

**Testimony of Patrick J. O’Connell
Chief, Civil Medicaid Fraud Section
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Mr. Chairman and members of the Subcommittee:

Good morning. My name is Patrick O’Connell. I am an Assistant Attorney General and Chief of the Civil Medicaid Fraud Section of the Texas Attorney General’s Office. Thank you for inviting us to testify this morning. In my remarks, I will describe for you the efforts undertaken by the Texas Attorney General to identify and vigorously litigate against those persons and companies that defraud the Medicaid system in Texas.

As you are aware, the federal False Claims Act has been in place since the Civil War. Texas adopted our version of the FCA in 1995. Our statute, the Texas Medicaid Fraud Prevention Act, is specific to fraud against the Medicaid Program. In 1999, then Texas Attorney General, now United States Senator, John Cornyn became concerned about fraud against the Texas Medicaid Program and created a special Civil Medicaid Fraud Section within the AG’s office. Our Civil Medicaid Fraud Section utilizes the Texas statute to initiate civil litigation to recover funds defrauded from Texas Medicaid. One of the first cases we received was filed by a small Florida pharmacy, Ven-A-Care of the Florida Keys, Inc., who you heard from earlier today.

Ven-A-Care brought information to us showing that certain drug manufacturers violated Texas law by intentionally reporting prices to the Texas Medicaid Program that did not bear a reasonable relationship to the prices for their products that were generally

and currently available in the market place. Unlike most other states which derive pricing information from third party price reporting services like First Data Bank, Texas requires manufacturers who want their products to be eligible for Medicaid reimbursement to fill out a questionnaire for each drug they wish placed on the Texas Medicaid formulary. For each drug, the manufacturer must report its prices to various classes of trade: e.g., its AWP; its price to wholesaler and/or distributor; its direct price; special price to chain warehouse, etc. A drug company representative is required to sign the form and certify that the information included in it is accurate. Texas law also requires drug companies to update the Medicaid Program with any changes in reported pricing within 15 days of the change.

When Texas relies upon an inflated price report in calculating a provider's estimated acquisition cost ("EAC"), the resulting reimbursement to providers is well above the providers' actual acquisition cost, thus providing pharmacies with windfall profits. The information brought to us by Ven-a-Care indicated that certain drug companies may have knowingly and purposefully misrepresented their reported prices to Texas in order to enhance or drive up the reimbursement to their provider customers.

Under the Texas statute, we have broad powers to compel document production and testimony of potential witnesses. In 1999 and 2000, we used these civil investigative demand powers to require several manufacturers to produce documents. We also took examinations under oath of several industry representatives. Based on the information

that we received from Ven-a-Care, as well as the information we received pursuant to the CID process, General Cornyn authorized us to intervene against three VAC defendants in September 2000. The Texas lawsuit was the first state intervention in a qui tam case involving pharmaceutical manufacturer pricing fraud.

The evidence we have discovered in our investigations shows that some manufacturers make conscious, deliberate business decisions to create enhanced spreads and to market the sale of their products based on the spreads. For example, we found that some manufacturers engaged in the following activities:

- purposefully reported false and inflated prices to Texas Medicaid - as well as to third party price reporting services - in order to create enhanced spreads;
- deliberately failed to report prices to certain classes of trade in violation of Texas law;
- instructed their sales personnel to market spreads to customers;
- created spread sheets showing pharmacies how much more profit they can make off Medicaid when purchasing one product over another;
- tied sales personnel compensation to success in marketing the spread.

We also found that some manufacturers actually kept two sets of computer records with prices: one, with inflated prices that are reported to the price reporting services like First Data Bank, or in Texas' case, directly to the Medicaid Program; and another with

real contract prices that are used in every day business transactions with the manufacturer's customers.

In June 2003, we settled our case with one defendant drug company for \$18.5 Million, and in May 2004, we settled with another for \$27 Million. The total recovery in both settlements was \$45.5 Million. In both cases, Texas recovered more than two times the actual damages to the Medicaid Program, plus our costs and attorneys' fees. Since the federal government supplies approximately 62 cents of every dollar spent on Medicaid in Texas, so approximately 62% of the net settlements went to the United States Treasury.

It is important to remember that these were Texas State settlements only. My office continues to provide assistance to those authorities in other jurisdictions who are pursuing these and other companies. We have developed close and cooperative working relationships with the United States Department of Justice and with other state attorneys general who have instituted similar litigation. So far, California, Kentucky, Florida, Minnesota, Connecticut, New York, Ohio, Arkansas, Wisconsin, West Virginia, Massachusetts, and Nevada have sued drug companies for false price reporting.

Litigation in Texas is still pending against one of the defendants we sued in September 2000, and we are scheduled to go to trial against that manufacturer in the fall of next year. We have also intervened against three additional defendants. The case

against these three defendants is in the discovery phase where we are taking depositions and exchanging documents. That trial is scheduled to begin in the Spring of 2006.

I would like to briefly follow-up on the remarks from the Texas Medicaid Program. We have consistently found over the last five years of litigation that our Vendor Drug Program in Texas is one of the best, if not the best, program in the country. Texas is the only state thus far to require drug companies to report and certify their prices directly to our Medicaid administrators. This distinguishes Texas from all other Medicaid programs, which derive their pricing information from third party publishing services like First Data Bank. In addition, as you heard, Texas was the first state to move from **AWP** based reimbursement to **wholesaler cost** and the first to differentiate payments to chain pharmacies. In addition to these efforts, our Texas Program continues to search for new ways to improve. They have passed a law requiring drug companies to report their **AMP** to Texas Medicaid, and they intend to use the AMP as another benchmark for comparison with the prices reported by manufacturers. Unfortunately, to date, only 16% of manufacturers are reporting their AMPs.

Despite our efforts, some unscrupulous manufacturers continue to devise ways to defraud Texas Medicaid, and we are doing everything in our power to bring those companies to justice. Our current Texas Attorney General, Greg Abbott, has committed the resources of the agency to these efforts. Through his leadership and vision, we have obtained the funding to increase our staffing to 8 lawyers plus support staff. With this

additional staffing, we will be pursuing every manufacturer that we find has engaged in this type of activity.

I would like to make clear that, while Texas is pleased to have recovered significant sums of money in these qui tam cases, litigation is not the most efficient way to run this system. The Texas VDP has been required to spend thousands of man hours responding to discovery requests and preparing for and attending depositions in our litigation. The program could have used our hard earned tax dollars to provide more and better services if VDP personnel were not tied up in litigation caused by manufacturers who game the system. In addition, without the help of relators like Ven-A-Care, who took great personal and financial risks to present their allegations, we would not have been able to obtain the significant recoveries in the Dey and Schering. We hope that you will ensure that, in whatever system implemented in the future by Congress, the States and the Department of Justice continue to have laws with strong penalties to force compliance.

My time is about up. Thank you for your attention. I am happy to answer any questions.