NCPDP data, as well as 5 additional PSAOs that varied by the number of pharmacies they represented and by ownership. According to NCPDP data, these 10 PSAOs represented over 17,000 pharmacies.

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<sup>8</sup>NCPDP is a not-for-profit accredited standards development organization whose membership includes various entities in the pharmaceutical industry.

<sup>9</sup>Our review included reports that discussed PSAOs specifically or PSAOs in conjunction with independent pharmacies or third-party payers.

<sup>10</sup>The HHS OIG examined independent pharmacies' experiences contracting with Medicare Part D Prescription Drug Plan sponsors in 2006. As part of this work, the HHS OIG collected information about the PSAOs associated with the independent pharmacies included in its study. The FTC is one of two federal agencies responsible for enforcing federal antitrust laws and has conducted reviews of PSAOs.

We contacted a total of 20 independent pharmacies from the NCPDP data to request interviews. These independent pharmacies varied by location (urban vs. rural) and by the PSAO that provided them services. Of these 20 pharmacies, 3 responded to our request for an interview.

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- PBM sample: Our sample of PBMs to interview included the three largest PBMs as of March 2012, as defined by prescription volume, according to Atlantic Information Services data.<sup>11</sup> Combined, these PBMs represented about 60 percent of total prescription volume in the United States.

Finally, we analyzed NCPDP data and reviewed other available information, such as industry reports. We analyzed NCPDP data to determine the total number of PSAOs in operation in 2011 by first identifying potential PSAOs in the NCPDP data and then verifying whether the entity was a PSAO by reviewing its website and other available information.<sup>12</sup> We considered an entity to be a PSAO if it contracted to provide intermediary or other services that assist independent pharmacies in working with third-party payers or their PBMs. We developed this criterion on the basis of information we gathered from the literature review and interviews with key entities, including an industry expert and a PSAO. Using our list of PSAOs, we then searched the NCPDP database to determine the total number and types of pharmacies that each of the PSAOs represented in 2011.<sup>13</sup> We reviewed NCPDP data for reasonableness and consistency, including screening for outliers. We also reviewed documentation and spoke with NCPDP officials about steps taken to ensure data reliability.

We determined that the data used in this report were sufficiently reliable for our purposes. However, there are some limitations to the NCPDP data, including that these data may not contain the complete universe of PSAOs or independent pharmacies. For example, according to NCPDP officials, smaller independent pharmacies that do not conduct electronic transactions may not be included in the NCPDP data. Multiple entities we

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<sup>11</sup>Atlantic Information Services, a publishing and information company, reports data compiled from the company's quarterly survey of PBMs. These data contain information on the PBM membership, prescription volume, and drug spending, among other things.

<sup>12</sup>In some cases, we could not determine whether an entity was a PSAO on the basis of available information and contacted the entity directly to confirm whether it was a PSAO.

<sup>13</sup>Pharmacies in the NCPDP database may choose from among several primary codes that indicate the type of pharmacy it is. For example, a pharmacy may classify itself as a community pharmacy that stores, prepares, and dispenses medicinal preparations and prescriptions for a local patient population or it may classify itself as a long-term care pharmacy that dispenses preparations delivered to patients residing within an intermediate or skilled nursing facility.

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interviewed reported that there is no one comprehensive data source for information on PSAOs; however, several entities, including the HHS OIG, reported using NCPDP to determine the number of independent pharmacies in operation, the number of PSAOs in operation, or the affiliations between pharmacies and PSAOs. Due to NCPDP data limitations, we also reviewed industry reports and other sources of information, such as PSAO websites, to supplement these data when answering our research objectives. These supplemental data provided the number of PSAOs in operation and the number of pharmacies they contracted with in 2011 or 2012, which may vary from the data reported by NCPDP. Consequently, we report a range in the number of pharmacies represented by PSAOs in 2011 or 2012. Additionally, since PSAOs can represent other types of pharmacies, such as small chains, in addition to independent pharmacies and pharmacies can have agreements with multiple PSAOs for different services, the number of pharmacies that we report as being represented by PSAOs may be greater than the total number of independent pharmacies operating in the United States.

To describe the services provided by PSAOs and how PSAOs are paid for these services, we interviewed officials from the various entities noted above and reviewed agreements between PSAOs and independent pharmacies. In conducting our interviews with PSAOs and independent pharmacies, we asked about how payment for PSAO services were made and received, including the frequency and amount of payments. We also obtained model agreements from eight of the ten PSAOs we interviewed. We reviewed these agreements to determine the duties and obligations of each PSAO to its member pharmacies. In addition, we reviewed the duties and obligations of member pharmacies joining the PSAO network as well as the payment and termination provisions included in each agreement. The information obtained from these interviews and agreements may not be generalizable due, in part, to variation in the types of services offered by different PSAOs.

To determine the entities that own PSAOs and the types of relationships that exist between PSAO owners and the independent pharmacies they represent, we analyzed NCPDP data, reviewed industry reports and PSAO websites, and interviewed the various entities noted above. Specifically, using NCPDP data, we obtained the contact information for each PSAO, which in some cases indicated the owner of the PSAO. Where it did not indicate the owner, we reviewed industry reports that included ownership information for some PSAOs, reviewed the PSAO's website, or contacted the PSAO directly. We reviewed NCPDP data for

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reasonableness and consistency, including screening for outliers. We also reviewed documentation and spoke with NCPDP officials about steps taken to ensure data reliability. We determined that the data used in this report were sufficiently reliable for our purposes. In addition, we spoke with PSAOs, independent pharmacies, and other industry stakeholders as noted above about the relationships existing between PSAOs and the pharmacies that they represent.

We conducted this performance audit from June 2012 through January 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Because we did not evaluate the policies or operations of any federal agency to develop the information presented in this report, we did not seek comments from any agency.

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## Background

The distribution of and payment for prescription drugs involves interactions among multiple entities. These entities include drug wholesalers, independent pharmacies, PSAOs, and third-party payers and their PBMs. Interactions among these entities facilitate the flow of and payment for drugs from manufacturers to consumers.

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## Drug Wholesalers

Drug wholesalers (hereafter referred to as wholesalers) purchase bulk quantities of drugs from pharmaceutical manufacturers and then distribute them to pharmacies, including independent pharmacies. For example, a wholesaler may fill an order from an independent pharmacy for a specified quantity of drugs produced by manufacturers and deliver the order to the pharmacy. In addition to supplying drugs, some wholesalers offer ancillary services to independent pharmacies such as helping them manage their inventory. Three wholesalers—AmerisourceBergen Corporation, McKesson Corporation, and Cardinal Health Inc.—accounted for over 80 percent of all drug distribution revenue in the United States in 2011.<sup>14</sup>

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<sup>14</sup>Fein, *2011-12 Economic Report*.

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## Independent Pharmacies and PSAOs

Independent pharmacies are a type of retail pharmacy with a store-based location—often in rural and underserved areas—that dispense medications to consumers, including both prescription and over-the-counter drugs.<sup>15</sup> In this report, we define independent pharmacies as one to three pharmacies under common ownership. Approximately 21,000 independent pharmacies constituted almost 34 percent of the retail pharmacies operating in the United States in 2010.<sup>16</sup> Although independent pharmacies offer other products such as greeting cards and cosmetics, prescription drugs account for the majority of independent pharmacy sales. These sales accounted for almost 17 percent of the \$266 billion in prescription drug sales in the United States in 2010.<sup>17</sup> In addition to products, independent pharmacies provide patient-care services such as patient education to encourage patients' appropriate use of medications. According to a 2009 survey of pharmacists, independent pharmacies spend the majority of their time dispensing prescription drugs and providing patient-care services.

Independent pharmacies primarily purchase drugs from wholesalers (although they may also purchase them directly from manufacturers) and represented slightly over 15 percent of wholesalers' total sales to retail pharmacies in 2010.<sup>18</sup> Independent pharmacies are an important part of a wholesaler's customer portfolio because, in addition to purchasing drugs, independent pharmacies may also pay the wholesaler to provide logistical functions and ancillary services such as direct delivery of drugs to individual stores and inventory management. Thus, a wholesaler's relationship with an independent pharmacy may result in multiple

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<sup>15</sup>Retail pharmacies are store-based retail locations that dispense medications to the public.

<sup>16</sup>Chain pharmacies and pharmacies operated by a supermarket or mass merchant such as Wal-Mart comprised the remaining 66 percent of retail pharmacies operating in the United States in 2010. National Association of Chain Drug Stores, *2011-2012 Chain Pharmacy Industry Profile*, (Alexandria, VA: 2011).

<sup>17</sup>Other types of pharmacies that accounted for the remaining 83 percent of prescription drugs dispensed in 2010 included chain pharmacies, pharmacies operated by a mass merchant such as Wal-Mart or a supermarket, and mail-order pharmacies.

National Association of Chain Drug Stores, *2011-2012 Chain Pharmacy Industry Profile*, (Alexandria, VA: 2011).

<sup>18</sup>Center for Healthcare Supply Chain Research, *2011-2012 HDMA Factbook: The Facts, Figures and Trends in Healthcare*, (Arlington, VA: 2011).

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business opportunities for the wholesaler and administrative efficiencies for the pharmacy. After receipt of drugs from a wholesaler or manufacturer, pharmacies then fill and dispense prescriptions to consumers, such as health plan enrollees. These latter prescriptions are dispensed according to contractual terms agreed upon with each enrollee's health plan, that is, with each third-party payer or its PBM.

According to the National Community Pharmacists Association (NCPA), payments based on the contractual terms of third-party payers or their PBMs significantly affect the financial viability of independent pharmacies. Consequently, these pharmacies must carefully choose which contracts to accept or reject. Accordingly, most independent pharmacies rely on PSAOs to negotiate directly, or to make recommendations for negotiating contracts on their behalf with third-party payers or their PBMs. When a PSAO enters into a contract with a third-party payer or its PBM, the pharmacies in its network gain access to the third-party payer or PBM contract—and the individuals it covers—by virtue of belonging to the PSAO's network.

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## Third-Party Payers and PBMs

Third-party payers accounted for almost 80 percent of drug expenditures in 2010, which represents a significant shift from 30 years ago when payment from individual consumers accounted for the largest portion of expenditures.<sup>19</sup> Third-party payers include private and public health plans such as those offered by large corporations and the federal government through Medicare and the FEHBP, many of which use PBMs to help them manage their prescription drug benefits. As part of the management of these benefits, PBMs assemble networks of retail pharmacies, including independent pharmacies, where the health plan's enrollees can fill prescriptions.<sup>20</sup> A pharmacy becomes a member of a third-party payer's or its PBM's network by entering into an agreement with the third-party payer or its PBM. It does so either directly or through a PSAO that has negotiated with that third-party payer or its PBM on the pharmacy's behalf. Contract terms and conditions may include specifics about

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<sup>19</sup>Agency for Healthcare Research and Quality, *Prescription Medicines—Mean and Median Expenses per Person With Expense and Distribution of Expenses by Source of Payment: United States, 2010*. Medical Expenditure Panel Survey Household Component Data. Generated Interactively. Accessed December 19, 2012. <http://mepps.ahrq.gov>.

<sup>20</sup>PBMs may also provide health plans with clinical, cost containment, and administrative services such as claims processing.

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reimbursement rates (how much the pharmacy will be paid for dispensed drugs), payment terms (e.g., the frequency with which the third-party payer or its PBM will reimburse the pharmacy for dispensed drugs), and audit provisions (e.g., the frequency and parameters of audits conducted by the third-party payer, its PBM, or designee), among other things.<sup>21</sup>

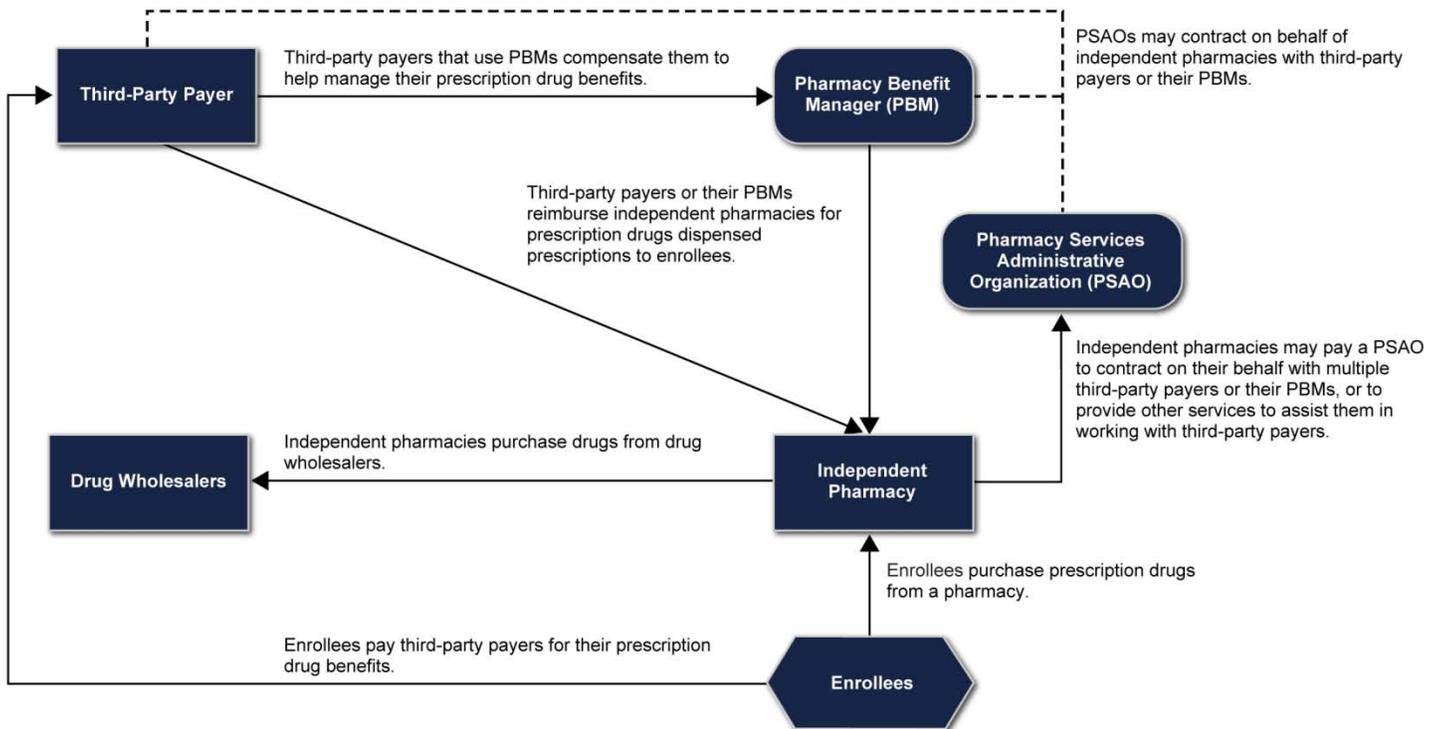
The reimbursement rate that third-party payers or their PBMs pay pharmacies significantly affects pharmacy revenues. Retail pharmacies participating in a PBM's network are reimbursed for prescriptions below the level paid by cash-paying customers (those whose prescriptions are not covered by a third-party payer). In addition, pharmacies must undertake additional administrative tasks related to transactions for customers who are covered by third-party payers that are not required for cash-paying customer transactions. For example, for customers covered by third-party payers, pharmacy staff must file claims electronically and may be required to counsel them on their health plan's benefits. However, most retail pharmacies participate in PBM networks because of the large market share PBMs command, which represents potential pharmacy customers. The five largest PBMs operating in the first quarter of 2012 represented over 330 million individuals.<sup>22</sup> In addition, retail pharmacies benefit from the prescription and nonprescription sales generated by customers that PBMs help bring into their stores. (See fig. 1 for a diagram of the network of entities in the distribution of and payment for pharmaceuticals.)

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<sup>21</sup>Audits of pharmacies by a third-party payer or its PBM may include an on-site inspection of various aspects of the pharmacy including inspections of its dispensing records to ensure compliance with regulatory and contractual requirements.

<sup>22</sup>This number includes duplication because every PBM involved in providing services to an individual includes that individual in its count of covered lives. As such, individuals may be counted multiple times across all PBMs. Atlantic Information Services, <http://www.aishealth.com>.

**Figure 1: Interactions Among Key Entities Involved in the Distribution of and Payment for Pharmaceuticals**



Source: GAO analysis based on interviews and industry reports.

Note: Arrows represent some of the financial interactions that occur between key entities involved in the distribution of and payment for pharmaceuticals. The dashed lines represent nonfinancial interactions between PSAOs and third-party payers or their PBMs on behalf of independent pharmacies.

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## At Least 22 PSAOs Contracted with over 20,000 Pharmacies in 2011 or 2012, the Majority of Which Were Independent Pharmacies

At least 22 PSAOs, which varied in the number and location of pharmacies to which they provided services, were in operation in 2011 or 2012.<sup>23</sup> In total, depending on different data sources, these 22 PSAOs represented or provided other services to between 20,275 and 28,343 pharmacies in 2011 or 2012.<sup>24</sup> (See table 1.) The number of pharmacies contracted with each PSAO across these sources ranged from 24 to 5,000 pharmacies; however, according to NCPDP data most contracted with fewer than 1,000 pharmacies. The largest 5 PSAOs combined contracted with more than half of all pharmacies that were represented by a PSAO in 2011 or 2012. Because pharmacies may change their PSAO, the number of pharmacies contracting with each PSAO fluctuates as PSAOs enroll and disenroll pharmacies.<sup>25</sup> For example, according to one PSAO, member pharmacies will change PSAOs whenever they think that another PSAO can negotiate better contract terms with third-party payers or their PBMs. Some PSAOs contracted primarily with pharmacies located in a particular region. These PSAOs generally represented fewer pharmacies than PSAOs representing pharmacies across the United States. For example, the Northeast Pharmacy Service Corporation

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<sup>23</sup>In determining the number of PSAOs in operation, we found a PSAO that did not identify itself as such, PSAOs that represented other types of pharmacies that were not independent, and a PSAO that did not appear in the NCPDP database. We included these PSAOs when determining the number of PSAOs in operation and the number of pharmacies represented by them in 2011 or 2012. The PSAO that did not identify itself as such met our criteria for inclusion because it provided intermediary and other services that assisted independent pharmacies in working with third-party payers or their PBMs. Additionally, of the two PSAOs that represented other types of pharmacies, one represented small chain pharmacies while the other represented members of a franchise. Finally, one PSAO did not appear in the NCPDP database but was identified by another source. We contacted the organization to confirm that it was a PSAO.

<sup>24</sup>Since no single comprehensive source on PSAOs exists, we used several sources—including 2011 NCPDP data, and 2012 industry reports, PSAO websites and PSAO interviews—to determine the range in the number of independent pharmacies represented by these PSAOs in 2011 or 2012. These data were self-reported and varied in terms of the PSAOs identified and the number and types of pharmacies represented by each PSAO. Additionally, the number of pharmacies represented across all PSAOs may be larger than the total number of independent pharmacies in operation in 2011 or 2012. This is because pharmacies may join multiple PSAOs that offer complimentary services and PSAOs may represent small chain pharmacies in addition to independent pharmacies.

<sup>25</sup>All but one of the PSAO-pharmacy model agreements we reviewed included termination provisions that provided a member pharmacy the right to terminate the agreement—and thus leave the PSAO. Typically, a member pharmacy may terminate its relationship with the PSAO by providing the PSAO with 30 to 90 days written notice. However, some PSAOs require member pharmacies to meet an initial contract period before they may submit a termination notice.

represented 250 independent pharmacies while the RxSelect Pharmacy Network represented from 451 to 569 independent pharmacies.

**Table 1: Number of Pharmacies Contracting with Pharmacy Services Administrative Organizations (PSAO) in 2011 or 2012**

<b>PSAO</b>	<b>Number of pharmacies contracting with each PSAO according to NCPDP data (2011)</b>	<b>Range in number of pharmacies contracting with each PSAO across all data sources (2011-2012)<sup>a</sup></b>
Good Neighbor Pharmacy Provider Network	4,198	3,600-5,000
Access Health	3,635	3,000-3,850
LeaderNET	1,901	1,900-2,000
EPIC Pharmacy Network, Inc.	1,830	1,830-2,000
Third Party Station	1,814	1,814-2,500
United Drugs	1,102	1,102-2,000
MHA Long Term Care Pharmacy Network	1,025	1,025-1,100
Third Party Network	952	952-1,027
American Pharmacy Network Solutions	938	750-938
TriNet Third Party Network	777	777-1,200
RxPr1de / Managed Pharmacy Care <sup>b</sup>	675	675-3,300
Managed Care Connection <sup>c</sup>	619	619-630
Medicine Shoppe International <sup>d</sup>	456	456-600
RxSelect Pharmacy Network	451	451-569
FamilyCare Pharmacy Member Network	441	441
GeriMed Long Term Care Network, Inc.	291	291
Innovatix Network, LLC	177	177
Progressive Pharmacies, LLC	104	40-104
Valu Merchandisers Company	75	75
Pharmacy Select	26	26
United Pharmacist Network, Inc.	24	24-265
Northeast Pharmacy Services Corporation <sup>e</sup>	N/A	250
<b>Total</b>	<b>21,511</b>	<b>20,275-28,343</b>

Source: GAO analysis of National Council for Prescription Drug Programs (NCPDP) data, interviews with PSAOs, PSAO websites, and industry reports.

Notes: The number of pharmacies associated with each PSAO is self-reported across all sources and a pharmacy may contract with multiple PSAOs that provide complementary services. As such, the number of pharmacies contracting with PSAOs may be larger than the total number of independent pharmacies in the market. In addition, not all pharmacies and PSAOs are contained in NCPDP and other data sources. The number of pharmacies associated with each PSAO according to the PSAO website may be approximate. For example, MHA Long Term Care Pharmacy Network states that “more than 1,100 pharmacies” are represented by its PSAO. Finally, although the majority of pharmacies represented by PSAOs are independent pharmacies, some PSAOs contract with small chains and franchise pharmacies. A franchise pharmacy is an independently owned pharmacy that

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has signed a franchise agreement with a franchisor to receive services such as training, marketing, and other support.

<sup>a</sup>The ranges presented are based on all sources of data used, including NCPDP data, interviews with PSAOs, PSAO websites, and an industry report. These data are self-reported by the PSAOs and may vary by source. Additionally, some PSAOs may have appeared in only one source and therefore do not have a range of pharmacies that they represent in this table.

<sup>b</sup>RxPr1de is owned by Managed Pharmacy Care, both of which appear in the NCPDP database. Managed Pharmacy Care identifies itself as a PSAO, but RxPr1de does not. RxPr1de does serve as an intermediary between independent pharmacies and pharmacy benefit managers (PBM), therefore, we consider RxPr1de a PSAO for purposes of this report. We combined the number of pharmacies represented by RxPr1de and Managed Pharmacy Care. The total number of pharmacies included in the range for these entities may include some duplication. We could not confirm with RxPr1de and Managed Care Pharmacy the number of pharmacies that they represent.

<sup>c</sup>Managed Care Connection represents small pharmacy chains ranging in size from 25 to 150 pharmacies.

<sup>d</sup>The Medicine Shoppe International PSAO represents members of the Medicine Shoppe pharmacy franchise.

<sup>e</sup>Northeast Pharmacy Services Corporation did not appear in our search of the NCPDP database, but was cited by another source. We contacted the organization to confirm that it is a PSAO and use "N/A" to indicate that there were no pharmacies represented by this entity in the NCPDP data.

According to NCPDP data, PSAOs provide services primarily to independent pharmacies. Of the 21,511 pharmacies associated with PSAOs in the 2011 NCPDP database, 18,103 were identified as independent pharmacies.<sup>26</sup> These independent pharmacies represent nearly 75 percent of the total number of independent pharmacies in the 2011 NCPDP database. This is close to an estimate reported by NCPA and the HHS OIG, both of which conducted surveys in which approximately 80 percent of responding independent pharmacies were represented by PSAOs.<sup>27</sup> In addition to independent pharmacies, some PSAOs also contracted with small chains and franchise pharmacy members.<sup>28</sup> For example, Managed Care Connection provides services to small chain pharmacies ranging in size from 25 to 150 pharmacies under

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<sup>26</sup>Pharmacies may choose from five designations in the NCPDP database: independent pharmacy, chain pharmacy, franchise pharmacy, government pharmacy, and alternate dispensing site, such as a physician's office or mail-order pharmacy.

<sup>27</sup>In all, 24,317 pharmacies in the NCPDP database were identified as independent pharmacies. This is larger than the total number of independent pharmacies in operation in 2010 (approximately 21,000 according to industry reports). However, NCPDP designations are self-reported and there are different definitions for an independent pharmacy.

<sup>28</sup>A franchise pharmacy is an independently owned pharmacy that has signed a franchise agreement with a franchisor to receive services such as training, marketing, and other support.

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common ownership, and the Medicine Shoppe only offers its PSAO services to its franchise pharmacies.

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## PSAOs Provide Independent Pharmacies with a Range of Services Intended to Achieve Administrative Efficiencies, and Most PSAOs Are Paid a Monthly Fee for These Services

PSAOs provide a broad range of services to independent pharmacies including negotiating contractual agreements and providing communication and help-desk services. These and other services are intended to achieve administrative efficiencies for both independent pharmacies and third-party payers or their PBMs. Most PSAOs charge a monthly fee for a bundled set of services and separate fees for additional services.

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## PSAOs Provide a Range of Services to Independent Pharmacies Including Contract Negotiation, Communication, and Help-Desk Services

While PSAOs provide a broad range of services to independent pharmacies and vary in how they offer these services, we found that PSAOs consistently offer contract negotiation, communication, and help-desk services. Several entities, including industry experts, trade associations, and PSAOs we spoke with, referred to one or all of these services as a PSAO's "key service(s)"—meaning that a PSAO can be distinguished from other entities in the pharmaceutical industry by its provision of these services. In addition, PSAOs may provide many other services that assist their member pharmacies—the majority of which are independent pharmacies—in interacting with third-party payers or their PBMs, although those PSAOs we spoke with did not provide these other services as consistently as their key services.

### Contract Negotiation Services

On behalf of pharmacies, PSAOs may negotiate and enter into contracts with third-party payers or their PBMs. Both the HHS OIG and an industry study reported that small businesses such as independent pharmacies generally lack the legal expertise and time to adequately review and negotiate third-party payer or PBM contracts, which can be lengthy and

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complex.<sup>29</sup> All of the model agreements between PSAOs and independent pharmacies that we reviewed indicated, and all of the PSAOs we spoke with stated, that the PSAO was explicitly authorized to negotiate and enter into contracts with third-party payers on behalf of member pharmacies. By signing the agreement with the PSAO, a member pharmacy acknowledges and agrees that the PSAO has the right to negotiate contracts with third-party payers or their PBMs on its behalf.

PSAOs we spoke with had different processes for negotiating and entering into contracts with third-party payers or their PBMs. These processes included following guidance or parameters established by a governing body such as a board of directors composed partially or entirely of representatives from the PSAO's member pharmacies. In addition, some PSAOs' decisions about entering into contracts are made by their contracting department or executive staff that base the decision on factors such as analyses of the contract's proposed reimbursement rate and the efficiencies and value that the PSAO's member pharmacies would provide to the particular market in which the contracts are offered. Decisions about entering into contracts may also include consultation with a PSAO's advisory board composed of representatives from the PSAO's member pharmacies.

While PSAOs may review and negotiate a wide range of contract provisions, PSAOs we spoke with reported negotiating a variety of provisions including reimbursement rates, payment terms, audits of pharmacies by third-party payers or their PBMs, price updates and appeals, and administrative requirements.<sup>30</sup> Regarding these contract areas, PBMs and PSAOs we spoke with reported that audits and reimbursement rates were of particular concern to pharmacies. One

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<sup>29</sup>Contract review is distinct from contract negotiation as a review may not include a PSAO entering into a contract on behalf of member pharmacies. A PSAO may review contracts on behalf of member pharmacies in order to provide guidance to pharmacies wishing to contract with a particular third-party payer. For example, one source reported that a PSAO may review contracts to make its member pharmacies aware of contract terms that could be problematic.

<sup>30</sup>The entities we spoke with had various perspectives regarding negotiation. For example, a trade association official reported that "contract negotiation is the PSAO's ability to review PBM contracts and help the pharmacy understand the contract and the pharmacies' obligations per their involvement with the PBM." One PSAO described it as "an arm's length back and forth process between two parties where both agree to meet somewhere in the middle."

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PSAO reported that its negotiations about a contract's audit provisions were intended to minimize member pharmacies' risks and burdens as audit provisions can include withholding reimbursement on the basis of audit findings. In addition, according to some PSAOs that we spoke with, reimbursement rates to pharmacies have decreased over time, and PSAOs and other sources we spoke with reported that PSAOs' ability to negotiate reimbursement rates has also decreased over time.

Over half of the PSAOs we spoke with reported having little success in modifying certain contract terms as a result of negotiations. This may be due to PBMs' use of standard contract terms and the dominant market share of the largest PBMs. Many PBM contracts contain standard terms and conditions that are largely nonnegotiable. According to one PSAO, this may be particularly true for national contracts, in which third-party payers or their PBMs have set contract terms for all pharmacies across the country that opt into the third-party payer's, or its PBM's network. For example, a national contract exists for some federal government programs, such as TRICARE.<sup>31</sup> In addition, several sources told us that the increasing consolidation of entities in the PBM market has resulted in a few PBMs having large market shares, which has diminished the ability of PSAOs to negotiate with them, particularly over reimbursement rates.

In contrast, PBMs we spoke with reported that PSAOs can and do negotiate effectively. PBMs and PSAOs reported that several factors may affect negotiations in favor of PSAOs and their members, including the number and location of pharmacies represented and the services provided by those pharmacies in relation to the size and needs of the third-party payer or its PBM. For example, a third-party payer or its PBM may be more willing to modify its contract terms in order to sign a contract with a PSAO that represents pharmacies in a rural area in order to expand the PBM's network in that area. In addition, a third-party payer or its PBM may be more willing to negotiate in order to add pharmacies in a PSAO's network that offer a specialized service such as diabetes care needed by a health plan's enrollees. One PSAO also reported that small PBMs wishing to increase their network's size may be more willing to negotiate contract terms.

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<sup>31</sup>The Department of Defense provides health care to active duty service members, retirees, and their families through the TRICARE program.

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We found that PSAOs vary in their requirements for their member pharmacies. Two PSAO-pharmacy model agreements that we reviewed stated that member pharmacies must participate in all contracts in which the PSAO entered on behalf of members. These PSAOs and six additional PSAOs we spoke with reported that their member pharmacies must participate in all contracts between the PSAO and third-party payers or their PBMs. The remaining two PSAOs we spoke with reported that they build a portfolio of contracts from which member pharmacies can choose. These PSAOs negotiate contracts with various third-party payers or their PBMs and member pharmacies review the terms and conditions of each contract and select specific contracts to enter into. Most of the PSAO-pharmacy model agreements we reviewed contained provisions expressly authorizing member pharmacies to contract with a third-party payer independent of the PSAO. Two additional PSAOs we spoke with confirmed that they do not restrict member pharmacies from entering into contracts independent of the PSAO. All three PBMs we spoke with confirmed that pharmacies may contract with them if their PSAO did not sign a contract with them on the pharmacies' behalf.

## Communication Services

PSAOs serve as a communication link between member pharmacies and third-party payers or their PBMs. Such communication may include information regarding contractual and regulatory requirements as well as general news and information of interest to pharmacy owners. All of the PSAOs we spoke with provided communication services to pharmacies such as reviewing PBMs' provider manuals to make member pharmacies aware of their contents.<sup>32</sup> Communication with pharmacies was provided by means of newsletters and the PSAOs' Internet sites. In addition to communicating contractual requirements, PSAOs may also communicate applicable federal and state regulatory updates. For example, one PSAO we spoke with told us that it provides its member pharmacies with regulatory updates from the Centers for Medicare & Medicaid Services by publishing this information in its newsletter. Another PSAO we spoke with provided regulatory analyses that included examining and briefing its member pharmacies on durable medical equipment accreditation requirements, and fraud, waste, and abuse training requirements. According to the PSAO, this was to ensure that its member pharmacies were taking the right steps to comply with applicable regulations.

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<sup>32</sup>Provider manuals contain details related to a pharmacy's rights and obligations per its contract with the PBM.

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## Help-Desk Services

PSAOs provide general assistance to pharmacies and assistance with issues related to third-party payers and their PBMs such as questions about claims, contracting, reimbursement, and audits. PSAOs may provide such assistance by means of a help-desk (or customer service department) or a dedicated staff person. For example, one PSAO we spoke with reported that it provides general pharmacy support services to help pharmacies with any needs they may have in the course of operating their businesses. This PSAO also had a staff person responsible for providing support services to member pharmacies including answering their questions about claims and each contract's reimbursement rate or payment methodology. A PSAO may also help a pharmacy identify why a certain claim was rejected.

## Other Services

PSAOs provide many other services that assist member pharmacies in interacting with third-party payers or their PBMs. For example, PSAOs may provide services that help the pharmacy with payment from a third-party payer or its PBM, comply with third-party payer requirements, or develop services that make the pharmacy more appealing to third-party payers or their PBMs. (See table 2 for a list and description of these services.)

**Table 2: Description of Other PSAO Services**

<b>PSAO Service</b>	<b>Description</b>
Assistance with claims <sup>a</sup>	A variety of services and tools intended to help a pharmacy submit and receive correct claims reimbursements. Assistance may include processing certain claims on behalf of pharmacies. For example, one PSAO we spoke with processed Medicare and Medicaid claims for member pharmacies
Audit assistance <sup>b</sup>	Educational and informational support to help pharmacies prepare and undergo audits, including helping pharmacies understand their rights and responsibilities when undergoing an audit and in responding to or appealing audit findings.
Central payment	A service in which a PSAO receives aggregated, single payments from a third-party payer on behalf of its member pharmacies. The PSAO then distributes individual payments to its members from the single payment made by the third-party payer.
Certification in specialized care programs	One or multiple certification programs that may include training, marketing, and program development in specialized areas including immunization/vaccination, diabetes management, long term care, home health, medication therapy management, patient safety, and quality assurance programs.
Compliance support	A service that assists pharmacies comply with regulatory and credentialing (e.g., proper licensure and accreditation) requirements.
Flat generics	A service that provides resources for pharmacies wishing to operate a program that offers generic drugs for a flat fee (e.g., \$4.00).
Front store layout assistance	A service that assists pharmacies with the design of the “front” of the pharmacy (i.e., the part that customers see), including assistance with signage and placement of products to facilitate customer flow.
Inventory management	An inventory control service to achieve a product mix intended to increase cash flow, improve customer service, and reduce wasteful expenses.
Marketing support	A service that may include media advertising and marketing strategy consultation intended to increase public awareness of the pharmacy.
Reconciliation or access to a reconciliation vendor	A service in which a PSAO manages and analyzes pharmacies’ payment and drug dispensing data to identify claims that have not been paid or were paid incorrectly by a third-party payer. A PSAO may also provide access to a vendor that performs this service.
Retail cash cards	A service that provides resources for pharmacies wishing to operate a discount program for cash paying customers.

Source: GAO analysis of PSAO interviews and marketing materials.

Note: The PSAOs we interviewed consistently offered three key services to its member pharmacies, namely: contract negotiation, communication, and help-desk services. In addition, PSAOs may also offer the other services listed, although the PSAOs we spoke with did not provide these other services as consistently as their key services.

<sup>a</sup>Although PSAOs we interviewed provided help-desk services that may have included assistance with claims, PSAOs varied in their provision of other claims related services.

<sup>b</sup>Pharmacies must submit to audits conducted by third-party payers or their designee(s). Audits by a third-party payer may include an on-site inspection of various aspects of the pharmacy including inspections of its dispensing records to ensure compliance with regulatory and contractual requirements.

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The PSAOs we spoke with varied in their provision of these other services although 9 of the 10 PSAOs we spoke with provided central payment and reconciliation services or access to reconciliation vendors that provided the service. However, other services were not provided as consistently across PSAOs. For example, only 1 PSAO reported that it provided inventory management or front store layout assistance.

PSAO services have changed over time to meet member pharmacies' interests. In some cases, this has meant adding new services, while in other cases PSAOs have expanded existing services. Several PSAOs we spoke with reported adding services intended to increase cost efficiencies and member pharmacies' revenues. For example, three PSAOs we spoke with reported that they began offering central pay services and two of these PSAOs and an additional PSAO reported that they began offering reconciliation services. PSAOs we spoke with also reported expanding existing services. For example, one PSAO reported adding electronic funds transfers, while two other PSAOs reported that although they were already providing electronic funds transfers, they increased the frequency of transfers to five days per week.<sup>33</sup> This increase was made to improve pharmacies' cash flow by giving them quicker access to funds owed them by third-party payers or their PBMs. Two PSAOs we spoke with reported adding certification programs, particularly vaccination/immunization certification programs, because of the needs of third-party payers or their PBMs for this service to be provided through their network pharmacies.<sup>34</sup>

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<sup>33</sup>“Electronic funds transfers” refers to the PSAOs ability to receive funds electronically, such as reimbursements from a third-party payer or its PBM. For example, a PSAO that provides central pay may receive consolidated funds electronically from a third-party payer or PBM and send individual payments electronically to its member pharmacies.

<sup>34</sup>Certification programs may include training, marketing, and program development provided by the PSAO to the pharmacy so that the pharmacy is qualified to provide a specialized service.

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**PSAOs Provide Services Intended to Achieve Administrative Efficiencies for Independent Pharmacies and Third-Party Payers or Their PBMs**

PSAOs provide services intended to achieve administrative efficiencies for both independent pharmacies and third-party payers or their PBMs. PSAO services enable pharmacy staff, including pharmacists, to focus on patient-care services rather than administrative issues that pharmacists may not have the time to address. PSAO services also reduce the number of resources that PBMs must direct toward developing and maintaining relationships with multiple independent pharmacies.

PSAO services are intended to help independent pharmacies achieve efficiencies particularly in contract negotiation. For example, independent pharmacies and PBMs we spoke with told us that PSAO contract negotiation services eased their contracting burden and allowed them to expand the number of entities with which they contracted. As a member of a PSAO, pharmacies may no longer have to negotiate contracts with multiple third-party payers or their PBMs operating in any given market. Independent pharmacies also told us that PSAOs provide other services that create both administrative and cost efficiencies for them. For example, one pharmacist told us that the marketing services provided by his PSAO relieved him of advertising costs because the PSAO provided advertising circulars to its PSAO-franchise members. Another independent pharmacy reported that its PSAO provides services such as claims reconciliation less expensively than the pharmacy could perform on its own.

Similar to independent pharmacies, PBMs we spoke with reported that PSAO services create administrative efficiencies for them, including efficiencies in contracting, payment, and their call centers. PSAO services create contracting efficiencies because they provide PBMs with a single point through which they can reach multiple independent pharmacies. For example, the PBMs we spoke with each had over 20,000 independent pharmacies in their networks, however, each PBM only negotiated contracts with 15 to 19 PSAOs, representing a majority of the pharmacies in its network. PBMs also reported that PSAO services create payment efficiencies when PSAOs provide central payment services. One PBM reported that instead of mailing checks to hundreds of individual pharmacies, the PBM made one electronic funds transfer to the PSAO, which then distributed the payments to its members. Finally, PBMs benefit from reduced call center volume because PSAOs often provide similar support directly to member pharmacies. For example, a call that may have gone to the PBM about a claim that was not paid may instead go to the pharmacy's PSAO, which will help the pharmacy understand any issues with the claim. PSAOs may also aggregate member pharmacies' issues and contact the PBM to discuss issues on behalf of

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multiple pharmacies and relay pertinent information back to those pharmacies.

While creating efficiencies by acting on behalf of multiple pharmacies, PSAOs must ensure that their arrangements do not unreasonably restrain trade, thereby raising antitrust concerns.<sup>35</sup> The FTC and the Antitrust Division of the Department of Justice (DOJ) are the federal agencies responsible for determining whether a particular collaborative arrangement may be unlawful and for enforcing applicable prohibitions.<sup>36</sup> According to FTC officials, such a determination is dependent on multiple factors including the geographic region that a PSAO is operating in and the health care program (e.g., Medicare Part D) with which a PSAO is contracting. These factors affect the PSAO's ability (and the abilities of the pharmacies the PSAO represents) to affect the terms of a contract or the pricing of a good. For example, a group of rural pharmacies may more effectively influence contract negotiations than a single pharmacy operating in an urban area with many competitors. PSAOs we spoke with were aware of potential antitrust issues and reported taking measures to minimize them. For example, two of the PSAOs we spoke with reported developing their PSAO's organizational structure to ensure compliance with antitrust laws.

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### Most PSAOs Charge a Monthly Fee for Bundled Services and Additional Fees for Other Services

Although PSAOs' charges to member pharmacies for their services may vary depending on how the services are provided, 8 of the 10 PSAOs we spoke with charged a monthly fee for a bundled set of services. For example, 1 PSAO charged \$40 to \$80 per month for a bundle of services that included contract negotiation, communication with member pharmacies, help-desk services, business advice, and limited audit support. In comparison, another PSAO's monthly fee ranged from \$59 to \$149 per month depending on the combination of services that the

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<sup>35</sup>Applicable federal antitrust laws include the Sherman Act, July 2, 1890, c. 647, 26 Stat. 209 (codified as amended at 15 U.S.C. §§ 1 et seq.); the Clayton Act, Oct. 15, 1914, c. 323, 38 Stat. 730 (codified as amended at 15 U.S.C. §§ 12 et seq.); and the Federal Trade Commission Act, Sept. 26, 1914, c. 311, 38 Stat. 717 (codified as amended at 15 U.S.C. §§ 41 et. seq.).

<sup>36</sup>FTC issues commission or staff advisory opinions and DOJ issues business review letters in response to requests to review specific proposed collaborative arrangements. According to agency officials, the review of a given collaborative arrangement is generally done by the agency with the most expertise with that type of arrangement.

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pharmacy requested. One of the remaining PSAOs we spoke with charged an annual fee rather than a monthly fee, while the other PSAO did not charge any fees for its PSAO services. The latter PSAO provided PSAO services as a value-added service to members of its group purchasing organization, for which it charged a monthly fee.<sup>37</sup> Other services that are offered by most, but not all, PSAOs we spoke with are either provided within the bundle or as separate add-on services. PSAOs may also charge fees for individual services that are based on the type or value of that service.

Virtually all of the fees for PSAO services are paid for by member pharmacies. All of the PSAOs we spoke with reported that they did not receive any type of fees from other entities such as an administrative fee from a third-party payer or its PBM. Similarly, all of the PBMs we spoke with told us that they did not pay PSAOs for their services. However 1 of the 3 PBMs we spoke with reported that it paid part of a pharmacy's dispensing fee to 1 of the 16 PSAOs with which it contracted rather than to the pharmacy.

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## Wholesalers and Independent Pharmacy Cooperatives Owned the Majority of PSAOs; Requirements to Use Non-PSAO Services Varied by Owner

The majority of PSAOs in operation in 2011 or 2012 were owned by wholesalers and independent pharmacy cooperatives.<sup>38</sup> In addition, these PSAO owners varied as to whether they require member pharmacies to also use the non-PSAO services they offer.

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<sup>37</sup>A group purchasing organization negotiates on behalf of a group of pharmacies to get discounts and rebates from suppliers of prescription drugs, such as drug manufacturers. In some cases, an organization will operate both a group purchasing organization and a PSAO.

<sup>38</sup>Independent pharmacy cooperatives are organizations composed of independent pharmacies that may, for example, operate a group purchasing organization or provide other services to their members.

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## Wholesalers and Independent Pharmacy Cooperatives Owned the Majority of PSAOs

Wholesalers and independent pharmacy cooperatives owned the majority of the PSAOs in operation in 2011 or 2012. Specifically, of the 22 PSAOs we identified, 9 PSAOs were owned by wholesalers, 6 were owned by independent pharmacy cooperatives (“member-owned”), 4 were owned by group purchasing organizations, and 3 were stand-alone PSAOs owned by other private entities. (See table 3.) Three of the 5 largest PSAOs were owned by the 3 largest wholesalers in the U.S.: AmerisourceBergen Corporation, Cardinal Health Inc., and McKesson Corporation. Across all sources included in our review, the PSAOs owned by these wholesalers represented 9,575 to 12,080 pharmacies, and PSAOs owned by independent pharmacies represented 4,883 to 8,882 pharmacies. According to one industry report, the services provided by member-owned PSAOs are similar to those offered by wholesaler-owned PSAOs.<sup>39</sup> One PBM we spoke with noted that because of the financial backing of wholesaler-owned PSAOs, their PSAOs generally offer central payment services more often than PSAOs owned by other types of entities. This strong financial backing is necessary to offer these services because there is a considerable liability and risk in providing a central payment service.

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<sup>39</sup>Fein, *2011-12 Economic Report*.

**Table 3: Ownership of Pharmacy Services Administrative Organizations (PSAO) in Operation in 2011 or 2012**

<b>PSAO (ranked largest to smallest by number of pharmacies represented)</b>	<b>Ownership type (owner name)</b>
Good Neighbor Pharmacy Provider Network	Wholesaler (AmerisourceBergen Corporation)
Access Health	Wholesaler (McKesson Corporation)
LeaderNET	Wholesaler (Cardinal Health Inc.) <sup>a</sup>
EPIC Pharmacy Network, Inc.	Member-owned (EPIC Pharmacies, Inc.)
Third Party Station	Wholesaler (Wholesale Alliance, LLC)
United Drugs	Member-owned (American Associated Pharmacies)
MHA Long Term Care Pharmacy Network	Group purchasing organization (Managed Health Care Associates, Inc.)
Third Party Network	Wholesaler (H.D. Smith Wholesale Drug Co.)
American Pharmacy Network Solutions	Member-owned (American Pharmacy Cooperative, Inc.)
TriNet Third Party Network	Group purchasing organization (PBA Health)
RxPr1de / Managed Pharmacy Care <sup>b</sup>	Member-owned
Managed Care Connection	Wholesaler (Cardinal Health Inc.) <sup>a</sup>
Medicine Shoppe International	Wholesaler (Cardinal Health Inc.) <sup>a</sup>
RxSelect Pharmacy Network	Member-owned (Pharmacy Providers of Oklahoma)
Family Care Pharmacy Member Network <sup>c</sup>	Wholesaler (JM Smith Corporation)
Gerimed Long Term Care Network, Inc.	Group purchasing organization (Gerimed, Inc.)
Innovatix Network	Group purchasing organization (Innovatix Group Purchasing Organization)
Progressive Pharmacies, LLC	Wholesaler (Frank W. Kerr Company)
Valu Merchandisers Company	Member-owned (Associated Wholesale Grocers)
Pharmacy Select	Stand alone pharmacy services company (Pharmacy Providers Services Corporation)
United Pharmacist Network, Inc.	Stand alone pharmacy services company
Northeast Pharmacy Services Corporation	Stand alone pharmacy services company

Source: GAO analysis of National Council for Prescription Drug Programs (NCPDP) data, pharmaceutical industry reports, PSAO websites and interviews.

Notes: Although the majority of pharmacies represented by these PSAOs are independent pharmacies, some PSAOs represent small chains and franchise pharmacies. Pharmacies are listed by size on the basis of the number of pharmacies each represented according to NCPDP data from February 2011, with the exception of Northeast Pharmacy Services Corporation, which did not appear in the NCPDP data. For the purposes of this report, PSAOs that are owned by independent pharmacy cooperatives are referred to as “member-owned.”

<sup>a</sup>Cardinal Health Inc. operates three separate PSAOs that serve different segments of its business. LeaderNET provides services to its drug distribution customers, Medicine Shoppe International provides services to members of its pharmacy franchise, and Managed Care Connection provides services to small independent chains.

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<sup>b</sup>RxPr1de is owned by Managed Pharmacy Care. Managed Pharmacy Care identifies itself as a PSAO, but RxPr1de does not. RxPr1de does serve as an intermediary between independent pharmacies and pharmacy benefit managers (PBM), therefore, we consider RxPr1de a PSAO for purposes of this report.

<sup>c</sup>Family Care Pharmacy Network is run by QS/1, a division of the JM Smith Corporation. The JM Smith Corporation is focused on various areas of healthcare and technology and operates six divisions, including its original division that provides drug distribution services.

PSAO owners may operate PSAOs for a number of reasons, including to benefit another, non-PSAO line of their business. The wholesalers we spoke with provided various reasons for offering PSAO services, such as wanting to assist independent pharmacies in gaining access to third-party payer or PBM contracts, or to help pharmacies operate more efficiently. Additionally, one wholesaler noted that it created its PSAO because third-party payers and independent pharmacies indicated there was a need for PSAO services in the market. These third-party payers wanted a sole source for reaching multiple pharmacies, while independent pharmacies wanted a facilitator to assist them with reviewing third-party payer contracts. Other pharmaceutical entities noted that wholesalers may have an interest in developing relationships with independent pharmacies, which are potential customers of the wholesaler's drug distribution line of business. By obtaining multiple services from a wholesaler, an independent pharmacy may be less likely to switch wholesalers. Additionally, by having their PSAOs assist independent pharmacies with entering multiple third-party payer or PBM contracts, wholesalers may benefit from the increased drug volume needed by independent pharmacies to serve the third-party payer's or PBM's enrollees. Other types of PSAO owners also provided a number of reasons for providing PSAO services, for instance, a number of these owners stated that they began offering PSAO services as a market-driven response to the growth of third-party payers and PBMs. In fact, one PSAO owner we spoke with stated that it reluctantly began offering these services at the request of customers of its group purchasing services, who wanted help navigating the issues and complexities of third-party payer and PBM contracting.

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## PSAO Owners Vary As to Whether They Require Member Pharmacies to Use Their Non-PSAO Services

The owners of PSAOs we spoke with varied as to whether they require PSAO member pharmacies to also use services from a separate non-PSAO line of their business. Of the nine PSAO owners we spoke with that had a separate non-PSAO line of business (e.g., drug distribution or group purchasing), six did not require their PSAO member pharmacies to use services from that non-PSAO line of business.<sup>40</sup> Of the remaining three, one wholesaler-owned PSAO limited its offer of services to pharmacies that were existing customers of its drug distribution line of business, while two member-owned PSAOs reported requiring their PSAO member pharmacies to join their group purchasing organizations. Officials from the wholesaler-owned PSAO stated that their limiting the availability of PSAO services to existing customers ensures that their PSAO already has basic information about their member pharmacies and a salesperson who serves as each member pharmacy's point of contact.

While most PSAO owners do not require their member pharmacies to use services from their primary line of business, member pharmacies may choose to do so. In this case, a pharmacy must contract and pay for PSAO and other services separately. In fact, according to one wholesaler we spoke with, approximately 36 percent of its drug distribution customers were also members of its PSAOs.<sup>41</sup> Pharmacies may be required to submit an application to join a PSAO network. PSAO applications we reviewed requested information about the pharmacy's licensing, services provided, and insurance. Additionally, applications asked pharmacies to indicate whether they had been investigated by the HHS OIG, had filed for bankruptcy, or had their pharmacy's state license limited, suspended, or revoked. PSAOs stated they used the information provided in applications to verify that the pharmacies applying for membership in their network are licensed by their state and in good standing.

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<sup>40</sup>Member-owned PSAOs may also operate group purchasing organizations and provide other non-PSAO services to their members.

<sup>41</sup>Pharmacies may choose to obtain PSAO services from their wholesaler, but not all do so. Instead, some pharmacies may choose to join another PSAO.

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Most PSAOs we spoke with operated their PSAO separately from any separate non-PSAO line of business. For example, most wholesalers we spoke with stated their PSAO staff and drug distribution staff are distinct and do not interact. One of these wholesalers reported its PSAO has a distinct corporate structure, management team, sales organization and financial component from its drug distribution line of business. However, nearly all of the PSAO owners we spoke with operate their PSAO as a subsidiary of their non-PSAO line of business. For example, two PSAOs were organized as subsidiaries of a member-owned buying group, while another PSAO operated as a branded service under the owner's non-PSAO line of business.

Most PSAO owners reported that PSAO services are not a profitable line of business. Only 1 of the 10 PSAO owners we spoke with stated that its PSAO service was profitable. Other PSAO owners reported little to no profit earned from the PSAO services they provided.<sup>42</sup> For those PSAOs that are not profitable, the cost of operating them may be subsidized by the owner's non-PSAO lines of business. As previously noted, it may be the case that offering PSAO services may benefit the owner's non-PSAO line of business even if the PSAO service itself is not profitable. For example, one member-owned PSAO we spoke with also owned a group purchasing organization to which its members must belong in order to obtain PSAO services. The group purchasing organization may benefit from increased membership driven by pharmacies that want to obtain its PSAO services.

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As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Secretary of Health and Human Services, the Chairman of the Federal Trade Commission, and interested congressional committees. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

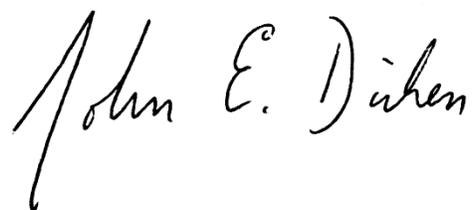
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<sup>42</sup>One PSAO owner that we spoke with did not provide information regarding the profitability of its PSAO.

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If you or your staff have questions about this report, please contact John E. Dicken at (202) 512-7114 or [DickenJ@gao.gov](mailto:DickenJ@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff members who made key contributions to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in black ink that reads "John E. Dicken". The signature is written in a cursive style with a large, sweeping initial 'J'.

John E. Dicken  
Director, Health Care

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# Appendix I: GAO Contact and Staff Acknowledgments

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## GAO Contact

John E. Dicken, (202) 512-7114 or [DickenJ@gao.gov](mailto:DickenJ@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Rashmi Agarwal and Robert Copeland, Assistant Directors; George Bogart; Zhi Boon; Jennel Lockley; Laurie Pachter; and Brienne Tierney made key contributions to this report.

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