



PHARMACEUTICAL CAREER ENHANCERS



## Merck's House of Cards Collapses on Its Pepcid "Nominal Price" Program

[By Joel Hesch]

One of the last fraud cases I worked on as an attorney in the Fraud Division of the Department of Justice (DOJ) was an investigation to determine if Merck, a giant pharmaceutical company, was gouging Medicaid.

It was alleged that Merck was cheating under the Medicaid Rebate Statute by overcharging Medicaid for its popular antacid drug Pepcid. I was asked to investigate whether the fraud allegations were meritorious.

Working with another DOJ attorney in Washington, D.C., I asked Merck to provide its internal documents and memos relating to its nominal pricing program for Pepcid. The issue was whether that pricing structure was really a guise for disguising its true best price for that drug. Merck had not reported to Medicaid its sales of Pepcid to large hospital chains, claiming that the prices were less than 10% of its average wholesale prices and thus exempt as "nominal prices."

Merck buried us in paperwork. After months of pouring through records, however, we were able to piece together Merck's price-gouging scheme. Their own records hung the company. It was clear that Merck was knowingly violating the False Claims Act and thus liable for triple damages.

Merck should have evenly distributed its discounts under its so-called nominal pricing program because it really involved bundled or group sales. In other words, a hospital could not get the nominal price for Pepcid tablets unless it also bought large amounts of other formulations of that product, such as Pepcid in liquid or IV forms.

Before I left DOJ, I participated in meetings during which we explained to Merck the fraud allegations and listened to the company's side of the story. We were able to knock down every defense and calculate damages literally to the penny. Merck began talking settlement, but it would take many

more months before it was willing to face up to the full extent of its liability.

Recently, Merck agreed to repay Medicaid \$250 million to settle the allegations that it overcharged Medicaid for its Pepcid heartburn pills. That is correct. Merck wrote a check for a quarter of a billion dollars for underreporting rebates for just one drug.

Drug companies know that they are supposed to charge Medicaid the lowest price they charge others for their drugs. Initially, a set price is used, but at the end of each quarter, pharmaceutical companies are to find the lowest price they've given any customer. If it is lower than the price Medicaid paid, they must give Medicaid a rebate for the difference.

Merck had tried to exploit a loophole or small wrinkle in the Medicaid Rebate Statute. Pharmaceutical companies had convinced the government that at times they act compassionately by giving away or selling drugs at pennies per pill to charities and low-income clinics. The government did not want to stand in the way of such generosity and agreed to waive rebates for drugs sold for a "nominal price" (i.e., under 10% of the average price).

In the case of Pepcid, however, Merck was not acting for humanitarian reasons, but operating out of greed. It did not want the government to get the same price it charged its best customers — a condition of being able to sell drugs to Medicaid patients.

Merck was facing huge competition in the market for histamine-2 receptor antagonists (H2 blockers). Not wanting to lose sales,

Merck devised a scheme to make its customers happy with a low *overall* price for a group of drugs, while at the same time make itself happy by not reporting large discounts of Pepcid to Medicaid. Under its pricing program for Pepcid, Merck bundled all of its formulations into one pricing program and placed most of the discount into Pepcid tablets. That way, the hospital chain received a big overall discount on Merck's line of products, and the sales would not appear to set any best prices for any of the drugs. In other words, rather than give a 70% discount on all of the drugs, Merck gave a 91% discount on Pepcid tablets and a roughly 30% discount on the other formulations. That way, Merck reasoned, the tablets would be exempt from reporting to Medicaid as "nominal prices," and the other discounts would not appear to be any greater than other reported sales to other customers.

The problem with this scheme was that Medicaid had already issued guidance and regulations to the pharmaceutical companies instructing them that if any drugs are bundled together — i.e., if you must buy more than one drug to get the discount — then the drug company must unbundle the sales. The government provided a formula whereby the total discount must be spread out according to the volume of the drugs.

As part of investigating the allegations, we developed a damage calculation model based upon the government guidance by using a simple formula my DOJ colleague put together with Microsoft Excel. By simply plugging in the sales figures and total discounts from documents Merck produced for us, we could calculate the true amount of the discounts. What ended up happening



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was that the real discount for Pepcid tablets was not 91%, which would have been exempt, but closer to 70%. Thus, Merck was actually setting best prices for its H2 blockers through its sales to large hospitals.

A former employee of Merck stepped forward to report the fraud. He filed for a reward with the Department of Justice. I was one of two attorneys assigned to that reward application. It was that case that led DOJ to open the fraud investigation and recover \$250 million. The whistleblower will likely receive nearly \$40 million as a reward.

My last fraud case at DOJ, before becoming a law school professor and an advocate helping whistleblowers file for government rewards for reporting fraud, was a huge success.

I am pleased that DOJ pays large rewards to whistleblowers. Without their help, everyone would pay hundreds of dollars more each year in taxes because of Medicare and Medicaid fraud.

I estimate that as much as 10% of all billings to Medicare and Medicaid are fraudulent. For just one drug, Pepcid, the fraud under the Medicaid Rebate Statute was \$250 million. There are 4,000 other drugs that must pay rebates.

While at DOJ, I was assigned to the elite "Pharmaceutical Fraud Team." Thus, I am aware of the many other ways in which pharmaceutical companies are cheating. For instance, rebates fraud schemes also include concealing the best price given to a customer and lying about the average manufacturer price (AMP).

If you know of fraudulent claims under the Medicaid Rebate Statute, it may be well worth your time to report it.

### About the Author

Joel Hesch spent 15 years as an attorney in the Fraud Division of the Department of Justice (1990-2006), helping administer the national whistleblower reward program. He is the author of a recent book, *Whistleblowing: A Guide to Government Reward Programs (How to Collect Millions of Dollars for Reporting Fraud)*. He is currently a law school professor at Liberty University and represents whistleblowers filing for rewards. Please visit his informative website, [www.HowToReportFraud.com](http://www.HowToReportFraud.com), which contains up to the minute updates on government reward programs.

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