SHINING LIGHT ON THE "GRAY MARKET"

AN EXAMINATION OF WHY HOSPITALS ARE FORCED TO PAY EXORBITANT PRICES FOR PRESCRIPTION DRUGS FACING CRITICAL SHORTAGES

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EXECUTIVE SUMMARY

This investigation has examined a group of companies that buy and sell prescription drugs that hospitals and other health care providers urgently need to treat their sick patients. Operating outside of authorized distribution networks, these "gray market" companies take advantage of drug shortages to charge exorbitant prices for drugs used to treat cancer and other life-threatening conditions. These companies' questionable business practices put patients at risk and cost the United States health care system hundreds of millions of dollars each year.

The Role of Gray Market Companies in Drug Shortages

Over the past several years, a growing number of prescription drugs sold in the United States have experienced supply shortages. Because these shortages have been most severe among a group of injectable drugs used to treat patients with cancer and other serious illnesses, they have had a particularly serious impact on hospitals. Hospitals across the country have struggled to provide appropriate care to their patients and have spent hundreds of millions of dollars managing the administrative and clinical problems drug shortages cause.

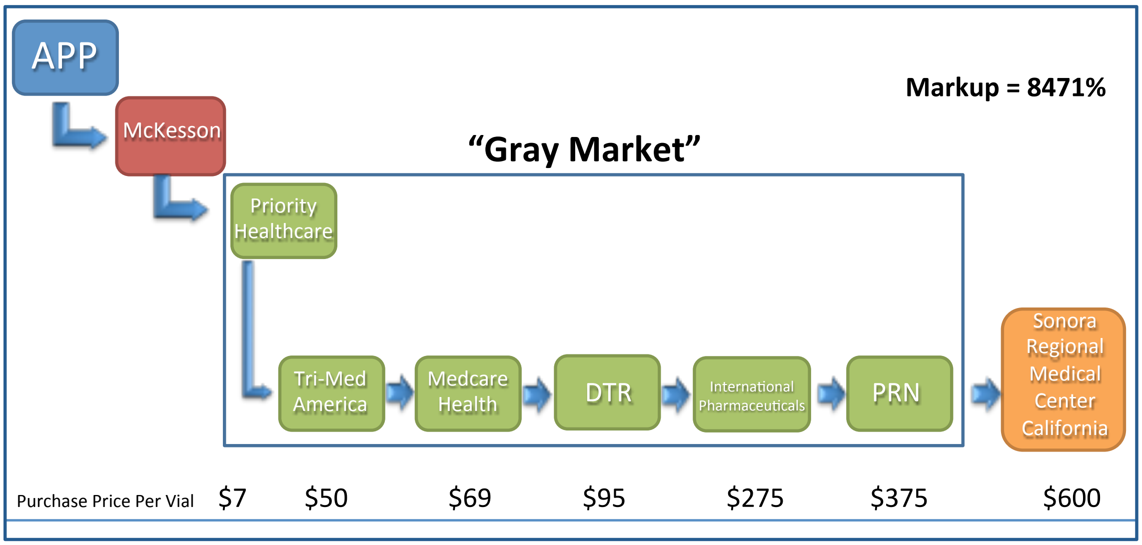
During drug shortages, hospitals are sometimes unable to buy drugs from their normal trading partners, usually one of the three large national "primary" distributors, AmerisourceBergen, Cardinal Health, or McKesson. At the same time, hospitals are deluged by sales solicitations from gray market companies offering to sell the shortage drugs for prices that are often hundreds of times higher than the prices they normally pay. Hospital pharmacists have been both angered and confused by these offers. They have asked, "why the hospitals can't get these products but the 'scalpers' can."

Gray Market Drugs "Leak" Out of Authorized Distribution Chains

The drug "pedigree" documents reviewed in this investigation show that some short-supply injectable drugs do not reach health care providers through the manufacturer-wholesaler distributor-dispenser chain that policymakers and industry stakeholders present as the typical model for drug distribution. Instead, these drugs "leak" into longer gray market distribution networks, in which a number of different companies – some doing business as pharmacies and some as distributors – buy and re-sell the drugs to each other before one of them finally sells the drugs to a hospital or other health care facility.

In more than two-thirds (69%) of the 300 drug distribution chains reviewed in this investigation, prescription drugs leaked into the gray market through pharmacies. Instead of dispensing the drugs in accordance with their professional duties, state laws, and the expectations of their trading partners, these pharmacies re-sold the drugs to gray market wholesalers. Some pharmacies sold their entire inventories into the gray market. The wholesalers in turn sold the drugs – usually at significant markups – to other gray market companies.

In the drug chain illustrated below, which documents the shipment of 25 vials of a chemotherapy drug called fluorouracil in September 2011, the leakage point was a Maryland pharmacy called Priority Healthcare. Instead of dispensing the drug to patients, the owner of this company, Marianna Pesti, sold the vials to a New Jersey distributor called Tri-Med America, which was owned by Ms. Pesti's husband, Gabor Szilagyi. The drugs were sold five more times before reaching their end user, a hospital in California.



Gray Market Companies Aggressively Mark Up Drug Prices

As the drugs pass through these gray market distribution chains, they are significantly marked up, sometimes to prices that are hundreds of times higher than the prices that hospitals and other health care providers normally pay. The markups in these chains often bear no relation to the companies' cost of purchasing, shipping, or storing the drugs. Instead, they reflect an intent to take advantage of the acute demand for short-supply drugs by charging health care providers exorbitant prices.

In the example above, each company in the chain marked up the vials by large margins, two by more than 100%, even if they never took physical custody of the vials or only held them for a short time. The hospital that purchased the drug ended up paying $600 per vial for a drug that a pharmacy had purchased for $7 per vial. Hospitals purchase short-supply drugs at these exorbitant prices because, as one hospital explained, "We have no other choice … We have to take care of our patients."

Other significant findings of this investigation are:

"Fake Pharmacies" Acquire Prescription Drugs from Authorized Distributors and then Sell Them Into the Gray Market. The investigation has identified a number of businesses holding pharmacy licenses that do not dispense drugs, but instead appear to operate for the sole purpose of acquiring short-supply drugs that can be sold into the gray market.

"Drug Brokers" Recruit Pharmacies to Purchase Drugs for the Gray Market. Some gray market wholesalers gain access to shortage drugs by recruiting pharmacies to act as their purchasing agents.

Gray Market Business Practices Are Widespread. Pedigree and price information collected for five different short-supply injectable drugs, documenting the activities of 125 different companies, showed similar patterns of leakage and aggressive gray market price markups. For all five drugs, units normally costing $10 to $20 were regularly marked up to prices of $200 or more while they traveled through the gray market.

Gray Market Drugs Are Marked Up as They Quickly Pass from Owner to Owner. On average, the prescription drugs examined in this investigation were owned by three to four different gray market businesses before being sold to a hospital; most of the drugs traveled through the gray market in five days or less.

Gray Market Companies Sometimes Charge Hospitals Significantly Different Prices for the Same Drug Product on the Same Day. Gray market companies sold units of the exact same drug product to different hospitals on the same day at significantly different prices. On the same day, for example, a gray market company sold a drug to a U.S. military hospital for $315 per unit, and sold the exact same drug product to another hospital for $215 per unit.