

BEFORE THE
MARYLAND STATE BOARD OF CONTRACT APPEALS

In The Appeals of)
Catalyst, Rx)
) Docket Nos. MSBCA 2759,
) 2762, 2768, 2780, and 2784
Under)
DBM Solicitation)
No. F10B0400006)

APPEARANCE FOR APPELLANT: Kenneth B. Weckstein
Michael D. Maloney
Tammy Hopkins
Brown Rudnick, LLP
Washington, D.C.

Philip M. Andrews
Sheila R. Gibbs
Kramon & Graham, P.A.
Baltimore, Maryland

APPEARANCE FOR RESPONDENT: Mary Beth Collins
Sharon Stanley Street
Assistant Attorneys General
Baltimore, Maryland

APPEARANCE FOR INTERESTED PARTY: James F. Monafo
Express Scripts, Inc. Urmila P. Paranjpe
Husch Blackwell, LLP
St. Louis, Missouri

Scott A. Livingston
Michael Miller
Rifkin, Livingston, Levitan &
Silver, LLC
Bethesda, Maryland

OPINION BY BOARD MEMBER DEMBROW

These consolidated protests are presented to the Maryland State Board of Contract Appeals (Board) by a provider of pharmacy benefit management services which currently serves as the State's

incumbent contractor for those services. In this procurement, appellant is ranked as the superior offeror in its technical proposal submission and protests the decision by the Department of Budget Management (DBM) to recommend to the Board of Public Works (BPW) award of this five-year multi-billion dollar contract to a competing firm ranked second technically but lower in cost. In the absence of evidence that DBM's evaluation was arbitrary, capricious or otherwise unlawful, these appeals must be denied.

Findings of Fact

Background

1. On December 8, 2009 DBM issued a certain Request for Proposals (RFP) entitled "Pharmacy Benefits Plan Management Services and Pharmacy Purchasing Pool Management" and known as DBM Solicitation No. F10B0400006, to select and procure a Pharmacy Benefits Management (PBM) company for the purpose of providing certain specified pharmaceutical purchasing services for state employees and other eligible participants enrolled in the State's pharmacy coverage program. (Joint Ex. 11.) The instant procurement follows a similar State RFP to select a PBM in 2005-06, which was also the subject of protests, namely, Caremark PCS, MSBCA Nos. 2544, 2548, and 2568. Like the prior PBM contract ultimately awarded to Catalyst, Rx (Catalyst), which is the appellant here, a principal goal of the current contested procurement is to assure that the cost of pharmaceuticals incurred by the State is limited to reimbursement to the PBM of its actual costs for drug acquisition, without further mark-up, except for the State's responsibility to remit a pre-set monthly administrative fee based on the total number of participating members enrolled in the State pharmacy coverage program and related utilization factors. (*Id.*)
2. The instant procurement is not a competitive sealed bid, by

which the proposer offering the technically acceptable low cost is awarded the contract. Instead, the RFP here in dispute is a competitive sealed proposal, by which the State is allowed and obliged to assess the value to the State of each qualified competing offer. (Tr. 156-159.)

3. In addition, the agreement arising from this procurement is not a fixed price contract, but instead, a contract based on cost reimbursement plus a flat per unit fixed fee for future indefinite quantities that are presently estimated but unknown with precision. (See Code of Maryland Regulations (COMAR) 21.06.03.02-21.06.03.03.)(Tr. 461.)
4. Consistent with the State's post-award contractual payment obligations to the selected vendor, the RFP contains a financial model which classifies calculation of the State's liabilities to its PBM into four separate pricing categories: (1) administrative fees, (2) dispensing fees, (3) ingredient costs, and (4) rebates. (Catalyst Ex. 11, 20, RFP Attachment K-4; Tr. 179-180.)
5. The administrative fee consists primarily of a fixed amount assessed on the basis of a per member per month (PMPM) charge imposed upon the State by the PBM, as well as the option for the offeror to propose additional administrative fees for paper claims, drug utilization review (DUR), and variable charges for Medicare claims support, depending on whether the eligible participant is enrolled in Part D. (Catalyst Ex. 11, 20, K-4, lines 1-5.) The collective administrative fees itemized in this first category of costs are intended by the State to constitute the sole profit component of the State's payments to its PBM and the only payment not directly related to reimbursement of out-of-pocket expenses incurred by the PBM to purchase drugs, fill prescriptions, and otherwise to fulfill its contract obligations. (Catalyst Ex. 1, pg. 4.)

6. The second category of payments, dispensing fees, represents the maximum negotiated average overall charges paid to retail pharmacies by the PBM to fill brand or generic prescriptions at retail pharmacy locations. (Tr. 1019-20.) This category also includes less frequently incurred charges for filling of specialty prescriptions as well as mail orders. Offerors commit by the contract terms to receive reimbursement from the State for no more than the prescribed maximum fee per prescription filled. Imposing reduced dispensing fees upon retail pharmacies creates a risk of network disruption, which the State addresses by a separate contract provision requiring the PBM to assure the availability of a retail location within reasonably close proximity to the home of virtually all participants, as more specifically set forth below. (Tr. 189-191.)
7. The lion's share of the total contract cost for PBM services falls into the third pricing category, namely, ingredient costs, and for this preeminent pricing factor, the PBM promises to pass along to the State whatever variable future ingredient costs are borne by the PBM for its wholesale volume prescription purchases, without adding any incremental charges of any nature or source. (Tr. 1075, 1093.) This huge portion of the total contract cost is not pre-determined in amount, but instead, is established by the PBM's offer to the State expressed as a guaranteed minimum percentage discount from the published average wholesale prices (AWP) of individual drugs as set forth in a recognized verifiable pricing list published by an independent authority. (Catalyst Ex. 11, 20, K-4, lines 10-13.)
8. Finally, the PBM is obligated to credit or refund to the State all rebates it receives for all of its purchases made for persons covered by the State's pharmacy plan, this

deduction constituting the fourth element of the PBM pricing structure set forth in this procurement. (Catalyst Ex. 11, 20, K-4, lines 14-17.)

9. Attachment J-4 to the RFP sets forth a total of more than 100 separate administrative requirements (AR) of contract performance, for which each proposer must respond by designating the option of "agree" or "disagree." Each response of "disagree" thereafter requires the proposer to make explanation on the Deviations Page provided for that purpose and included in the RFP as Attachment J-14. (Catalyst Ex. 1, pg. 30; Catalyst Ex. 2, pgs. 1-12; Tr. 602.) The opening sentence of the response page memorializing the proposer's agreement or deviation from each administrative requirement is, "Representations made by the Offeror in this proposal become contractual obligations that must be met during the contract term." (Catalyst Ex. 10.)
10. Among the many administrative requirements set forth in the AR Section of the RFP is the central component of the prescription coverage program, namely, AR-76, stating: "The Contractor will promptly process and fill all prescriptions submitted by the State's plan members." (Catalyst Ex. 2, pg. 7; Tr. 631, 1079.)
11. Unlike the AR Section of the RFP response proposal format, the Question Section (Q-1 thru Q-129) does not allow a one-word response of "agree" or "disagree" but instead requires explanatory narrative response to over 100 particular inquiries. (Catalyst Ex. 11.)
12. The original December 8, 2009 RFP was modified by five amendments promulgated between January 8 and February 19, 2010. Responsive proposals were due March 12, 2010.
13. Five firms submitted timely responses to the subject RFP, but two of them were determined early in the evaluation

process to be not reasonably susceptible for award, leaving only three proposals for full evaluation. One of the five original proposals was rejected for failure to comply with the minority business enterprise (MBE) requirements of the RFP and the other for failure to identify a certified third party administrator (TPA) as required by the minimum qualification conditions set forth in the RFP. (Tr. 243-245, 669-670.)

14. Two of the three offerors submitting responses to the subject RFP deemed reasonably susceptible for award were appellant Catalyst and interested party Express Scripts, Inc. (ESI). Catalyst is a Maryland-based firm, while ESI has its principal offices based in Missouri. A third offeror, Envision Rx, was initially deemed qualified and thereafter fully evaluated along with Catalyst and ESI, but ultimately ranked third in both the technical and financial phases of proposal evaluation, so its proposal is not pertinent to the instant appeals.
15. To refine and clarify the offers, individualized cure letters were developed by the Evaluation Committee and directed to offerors by DBM on June 22 and August 16, 2010.
16. Best and Final Offers (BAFOs) are expressly permitted by the RFP and ultimately the State solicited and received two BAFOs from both ESI and Catalyst, the first on October 1, and the final on November 4, 2010. (Catalyst Ex. 1, pg. 38; Tr. 173.)

Requirement of Private Review Agent (PRA)

17. The definitions section of the RFP states, "jj. **Offeror** means a vendor who responds to the RFP by submitting a proposal to provide the requested services." (Joint Ex. 11, pg. 7; Catalyst Ex. 1, pg. 7.)
18. Members of the Evaluation Committee were provided with written instructions entitled "How to Determine Whether to

Consider an Offeror for an Award," which states: "A 'Qualified Offeror,' as described in the Code of Maryland Regulations (COMAR) 21.05.03(C)(1), is one that is responsible and that has submitted a proposal that initially was classified by the procurement officer as being reasonably susceptible of being selected for award." (Catalyst Ex. 8, pg. 7.) COMAR 21.05.03.03(C)(1) provides:

The term 'qualified offerors' includes only those responsible offerors that submitted proposals initially classified by the procurement officer as reasonably susceptible of being selected for award. The term does not include those offerors that submitted proposals not reasonably susceptible of being selected for award or that are not deemed responsible. (Tr. 601.)

19. Section 2 of the RFP requires that:

Qualified Offerors must provide proof of registration and/or certification as required by the following State laws:

- (a) Certification as a private review agent under Md. Ann. Code, Insurance Art., Title 15, subtitle 10B;
- (b) Registration as a third party administrator of a group health plan under Md. Ann. Code, Insurance Art., Title 18, subtitle 3; and
- (c) Registration as a Pharmacy Benefits Manager under Md. Ann. Code, Insurance Art., Title 15, subtitle 16 and the required disclosure report as described in Md. Ann. Code, Insurance Art. § 15-1623.

Please refer to Attachment J-1: Minimum Requirements, in the Excel portion of this RFP. The minimum qualifications that relate to the Offeror's experience must be met by the Offeror itself (i.e. the legal entity); the experience of various personnel while with other employers or organizations may not be considered in determining whether a minimum qualification is met." (Catalyst Ex. 1, pg. 20.)

20. The function of a private review agent (PRA) is to conduct drug utilization review (DUR). (Tr. 704.)
21. The Procurement Officer explains DBM's rationale for setting forth the registration and certification requirements of the RFP as follows: "The intention was to meet the law, and the law required certain certifications, certain registrations in order to do business in Maryland as a PBM. We did not intend to go beyond the law. We did not intend to restrict the law in any way. It was just - the intention was to follow what the law required." (Tr. 700-701.) And later, "We meant that they had to meet the Maryland Annotated Code Insurance Article. That was our intention. We did not intend them to have any requirement beyond that, and so we stated, 'as required by the following state laws.'" (Tr. 705.)
22. At the pre-proposal conference conducted for this procurement on December 17, 2009, more than 30 individuals were in attendance when a representative of one prospective offeror inquired, "You're saying that all qualified offerors will have to have Maryland PBM registration, Maryland TPA registration and private review agent certification in place by the time of the bid submission?" The procurement officer answered directly, stating, "Correct." (Catalyst Ex. 101, pg. 71; Tr. 594, 941.)
23. During the question and answer phase of the procurement process prior to the proposal due date, DBM also stated, "Maryland Insurance Article, Sections 15-10B-10 *et seq.* apply to PBM/PBAs that conduct utilization review and require the PBM/PBA to hold certain certifications as a private review agent. The prior authorization and step therapy reviews and determinations required as part of the administration services for this RFP fall within the statutory definition of utilization review." (Catalyst Ex.

4, pg. 6.) Also as a part of this pre-proposal process of clarifying the RFP requirements by responding to questions from prospective offerors, DBM stated in response to Question Nos. 9 and 10 that by virtue of certain obligations stated in the RFP, "the State wishes to engage more stringent reporting requirements" than those minimum requirements established by law or regulation. (Catalyst Ex. 4, pg. 4.) In response to Question No. 15 pertaining to requisite certification as a PRA for DUR, DBM reiterated the statutory requirement of PBMs and prescription benefit administrators (PBAs) to hold PRA certification. (Catalyst Ex. 4, pg. 6.)

24. One of the amendments to the RFP repeats the requirement of eligible offerors to hold certification as a PBM, TPA, and PRA, stating, "The Offeror must demonstrate the following minimum qualifications as of the date of submission of the proposal," but thereafter permitted offerors to obtain and provide PRA certification from the Maryland Insurance Administration (MIA) within ten (10) days following recommendation for award. (Catalyst Ex. 6, pg. 2; Tr. 592-596.)
25. Strictly construing the above cited minimum requirements of the RFP, appellant argues that the offeror itself must hold PRA certification in order to be eligible for contract award. (ESI Ex. 1; Tr. 603-604, 919-948.) On the other hand, ESI joins the State in arguing that an otherwise qualified offeror is free by the terms of the RFP to engage a separate entity to fulfill the PRA service requirements of the contract. (Tr. 699-705, 1082-1083.)
26. Maryland law provides that a PRA which is a PBM must be examined by the MIA at least once every three (3) years, while a PRA which is not a PBM is subject to examination by the MIA only once every five (5) years, if the MIA considers

- it advisable. (Md. Insurance Code Ann. § 15-10B-19, *cf.* § 15-10B-20.) (Tr. 597.)
27. ESI's response to the RFP stated "Yes" in response to the minimum requirement of PRA certification. (Catalyst Ex. 10, Attachment J-1.) But in fact, ESI is certified as a PBM and a TPA but not as a PRA because it relies upon a separate corporate entity, namely, Express Scripts Utilization Management Co. (ESUMC), for ESI's PRA services. (Joint Ex. 9; Catalyst Ex. 116, 117; ESI Ex. 92, 107.)
 28. PBMs routinely use affiliated corporations and wholly owned subsidiaries to perform designated elements of PBM contract requirements. This is true of both ESI and Catalyst. Catalyst, for example, uses a wholly owned subsidiary known as Immediate Pharmaceutical Services, Inc., based in Ohio, to handle its pharmaceutical mail order business, including for the PBM mail order services solicited by this procurement. (Joint Ex. 47; ESI Ex. 41, pg. 29, Q-50; Tr. 122-123, 871-875.)
 29. ESI's 2008 Annual Report states, "Because of increased regulatory requirements on some of our managed care clients affecting prior authorization of drugs before coverage is approved, we have obtained utilization review licenses in selected states through our subsidiary, ESI Utilization Management Company." (Catalyst Ex. 10, bates No. 155.) This reference is apparently simply a misnomer of ESUMC. On November 17, 2008 the MIA awarded to "Express Scripts Utilization Management Co." two-year certification as a PRA. (Catalyst Ex. 10, bates no. 333; Tr. 926.) ESUMC is a wholly owned subsidiary of ESI. (ESI Ex. 107; Tr. 930.)
 30. Throughout the time of proposal evaluation neither the Procurement Officer nor the Evaluation Committee realized that ESI is not itself a PRA, though after the recommendation for award the Procurement Officer determined

that ESI's designation of its wholly owned subsidiary, ESUMC, as its PRA was sufficient to comply with the minimum requirements of the RFP. (Tr. 864-868, 921, 1068.)

31. The procurement officer testified, "an offeror or vendor could use an affiliate or subsidiary to perform the role of the private review agent." (Tr. 861.) In addition, according to the testimony of the Procurement Officer, offerors are free to subcontract to other entities various aspects of contract performance, and both Catalyst and ESI proposed to use subcontractors and/or wholly owned subsidiaries to perform parts of the contract work. (ESI Ex. 48; Tr. 707-709.)

Cost-Savings Associated with Generics

32. Prescription drugs may be classified into three (3) tiers for purposes of assessing the amount of the purchaser's co-payment, namely: generic, preferred brand, and non-preferred brand. The co-pay and the actual cost of medication increase for each tier, respectively. (Tr. 141-143.) Under the terms of the instant procurement, the amount of the co-payment required to be paid by the customer directly to the pharmacy is determined by the State, with current co-pays said to be set at \$25 and \$40, for a \$15 differential between preferred and non-preferred drug tiers. (Tr. 82.)
33. Use of generics is promoted as a cost-savings measure by affording to customers the option of no co-pay or a lower co-payment for generic than for brand name drugs. The average total cost of a single 30-day prescription of generic drugs is about \$30-35, compared to about \$270-300 for brand name drugs comprising the same essential chemical components. (Tr. 46, 83.)
34. Under the Maryland pharmacy coverage program, the State bears the actual cost of prescription medications over the co-payment remitted by the customer, up to the maximum

allowable cost (MAC), which is what the pharmacy is paid by the PBM to be thereafter reimbursed by the State. By way of illustration, assuming a cost difference of \$240 passed on to the State in excess of customer co-pay to fill a single month's prescription of a brand name drug in comparison to the cost of equivalent ingredients included in a month's supply of a generic form of the same drug, the State assumes that \$240 cost for each covered participant for each month for each drug that is purchased as a brand name rather than a generic, generating on the average literally thousands of dollars in unnecessary liability assumed by the State for each prescription so filled each year for each covered participant in the plan. (Tr. 147.)

35. Roughly speaking, each 1% increase in use of generics translates into a savings of about 1% in total PBM costs. (Tr. 57.) Typically, less than 3% of customers prefer to purchase a brand name when a generic is available as an alternative at a lower out-of-pocket cost. (Tr. 100.) However, because the Maryland pharmacy program places an annual limit on each member's total out-of-pocket prescription costs, there is less incentive for those persons to switch to generics once they have reached the total yearly maximum out-of-pocket expense. (Tr. 110-111, 131-132.) In addition, if a prescription is expressly restricted by the prescriber as "DAW," (dispense as written), substitution of a generic for a brand name is prohibited. (Tr. 102.)
36. Because drug ingredient costs are passed through to the State in their entirety except for the customer's co-pay, this RFP prevents the net profit or loss incurred by a PBM to be affected by whether prescriptions are filled by brand name or generic drugs. (Tr. 103-104.) As a result, the PBM's bottom line is unaffected by the degree to which

- prescriptions are filled using brand names or generics.
37. By contrast, increased use of generics in place of brand name drugs is directly correlated to significant cost savings to the State. Therefore each proposer's formulary analysis is an important feature of each proposal. (Tr. 145, 169.) DBM's consultants analyzed the formulary information submitted by the offerors and determined, "Catalyst has the highest percentage ... for Generic medications, theoretically resulting overall in lower medication costs," stating also, "the lowest % of Generic medications is ... for Express Scripts" while "Express Script's percentage of Non-Preferred Brand ... is significantly higher" and concluding, "Overall, Catalyst's Formulary Tier distribution is most advantageous to the State." (Catalyst Ex. 82, bates 5725.)
 38. Catalyst's original proposal claimed that its formulary classified more than twice as many of its listed drugs as generic than ESI's formulary. Later Catalyst was asked to submit its formulary using a different format; and by supplemental information submitted to DBM on July 14, 2010, Catalyst's percentage of generic drugs was lowered to a proportion comparable to but still slightly higher than ESI's formulary classification of pharmaceuticals. (Joint Ex. 61, bates 101; Catalyst Ex. 17, pg. 1; Catalyst Ex. 82; DBM Ex. 2; ESI Ex. 49, Tr. 311-327, 679-688, 797.) The dueling percentages here discussed pertain to portions of all of the drugs listed on each PBM's formulary, as contrasted to the percentage volume of those listed drugs that are actually prescribed and dispensed.
 39. Q-28 of the RFP requires offerors to disclose generic dispensing rates (GDR) from their books of business in fiscal year 2009, for which the difference in GDR between ESI and Catalyst is barely more than a percentage point,

each claiming a GDR of about two-thirds (2/3). (ESI Ex. 16, pg. 5; ESI Ex. 41, pg. 24; Tr. 111.)

40. Single source generics are those medications which may have recently come off of patent exclusivity under a brand name, and are therefore eligible for lawful manufacture by anyone, but for which in actual practice only a single manufacturer has yet entered the market. Single source generics are required by the RFP to be classified as generics. (Joint Ex. 38, pg. 1, item 2; Tr. 309.)
41. AR-88(c) states, "The contractor will provide a Generic Dispensing Rate guarantee including any requirements to the State, including the measurement protocol, and the results of performance relative to the performance guarantee." (Catalyst Ex. 10, bates 50.) In response, Catalyst offers to DBM a Generic Utilization Savings Guarantee, by which Catalyst promises to increase generic utilization by stepped increases during the course of the contract, amounting to a total increase of 6.9% over base generic utilization at the inception of the new contract, with an annual maximum penalty of \$2 million per year assessed "on a proportional basis by market share based upon utilization for each full one tenth percentage point (0.1%) below the respective year's guarantee target." This guarantee, however, is made conditional upon several factors, including the maintenance of a co-pay differential of at least \$10 in direct customer co-pay cost between generic and second tier prescriptions, as well as the actual future timely release from patent exclusivity of brand names anticipated to be released for generic manufacture during the contract term. (Catalyst Ex. 20, final page; Tr. 54-55, 70-72, 106-109, 342-354.) Catalyst proposes to meet its guaranteed targets of increased generic dispensing rate (GDR) by "educating" prescribers and through its step therapy program (STP).

(Tr. 50-51, 79, 87-88.) By contrast, ESI's proposal does not include any guarantee of increased use of generics, but does offer a variety of initiatives intended to accomplish the same goal, including its programs known as "Physician Report Card," "Formulary Rapid Response," and "RxSavings Select." (Tr. 125-128, 732-734, 747.)

Brand/Generic Algorithm (BGA)

42. At the time of DBM's evaluation of these PBM proposals, at least two private firms, MediSpan and First DataBank, offered tools used by PBMs to determine drug cost category. Catalyst used MediSpan, which classifies medications into one of four classes according to the acronym, M-O-N-Y: multi-source (M), originator (O), single source (N), and generic (Y), which includes single source generics. Under this method, "Y" indicates a generic while all other designations are non-generic. (Tr. 60-61, 112-114, 128-129.) First DataBank, which was used by ESI, offers a similar drug classification service to PBMs, though it is not quite as simplistic as MediSpan's MONY designation system, as a result of which ESI and other PBMs that rely upon First DataBank instead of MediSpan employ a secondary classification mechanism to categorize those rare drugs that are not easily and consistently determined to be either generic or non-generic. (Tr. 63.) It is to resolve those unusual discrepancies that ESI's proprietary brand/generic algorithm (BGA) is employed. (Tr. 66.)
43. As a part of its initial proposal to DBM on March 12, 2010, ESI described its proposed BGA as follows:

Brand/Generic Classifications - Prescription drugs may be classified as either a "brand" or "generic;" however, the reference to a drug by its chemical name does not necessarily mean that the product is recognized as a generic for adjudication, pricing or copay purposes. ESI distinguishes brands and generics through a proprietary

algorithm ("BGA") that uses certain published elements provided by First DataBank (FDB) including price indicators, Generic indicator, Generic Manufacturer Indicator, Generic Name Drug Indicator, Innovator, Drug Class and ANDA. The BGA uses these data elements in a hierarchical process to categorize the products as brand or generic. The BGA also has processes to resolve discrepancies and prevent "flipping" between brand and generic status due to price fluctuations and marketplace availability changes. The elements listed above and sources are subject to change based on the availability of the specific field. Updated summaries of the BGA are available upon request." (Catalyst Ex. 11.)

44. ESI's above proposal in response to the RFP was initially deemed unacceptable by DBM due to ESI's reliance on its proprietary algorithm developed and used by ESI to classify drugs as brand vs. generic. This fault was relayed to ESI by DBM's first cure letter to ESI dated June 22, 2010. (Joint Ex. 24; Catalyst Ex. 10, bates 14201; Tr. 400-406.)
45. Specifically, because DBM initially regarded ESI's proposed use of its above-described proprietary BGA as an unacceptable deviation from contract requirements, the Procurement Officer advised ESI:

2. **Non-Compliance.** **Q-13(a):** The State considers the use of a "proprietary algorithm" to re-classify each drug as either Brand or Generic to be an exception to the RFP. Further, the response attachment provided to the State in response to this item appears to be a "standard" document, and does not appear to be customized to the specific proposal for the State. **Remedy:** Please amend your technical proposal accordingly, removing the use of the "proprietary algorithm" and customizing the description of each revenue source for this specific proposal. Express Scripts will have the opportunity to revise its financial

proposal, if necessary, during the Best and Final Offer phase of this procurement process. Keep in mind that the response to this question needs to be consistent with the response to Q-129. As part of your response, please note and take into account RFP §3.4.1.1 and its requirements. (Joint Ex. 26, pg. 6.)

On July 2, 2010, ESI responded to DBM's concern over its BGA as follows:

Express Scripts has updated Response Attachment J-5: Revenue Sources as requested by the State because the Brand-Generic Algorithm is not a revenue source. We note, however, that every PBM uses a proprietary algorithm to determine the brand or generic status of each drug. Neither First DataBank nor MediSpan, which are the leading sources for drug pricing and classification information, and which are used by most or all major PBMs and other pharmacy claims processors, have a single indicator for the Brand-Generic status of each drug....

In general, most PBMs reach the same status results for the vast majority of drugs. When we receive claims data with Brand-Generic status indicator on each claim from other PBMs as a result of taking on a new client or when provided with an RFP, we usually find differences in the way we would calculate the status would affect only a few tenths of a percent of total claims. (Joint Ex. 26, pgs. 6-7.)

46. DBM's subsequent cure letter dated August 24, 2010 states:

7. Supplement and Clarify. Attachment J5: Questionnaire. Q-13(a): The State considers the use of a "proprietary algorithm" to re-classify each drug as either Brand or Generic discussed in Express Scripts' response to the June 22, 2010 cure letter to be an exception to the RFP. However, during its oral presentation, Express Scripts asserted that a methodology could be provided that

would make this process transparent for the purposes of proving that classifications of drugs have not been manipulated for the purposes of increasing revenue to the PBM. Remedy: Please amend Express Scripts' technical proposal accordingly, including written confirmation of the details of what will be provided to the State and/or its designated representative to ensure the ability to thoroughly audit this process. Understanding that utilization of this algorithm may allow Express Scripts to change the classification of a drug at any time (even making changes on a daily basis), please ensure that any methodology and audit process provided will be adequate to independently ensure the State that Express Scripts is not manipulating drug classifications in order to increase its revenue or profit. (Catalyst Ex. 11.)

ESI responded on October 8, 2010 as follows:

Express Scripts has provided the current Brand-Generic Algorithm (BGA) as **Exhibit 1** and will give the State online access to the claims processing system so it can see the brand-generic (B-G) status of every NDC (along with every other pricing element of every claim) and will advise the State if there are changes in the BGA itself (e.g., if First DataBank (FDB) changes the data elements available as it has done in the past). To help assure you of the validity of our BGA process, we suggest that the State periodically select a sample of NDCs from the State's utilization which we can review with the State to explain how we determined the B-G status. Our license from FDB prohibits us from making our FDB file available to clients directly, but we think the State's consultants have access to the FDB files which have the data elements we use to apply the BGA.

If there are other ways in which Express Scripts can reassure the State, we would be happy to discuss them. We also note:

- The BGA is not a revenue source for Express Scripts. It defines an NDC's B-G status in our claim processing system. The B-G status is separate from pricing.
- We are providing pass-through pricing at retail so we cannot make a profit on any retail drugs regardless of B-G status.

We think the fact that every PBM must make a proprietary determination of B-G status while we, apparently, are the only PBM that actually discloses this instead of just agreeing to an impossible requirement speaks strongly to our desire to be as open as possible and to demonstrate the highest level of integrity in all our dealings with the State. We will continue demonstrating this integrity, which is a core "Express Way Value," throughout the term of our contract. (Catalyst Ex. 11)

Ultimately, after discussion, the Evaluation Committee was satisfied with ESI's proposed use of its own proprietary BGA based in part upon ESI's assertion that its BGA would be employed to classify only a miniscule number of the pharmaceuticals contained in its formulary, estimated by ESI and confirmed by GRS to be in the range of one-tenth of one percent (1/10%), though there is no written record of the independent analysis performed by Gabriel, Roeder, Smith & Co. (GRS). (Tr. 406-408, 1033-1034.) Other factors influencing the Committee's ultimate decision to allow ESI's proposed proprietary BGA include ESI's arguments that every PBM must use some form of BGA to classify drugs and because brand/generic classification is not a revenue source to the PBM, as well as upon the verification assurance offered by ESI to allow DBM to audit ESI's BGA. (Joint Ex. 29; Tr. 378-380, 406-410, 425-429, 624, 809-823, 1034.)

Evaluation Process

47. Sec. 5.5.3 of the RFP summarizes the objective of the

evaluation process stating, "the Procurement Officer will recommend award of the contract to the responsible Offeror whose proposal is determined to be the most advantageous to the State considering technical evaluation factors and price factors as set forth in this RFP. In making the most advantageous Offeror determination, technical factors will be given equal weight with price factors." (Catalyst Ex. 1, pg. 38; Tr. 155, 171, 177, 305, 331, 462-464.) The Procurement Officer relied upon the work of the Evaluation Committee, which consisted of four persons, all of whom were also advised by GRS, retained by DBM as independent expert PBM consultants.

48. Each of the four members of the Evaluation Committee was provided with an unofficial written form DBM guideline for proposal evaluation entitled "Instructions to an Evaluation Committee." Those Instructions include the following advice and recommendations:

Make all substantive comments in writing on the Evaluation Sheets. These comments are official documents and become part of the procurement record....

Normally, evaluators should not make comments in the offerors' proposal documents themselves; however, evaluators may highlight passages or make short comments identifying pertinent passages for future reference ... Note that usually the evaluator's copies of the proposal should be returned to the procurement officer by the time that the contract is awarded and should be destroyed. Only the originals will be made a part of the procurement record.

The "Instructions" also summarize the mission of the Evaluation Committee as follows:

13. Bottom Line: Value To The State! The key factor in determining which offeror is finally selected as being the most

advantageous offeror is worth or value. The general procedure in doing this depends upon the relative importance of technical and financial factors in the overall award determination. (Joint Ex. 57, pg. 5; Catalyst Ex. 8, pg. 5, emphasis in original.)

49. COMAR 25.05.01.07 requires record-keeping, stating:

The procurement file on each procurement ... shall include:

A. A record of all inquiries required to be recorded....;

B. A listing of every bidder or offeror solicited;

C. All bids or offers received;

D. All internal and external correspondence regarding the procurement;

E. Written documentation from the procurement officer describing efforts to confirm the information in the affidavits submitted by the successful bidder or offeror, including, at a minimum, verification that the business has not been suspended or debarred by the State or federal government; and

F. The final contract.

50. The RFP set forth six criteria to be applied to the technical evaluations of proposals, along with sub-factors "listed in descending order of importance" as follows:

A. Administrative Capabilities, including, but not limited to:

- Experience and past performance
- Claims payment
- Transparency reporting and disclosure
- Member services
- Performance Guarantees
- Purchasing Pool management (including minimum plan size requirements, Purchasing Pool participant services, etc.)

B. Pharmacy network (retail, mail and specialty pharmacies networks), including but not limited to:

- Size of network
 - Network disruption
 - Network management and administration
- C. Clinical capabilities, including, but not limited to:
- Drug Utilization Review (DUR) Programs
 - Formulary management
- D. Implementation Plan and Account Management, including but not limited to:
- Account Management Team
 - Use and supervision of subcontractors
- E. Alternative Cost Management Programs
- F. Maryland Economic Impact

(Joint Ex. 11, pg. 36; Catalyst Ex. 1, pg. 36; Tr. 164-165.)

51. With respect to the process of evaluating proposals, the Procurement Officer publicly explained at the pre-proposal conference: "We don't use percentages or scoring. We don't assign points to any individual technical criteria. It's all subjective." (Joint Ex. 12, pg. 63, lines 6-8.) This is what was done by the Evaluation Committee when it ranked each proposal not with letter grading or assignment of numerical scoring values, but instead, only by ranking each proposal as first, second, or third. (Tr. 239, 878.)
52. The first substantive meeting of the Evaluation Committee to review and discuss the technical aspect of each proposal took place for a full day on April 22, 2010. (DBM Ex. 1; Tr. 673.)
53. Additional meetings and other critical dates for the Evaluation Committee over the nine month period of proposal evaluation are reflected by a small page of hand-written notes made by the Procurement Officer, which lists the following chronological order of activity:

3/26/10 - distribute proposals, instructions
to committee (Baltimore)
4/22/10 - technical evaluation (Baltimore)
5/18/10 - technical evaluation initial
rankings (Baltimore)
6/3/10 - prepare for orals (prepare
questions) (Baltimore)
7/8/10 - oral presentations (Baltimore)
8/30/10 - final technical evaluation meeting
(Baltimore)
9/22/10 - (phone conference) -
financials/BAFO discussion
10/19/10 - BAFO1 meeting (Baltimore)
11/19/10 - BAFO2 (phone conference)
(DBM Ex. 1.)

Minutes were not taken at the meetings of the Evaluation Committee, though the Procurement Officer made notes from time to time. (Tr. 447.) Notwithstanding the above recited provision in DBM's form "Instructions to an Evaluation Committee," not all evaluation sheets made by the individual members of the Evaluation Committee were turned over to the Procurement Officer as "official documents ... part of the procurement record." Instead, members' views were relayed orally at meetings and primary topics of verbal group discussion were memorialized by the Procurement Officer in his notes which are included as a part of the procurement record. (Tr. 497.)

54. According to the testimony of the Procurement Officer, by the conclusion of the evaluation on November 19, 2010, "everything submitted with the proposals was considered." (Tr. 374-375.)

Ranking - Technical

55. DBM's Evaluation Committee for its PBM proposal analysis relies heavily upon the private expert consulting services of GRS and its subcontractors, which attended each meeting of the Evaluation Committee and prepared for the Evaluation Committee an extensive report entitled "2010 Rx Technical Proposal Analysis" considered by the Evaluation Committee at

its first meeting on April 22, 2010. (Joint Ex. 22, bates 5625-5761; Tr. 142, 151, 674-677, 1001.) The April analysis was followed by a table captioned "Executive Summary of Technical Evaluation Criteria as of May 14, 2010." (Tr. 740.) That table noted strengths and weaknesses for both Catalyst and ESI in each of the criteria factors set forth in the RFP, except that no weakness was noted at that time for Catalyst for Criteria B (Pharmacy network), Criteria C (Clinical Capabilities), and Criteria D (Implementation Plan and Account Management); no weakness was noted for ESI for Criteria E (Alternative Cost Management Programs); and no strength was noted for Catalyst for Criteria E (Alternative Cost Management Programs) or Criteria F (Maryland Economic Impact). (ESI Ex. 128, bates 12557-12560.) The decision to continue an ongoing contract has no impact on the economic *status quo* of the State, but termination of such a contract may impact the state's economy. State agencies are directed to encourage offerors, "to be innovative in developing their proposals and to demonstrate how awarding the contract to them will provide economic benefits to the State of Maryland." (Joint Ex. 4.)

56. GRS also prepared an updated analysis of technical proposals following receipt of the second BAFOs and ultimately the Evaluation Committee ranked Catalyst ahead of ESI based in part on past performance, experience, absence of pharmacy disruption, account management, formulary management, administrative capability, and other strengths. (Joint Ex. 42; Tr. 274-301, 650-651, 997.)
57. As the incumbent provider of PBM services for the State of Maryland, Catalyst consistently met the performance guarantees established by the contract under which it is currently providing those services. (Catalyst Ex. 100.)
58. In its proposal for approval of a new five-year contract to

continue those services, Catalyst boasts: "Since the inception of the State of Maryland's relationship with Catalyst Rx in July 2007, your generic dispensing rate (GDR) has increased over 8.5% resulting in a savings of over \$45,000,000 (\$11.86 PMPM)." (Catalyst Ex. 13, pg. 1.)

59. Between 2007 and 2010, GDR for participants in the Maryland pharmacy plan rose significantly, the increased use of generics being attributable in large part to promotion of generics by Catalyst, but also due in part to expiration of patent exclusivity for some brand name drugs, and other factors not readily susceptible to quantification as to cause. (Joint Ex. 59, Tr. 42-47, 69, 73, 76.)
60. Catalyst's initiative to identify the State's top eight prescribers of brand name drugs and educate that handful of physicians on the cost savings associated with prescribing generics resulted in annual savings to the State of one million dollars. (Tr. 89.)
61. Catalyst claims that its contract performance and implemented initiatives have resulted in total cost savings to the State in an amount approaching \$100 million, caused by a combination of increased generic utilization, leveraged discounts through volume purchases, and optimization of rebates paid by pharmacy manufacturers. (Catalyst Ex. 21, pgs. 12, 25.)
62. Another strength attributed to Catalyst's proposal in response to the RFP is found in its offer to act as the State's full fiduciary with respect to all PBM services, obliging itself well beyond the minimum RFP requirement of serving as the State's fiduciary only with respect to DUR, and instead, expanding its voluntarily assumed duties to include all aspects of general fiduciary responsibility. (Catalyst Ex. 10, AR-80; Catalyst Ex. 13, pg. 3; Tr. 65, 389.) Catalyst emphasized this attribute at the oral

presentation of its proposal on July 8, 2010. (Catalyst Ex. 21, pg. 10.)

63. The Evaluation Committee completed its technical evaluation on August 30, 2010, determining to rank Catalyst's technical proposal ahead of ESI's because Catalyst was ranked ahead of ESI in five of the six categories of evaluation, while ESI ranked first in only one category and third, or last, in another category. Specifically, Catalyst was ranked first technically for administrative capabilities, pharmacy network, clinical capabilities, implementation plan/account management, and Maryland economic impact; and was ranked second technically for alternative cost management programs. By comparison, ESI was ranked first technically for alternative cost management programs, third for implementation plan/account management, and second in all other factors. (Catalyst Ex. 78, 80; Tr. 234-235, 996.) Evaluation sub-factors subsumed within the six aforementioned primary factors were considered but not separately ranked as first, second, or third. (Tr. 272.)

Performance Guarantees

64. Sec. 1.34 of the RFP sets forth certain performance guarantees which permit the State to assess liquidated damages for failure to achieve any one of multiple verifiable standards of satisfactory delivery of the PBM services required by the contract. (Catalyst Ex. No. 1, pg. 17; Tr. 166-168.)
65. The preface to Attachment J-12 of the RFP, the section of the RFP which establishes performance guarantees, states, "Representations made by the Offeror in this proposal become contractual obligations that must be met during the contract term."
66. The Instructions for Attachment J-12 are as follows:
As part of the effort toward continuous improvement in the services provided to

participants, the State of Maryland would like to implement performance standards with Contractors. Therefore, we would like you to propose guarantees using the following State specific definitions and measurements outline. The Offeror shall provide their organization's Proposed Amount at Risk using one of the following methodologies: 1) fixed dollar amount for each performance guarantee identified below, or 2) a fixed total annual amount at risk with the State able to allocate the total among each of the guarantees identified below. Offers [sic] should choose method 1) or method 2) but not both. In addition, the Offeror shall indicate their agreement to or deviation from the performance standard. (ESI Ex. 50; ESI Ex. 20; Catalyst Ex. 2, third pg. 1.)

67. "Clean scripts," more formally referred to as "non-protocol" prescriptions, are those for which no clarification is required because they are unambiguous and may be immediately filled. By contrast, "protocol" prescriptions are those for which some clarification is needed, usually by communication with the office of the prescribing physician. (Tr. 94-95, 350.) One of the performance guarantees set forth in the RFP requires the contractor to dispense all non-protocol prescriptions to be filled by mail within two business days after receipt, and to dispense or return all other prescriptions within three business days.
68. Rather than agreeing to this performance guarantee, ESI offers to DBM proposed deviations by which it seeks to reduce the threshold for imposition of liquidated damages from 100% to 95% for clean scripts required to be filled within two business days of receipt, 65% of protocol prescriptions within three business days, and 95% of protocol prescriptions within five business days. (Joint Ex. 32-34; ESI Ex. 35, pg. 17, Q-19, 20; Catalyst Ex. 11, Attachment J-12 & 14, PG-10; Catalyst Ex. 25, 26; Catalyst Ex. 48; Tr. 354-358, 503-504, 825-848, 1041.)

69. The Evaluation Committee allowed the aforementioned deviation requested by ESI but attributed a significant weakness to the ESI proposal because of its request to be allowed to depart from the standard of 100% compliance with the specified delivery deadlines set forth in the RFP for mail order prescriptions. (Tr. 209-211, Tr. 516-520.)
70. The amount of liquidated damages offered by ESI for violation of the foregoing performance guarantee for prompt mail house delivery is 20% of a total proposed amount at risk of \$3,050,000, or a maximum of \$610,000 per failure of performance guarantee per quarter. (ESI Ex. 20; Catalyst Ex. 11, Attachments J-12 & 14, PG-10.) By contrast, Catalyst offers liquidated damages capped at \$5,000 per occurrence per quarter. To summarize the disparate offers with respect to performance guarantees for late mailing of prescriptions, Catalyst offers a much lower penalty as liquidated damages in the event of breach, but agrees to allow that penalty to be assessed for any deviation from perfection, namely, filling and sending clean scripts within two business days of receipt. ESI on the other hand, consents to allow imposition of much higher liquidated damages, but they can be assessed only in the event of substantial departure from prompt compliance of timely mailing. Specifically, by the terms ESI's offer, 5% of mail order scripts, or 3,670 prescriptions per year, could be substantially delayed without recourse by the State by way of imposition of liquidated damages. (Catalyst Ex. 3, K-4, line 7; Catalyst Ex. 19, J-12, PG-10; Tr. 365, 1060.)
71. Included as Attachment A to the RFP is a general provision governing contract interpretation:
- If there is any conflict among the Exhibits,
the following order of precedence shall
determine the prevailing provision.

Exhibit A - The RFP, including addenda,

attachments and Excel worksheets.
Exhibit B - The Technical Proposal.
Exhibit C - The Financial Proposal.
Exhibit D - State Contract Affidavit
Addendum. (Tr. 649.)

Also included as a part of the same Attachment is another standard contractual provision on remedies, providing as follows:

4.3 In addition to any other available remedies, if, in the opinion of the Procurement Officer, the Contractor fails to perform in a satisfactory and timely manner, the Procurement Officer may refuse or limit approval of any invoice for payment, and may cause payments to the Contractor to be reduced or withheld until such time as the Contractor meets performance standards as established by the Procurement Officer. (Joint Ex. 11, pgs. 2, 3 of Attachment A.)

Privacy / Confidentiality

72. ESI's initial proposal in response to the RFP was deemed non-conforming to the State's prescribed AR-48, which states, "The Contractor will ensure that the State data will not be sold or shared with another organization without the prior written authorization of the State...." In particular, ESI sought permission to sell anonymous claims data, but the Evaluation Committee took that deviation request to the Secretary of DBM, who directed the Procurement Officer to demand that ESI withdraw and delete that proposed departure from RFP requirements, which ESI agreed to do. (Joint Ex. 25; Catalyst Ex. 10, bates 46, 1436; Catalyst Ex. 11, ESI 10/8/10 response to DBM 8/24/10 cure letter; Tr. 1000.)

Network Disruption

73. One of the performance guarantees set forth in the RFP requires each offeror to assure the availability of at least one participating retail pharmacy within 3 miles of at least

98% of members' home zip code for homes located in an urban area, within 5 miles of 98% of members' home zip code for homes located in a suburban area, and within 10 miles of 98% of members' home zip code for homes located in a rural area. (Joint Ex. 11, pg. 31; ESI Ex. 20, pg. 3.)

74. Among the important factors considered by the Evaluation Committee is the possibility of network disruption, that is, future failure or refusal of one or more pharmacies to enter into dispensing agreements with the State's PBM to permit beneficiaries of the State's pharmacy program to continue to make pharmacy purchases at retail locations currently servicing them. (Tr. 267-270.) Naturally, reducing the amount of the dispensing fees paid to retail pharmacies for filling prescriptions increases the risk of network disruption, should pharmacies refuse to fill prescriptions at lower rates. (Tr. 303, 508, 714-716, 853-860, 1015-1032.) This possibility was a continuing concern to the Evaluation Committee and therefore included in DBM's first cure letter to ESI dated June 22, 2010, to which ESI's initial response is criticized by Catalyst as being somewhat vague and evasive, essentially repeating the assurances it set forth in its original proposal. (Joint Ex. 24; Catalyst Ex. 10, bates 1421, 1433, Supplement No. B-9, Q-31.)
75. The explanation initially set forth in ESI's proposal in defense of DBM's concern to avoid network disruption is as follows:

Express Scripts' broad network currently has more than 61,700 participating pharmacies nationwide. By design, our broad network provides the State's participants with the greatest accessibility at a competitive price. All major pharmacy chains, Pharmacy Services Administration Organizations, and many independent pharmacies participate in this network. In addition any pharmacy that agrees to the rates, terms and conditions of the contract and meets the credentialing

requirement can be a part of this network. Within the broad network, 96.8% of participating locations in the state of Maryland and more than 90% nationwide are contracted to fill 90 day scripts. (Catalyst Ex. 11, pg. 5, Q-30.)

ESI further explained:

All national and major regional pharmacy chains and Pharmacy Services Administration Organizations participate in our broad network. Express Scripts' contracts create stable, nationwide networks. We developed our first retail pharmacy network in 1990 and have a long track record of network stability. In order to provide competitive pricing to our clients, Express Scripts prefers to guarantee access and/or minimum number of locations, rather than specific providers. We will provide proper notice of any major chain terminations. (Catalyst Ex. 11, pg. 6, Q-31.)

Later, on November 11, 2010, in its second and final BAFO, ESI embellished its assurances to DBM of the low likelihood of network disruption but marked its response as "CONFIDENTIAL TRADE SECRET INFORMATION" so the information set forth therein will not be repeated here. (ESI Ex. 130, bates no. 1447-1448.)

History of Deceptive Practices in the PBM Industry

76. Q-10 of the RFP requires each proposer to:

Describe any litigation and/or government action taken, proposed or pending against your company or any entities of your company during the most recent five (5) years. This information shall include notice whether the Offeror's organization has had its registration and/or certification suspended or revoked in any jurisdiction within the last 5 years, along with an explanation. (Catalyst Ex. 2, second pg. 2.)

ESI responded as follows:

Express Scripts is occasionally party to legal or administrative proceedings arising

out of the ordinary course of our business. We report significant legal proceedings in accordance with Securities and Exchange Commissions (SEC) rules in our 10-Q and 10-K filings.

You can access our SEC filings through the investor information link of our company website at www.express-scripts.com. A summary of the current status as reported in our most recent filings is attached as J-5b Appendix for Q-10. Quarterly Financials. (Supplemental Exhibit 2).

You can access our complete SEC filings through the Investor Information link of our company website at www.express-scripts.com. Express Scripts has not had any registration or certification suspended or revoked in any jurisdiction in the last 5 years. (Catalyst Ex. 10.)

Counsel for Catalyst characterizes the foregoing response as evasive of full production of the information solicited by the RFP, but on this point the Procurement Officer testified, "we did not have an issue with what was provided to us." (Tr. 523-527, 891.)

77. ESI's Form 10-K filed with the SEC discloses several lawsuits to which ESI was a party defendant as well as a civil investigative demand probing ESI's business practices. (Catalyst Ex. 10, bates nos. 381-383.) This was not known or considered by the Evaluation Committee prior to its recommendation for award because ESI's SEC 10-K was not attached to its proposal; but that public information is now being considered as a part of DBM's continued monitoring of ESI's responsibility for contract award and has not caused DBM to reverse its recommendation of award of the contract to ESI. (Tr. 692-693.)
78. ESI's SEC Form 10-K for the pertinent time period also discusses deceptive practices of other PBMs, noting:

There have been several *qui tam* actions filed

under the Federal False Claims Act, the Public Contractor Anti-Kickback Statute and similar state laws in various federal courts against several PBMs. The complaints allege, among other things, that such PBMs improperly favored the products of certain pharmaceutical manufacturers over less expensive products and engaged in improper mail order pharmacy practices.

For example, in October 2006, Medco Health Solutions entered into a \$155 million civil settlement of claims under both state and federal false claims statutes that it destroyed and canceled valid patient prescriptions, solicited kickbacks from pharmaceutical manufacturers to favor their drugs, and paid kickbacks to health plans to obtain business. Also, in September 2005, Caremark Inc. entered into a \$137 million civil settlement of claims under both state and federal false claims statutes that its subsidiary, AdvancePCS, allegedly solicited and received kickbacks from pharmaceutical manufacturers in the form of excessive administrative fees, over-priced services agreements as a reward for favorable formulary treatment, and improper flat fee rebates, and that AdvancePCS allegedly paid kickbacks to customers and potential customers to induce them to contract with AdvancePCS. Both Medco and Caremark agreed to enter into 5-year corporate integrity agreements with the federal government in connection with their respective settlements....

Most states have enacted consumer protection and deceptive trade laws that generally prohibit payments and other broad categories of conduct deemed harmful to consumers. These statutes may be enforced by states and/or private litigants. Such laws have been and continue to be the basis for investigations, prosecutions, and settlements of PBMs, initiated by state prosecutors as well as by private litigants.

For example, in February 2008, CVS Caremark Corporation agreed to a settlement with 28

states attorneys general for \$41 million to resolve allegations that CVS Caremark engaged in deceptive business practices by retaining the discounts and rebates obtained from switching patients to different brand-name prescription drugs.

We believe that we are in substantial compliance with the legal requirements imposed by such laws and regulations. However, no assurance can be given that we will not be subject to scrutiny or challenge under one of more of these laws, or under similar consumer protection theories. (ESI Ex. 83, pgs. 9, 12; Tr. 888.)

79. On May 27, 2008, ESI entered into a "Settlement Agreement and Assurance of Voluntary Compliance and Discontinuance" (AVC) with a number of Attorneys General, including the Maryland Attorney General, by which ESI agreed to pay to participating states \$9.5 million in damages and in which it is stated:

The Attorneys General contend that ESI may have engaged in or promoted some drug switches which may have resulted in additional medical costs to consumers or ESI's Client Plans, and that ESI did not reimburse consumers or Client Plans for these medical costs. The Attorneys General further contend that ESI engaged in drug switches on the grounds that such switches would result in cost savings to Client Plans and consumers when these switches may have actually involved little or no cost savings, before consideration of any rebates to the Client Plans. The Attorneys General contend that in certain instances switches were made to a more expensive drug on an Average Wholesale Price basis. The Attorneys General contend that ESI may have distributed literature and promotional materials which did not adequately disclose the extent to which the literature or promotional materials were funded by drug manufacturers. The Attorneys General also contend that ESI did not adequately define pricing terms used in its Client contracts, such as "rebate" and "MAC."

The Attorneys General also contend that ESI failed to adequately disclose that Phoenix Marketing Group, a subsidiary of ESI since 2002, provided sample fulfillment services to manufacturers for brand drugs which were not always on ESI's national formularies.

ESI denies that it has engaged in any wrongful or unlawful conduct. ESI does not admit any of the allegations in this AVC. (Joint Ex. 2; Catalyst Ex. 89.)

The aforementioned settlement of litigation was not specifically disclosed to DBM in ESI's proposal in response to this RFP except by reference to its SEC filings. (Tr. 528-534, 568.)

80. On July 25, 2008, ESI entered into a Consent Order in an action brought against it by the Attorney General of the State of New York in which ESI and other co-defendants agreed to pay to the State of New York \$27 million arising out of allegations that ESI inflated prices for generic drugs, diverted rebates which should have been paid to the State, and engaged in switching prescription medication without informing patients of the drug switch. (Joint Ex. 5; Catalyst Ex. 92, Tr. 536-541.)
81. Following the Evaluation Committee's recommendation of award of the PBM contract to ESI, and in anticipation of BPW questions about that recommendation, DBM solicited and received from ESI compliance letters evidencing ESI's satisfaction of the Court ordered liabilities described above. (Tr. 546, 563.)

Security

82. Of significant importance in developing PBM computer records systems is the necessity to protect them against the possibility of intrusion by security breach or other unauthorized release of personal private confidential medical information. As an attachment to its proposal in

- response to Q-102 of the RFP on this subject, ESI completed Appendix J-5A, setting forth a three-page explanation of the security design elements of its computerized records systems. (ESI Ex. 32.)
83. RFP Q-103 requests of each offeror: "Please identify and describe all breaches of HIPAA privacy and security provisions within the last 18 months." In response, ESI attached a disclosure identified as J-5, which divulges a certain criminal attempt in October 2008 by an unknown person to extort from ESI payment of monies to avert illegal disclosure of confidential information pertaining to ESI's member records. (Tr. 528, 549-560.)
84. A year and a half later, as of the date of ESI's RFP proposal submission to DBM on March 10, 2010, ESI claimed to be still "in the process of notifying these members and continues to offer identity restoration services provided by Kroll Fraud Solutions to anyone who suspects they are victims of identify theft as a result of the incident." (Catalyst Ex. 10, bates 617.)
85. ESI also states in another public disclosure document known as its Form 10-Q dated October 28, 2009: "We and/or our subsidiaries are defendants in a number of lawsuits" thereafter identifying three specific actions in addition to the nine lawsuits itemized in its prior 10-Q filing, and further stating, "in October of 2008 we received a letter from an unknown person or persons attempting to extort money from the company by threatening to expose millions of member records allegedly stolen from our system." (Joint Ex. 62; Catalyst Ex. 10, bates 1290.)
86. In response to concerns expressed by DBM to ESI regarding this security breach, ESI provided to the Evaluation Committee additional information about various design improvements to its security system. (ESI Ex. 33.)

Ultimately the Evaluation Committee was sufficiently impressed by ESI's remedial actions in response to the 2008 extortion attempt that the Evaluation Committee gave favorable credit to ESI for its upgraded security systems. (Tr. 882.)

87. By contrast, Catalyst's response to the RFP with respect to wrongful disclosure of protected health information (PHI) was simple and direct: "Catalyst Rx has not experienced any security breaches where PHI was obtained from our system in the last 18 months." (Catalyst Ex. 15, Response Attachment J-5.)

Ability to Audit (hereinafter also referred to as "auditability")

88. Central tenets of this RFP mandate pass-through pricing, pricing guarantees and pricing transparency. (Tr. 762.) The only compensation allowed to be received by the PBM for the performance of the contract at issue is that compensation which is paid to the PBM directly by the State. (Tr. 574, 639.) This is facilitated in part through Sec. 1.1.1.1 of the RFP which states:

The Contractor shall provide adequate reporting that conclusively verifies that the selected Contractor is disclosing any and all Manufacturer Payments and any **and all** other revenue attributable to PBM Services provided to State of Maryland, including revenue attributable to the Plan's membership, claims, formulary, market share, or drug utilization and including the contractor's receipt of any other revenue (including grants) from **any source** other than the administrative fees paid to it by the State. (Catalyst Ex. 1, pg. 4; emphasis in original.)

89. The RFP also provides:

4. Your offer for claims processed at retail pharmacies must provide complete "pass-through" pricing for all Maryland Rx Program Purchasing Pool Participants, including the State. In other words, you

pass directly to the State the contract prices you have negotiated with those pharmacies (i.e., you take no spread), which includes the benefit of "lowest-of-pricing logic"....

7. For the guaranteed minimum discount percentages off AWP: The AWP must be from one nationally recognized source like First DataBank or Medispan and be the one associated with the actual NDC-11 submitted by the pharmacy, and used to fill the prescription. (Catalyst Ex. 3, pgs. 1-2.)

90. Sec. 3.4.1.1 of the RFP further stipulates:

A. The contract shall be a transparent arrangement. The Contractor shall provide the State with reports and audit access to: (1) any and all data related to the State Plan and (2) data related to the Contractor's receipt of revenue, including any Manufacturer payments and/or other revenue streams received by the contractor that are directly or indirectly related to the State's Plan.... (Catalyst Ex. 1, pg. 23.)

Catalyst agreed to these contract requirements, stating in its offer, "we confirm." (ESI Ex. 45, bates no. 8026.)

91. Despite the aforementioned assurance, in the course of the evaluation it became evident to the Evaluation Committee that Catalyst was and is unable to authorize DBM to audit the amounts actually paid by pharmacy manufacturers to the next immediate drug purchaser in line as a supplier to Catalyst because Catalyst uses MedCo as its bulk purchase aggregator to combine volume acquisitions of drugs from the manufacturers. (Tr. 115, 765-774.)

92. Specifically, Catalyst employs a purchasing "consortium," using its wholly owned subsidiary, the Coalition for Advance Pharmacy Services (CAPS), to contract with its aggregator, a separate and independent company, MedCo, to make large-scale purchases from pharmaceutical manufacturers by combining Catalyst's purchases with purchases made by others.

Therefore Catalyst can and did offer to DBM the opportunity of auditing all contractual arrangements between Catalyst, CAPS, and MedCo, but was and is unable to authorize DBM to audit the contractual agreements between manufacturers and an entity not owned or controlled by Catalyst, namely, its aggregator, MedCo. The Evaluation Committee did not learn about this weakness in Catalyst's proposal with respect to DBM's capability of auditing pricing transparency until the BAFO phase of proposal evaluation. (Tr. 116-119, 960-986.)

93. By contrast, ESI contracts directly with drug manufacturers rather than using an independent aggregator, so ESI's costs are auditable all the way through the stream of commerce from the manufacturer to ESI's retail and mail order sales, while Catalyst's costs are auditable only from the point of acquisition from the manufacturers by MedCo. (Catalyst Ex. 118; ESI Ex. 56, 57.) This distinction in auditability of the two offers was not recognized by the Evaluation Committee until late in the evaluation process but ultimately caused the Committee to assign a weakness to the Catalyst proposal as compared to ESI's on this important point. (Tr. 439, 773-776, 785.)

94. Although DBM's auditability of ESI is superior to Catalyst for the reasons stated above, a separate component of auditability of ESI's proposal is criticized by Catalyst for proposing to charge pharmacies a "transaction fee." This potential for confusion arose as a result of the following series of communications. First, the Procurement Officer directed a cure letter to ESI on August 24, 2010 which stated:

After reviewing the response provided by Express Script to the June 22, 2010 cure letter, it appears that Express Script's response to this question is still non-responsive. Remedy: Please provide the State with a description of how the State's

auditors and consultant can independently verify that the contractor is not receiving revenue attributable to the State's plan from any source that is not disclosed in Q-13. If in the opinion of the offeror there is no way to provide a methodology, please state so in your response. (ESI Ex. 35, bates 5318.)

ESI responded to that cure letter on October 8, 2010, stating:

We think there is no practical way that the State can definitely verify any PBM is not receiving revenue from any source that is not disclosed to the State because it is not possible to "prove a negative." All that the State and any vendor can do is to work together to clearly define the obligations of each party and to provide extensive audit rights to ensure that all contractual obligations are met. As with the Brand-Generic Algorithm discussed above, we try very hard to make sure that all our clients understand how we make our money. (*Id.*)

Thereafter ESI disclosed:

We do charge the pharmacies a transaction fee that averages a few cents a claim which is deducted from the reimbursement we pay to the pharmacies. We can either retain this fee and offer a lower administrative fee or we can pay the book-of-business average amount of this fee to the State on a periodic basis and raise the administrative fee charged to the State by the same amount. Both options are financially neutral. (*Id.*)

The Procurement Officer rejected both of these options as contrary to the requirements of the RFP, but did not notify ESI accordingly. (Catalyst Ex. 11, pg. 4-5, ESI's 10.8.10 Amended Response to Maryland's 8.24.10 Cure Letter; Tr. 577-583.) It is unclear from the record what ESI's belief may be with respect to its desire to impose a transaction fee upon pharmacies, but the pass-through and transparency aspects of the RFP are intended to prohibit ESI from

receiving any profit from such an accounting gimmick.

Ranking - Financial

95. After completion of the technical submissions, the Evaluation Committee on August 31, 2010 opened and commenced examination of each of financial offers for the three proposals pending. (Tr. 155.) Offerors were required to complete and submit Attachment K to the RFP as their Financial Proposal, the first sentence of which provides, "Representations made by the Offeror in this proposal become contractual obligations that must be met during the contract term." (Catalyst Ex. 20, pg. 1.)
96. Attachment K-4 to the RFP constitutes a static financial model developed by DBM consultants and intended to enable the Evaluation Committee to receive and compare a single hypothetical "snapshot" of pricing based upon certain assumptions, including a specified level of membership and filled prescription volumes. (Tr. 179-180, 473, 787, 897, 915.) The assumptions set forth in that model include a pool of 110,000 members annually in each of the five (5) years of the contract term, including active state employees as well as retirees, those members (as well as a substantial number of non-member participants eligible by virtue of a family relationship to a state employee or retiree member) requiring 1,179,500 brand-name drugs to be filled at retail pharmacies, 1,904,000 generic drugs filled at retail pharmacies, 43,200 brand-name drugs filled by mail order, and 30,200 generic drugs filled by mail order. (Catalyst Ex. 3.) These fixed numerical assumptions set forth in Attachment K-4 were derived by GRS based on actual historic figures but are not intended to reflect accurate projections for the future. Neither party raised or raises any objection or complaint in the context of the instant appeals with respect to the suitability of the known and accepted

static financial model developed by GRS to evaluate the relative projected costs of the proposals submitted in response to the subject RFP. (Tr. 788.)

97. As determined by GRS and adopted by the Evaluation Committee, the evaluated five-year contract cost quoted in Attachment K-7 by appellant Catalyst is nearly \$50 million more than the total price quoted by ESI over the same term. The \$50 million price differential equates to a difference of about 3% based upon the pricing model for which all cost proposals are calculated to be in excess of one and one-half billion dollars. (Joint Ex. 43, 63-66; Tr. 231, 247.)
98. GRS prepared a 31-page analysis of the financial proposals and circulated that report to the members of the Evaluation Committee on or about September 20, 2010. (Joint Ex. 31.) The total evaluated price submitted by ESI under the financial model used was calculated to be almost \$10 million per year cheaper to the State than the Catalyst proposal due primarily to the lower ingredient costs guaranteed by ESI, that liability comprising the most significant portion of the State's total of the various components of pharmacy costs. In comparison to ESI's proposal, however, the Catalyst proposal is less expensive to the State on other factors. Catalyst offers higher rebates to the State and lower administrative fees paid by the State, but not lower ingredient costs. (Tr. 303-306, 476-485, 590.) The amount of the fixed administrative fees proposed by Catalyst PMPM are about one-half (1/2) of the fixed administrative fees proposed by ESI, a difference of about \$15 million in favor of Catalyst. (Catalyst Ex. 11, 20, K-5, line 18; Tr. 192-193, 589.) In addition, the proposed rebates offered by Catalyst exceed ESI's rebate assurance by more than \$10 million. (Catalyst Ex. 11, 20, K-5, line 21.) Furthermore, Catalyst offers to impose no charge for DUR. (Catalyst Ex.

- 11, 20, K-4, line 4.) ESI and Catalyst each propose a diminishing dispensing fee payable to pharmacies, but ESI proposes a much steeper decline in dispensing fees, with a fifth-year dispensing fee about half of Catalyst's proposed dispensing fee. (ESI Ex. 132, 133; Catalyst Ex. 10, bates 1467; Catalyst Ex. 20, K-4, line 1.)
99. Notwithstanding ESI's superior offer of minimum guaranteed discount from AWP, ESI's historical average of actual ingredient costs used to calculate the State's future liability is higher than Catalyst's. (Catalyst Ex. 10, bates 59; Catalyst Ex. 15, J-5a, Q-28; Tr. 759.) ESI's actual drug ingredient costs for 2008-09 were higher than Catalyst in all three (3) tiers of drug category: single source, multi-source brand, and generic. (Catalyst Ex. 10, bates 59; Catalyst Ex. 14, J-5a, Q-28.)
100. The Evaluation Committee met on October 19, 2010 to discuss the financial aspects of the three proposals being evaluated and had extensive discussions at that time concerning what issues to include in the second BAFO. (Joint Ex. 73.) Among several topics reviewed during that meeting were the adequacy of the selected financial model and whether it was satisfactory to promote generics, whether Catalyst's indirect contractual arrangement with drug manufacturers was sufficiently auditable, and how to avoid pharmacy network disruption in light of the lower anticipated dispensing fees proposed by both Catalyst and ESI. (Catalyst Ex. 72.)
101. The lower evaluated total cost submitted by ESI under the financial model prescribed by Attachment K to the RFP is attributable principally to lower ingredient costs available to ESI as offered to the State as a guaranteed percentage reduction from AWP of the drugs on its formulary. The projected amount of savings to the State for payment to ESI of lower ingredient costs more than compensates for the

dramatically higher fixed administrative fee charged by ESI, which constitutes only about 5-10% of total contract costs. (Tr. 1075, 1093.) Although ESI proposes guaranteed discounts for ingredient costs approximately 4% more than Catalyst, because of the huge portion of the total contract cost which represents ingredient costs, the relatively small difference in the percentage of the guaranteed discount from AWP of ingredient costs assured by ESI more than exceeds the substantially higher fixed PMPM administrative fees proposed by ESI as compared to the dramatically lower fixed cost administrative fees proposed by Catalyst, as well as the better deal proposed by Catalyst for rebates and DUR. (Catalyst Ex. 11, 20, K-4, lines 10, 20; Tr. 913-916, 1031.)

102. Catalyst self-reports 20% of the administrative fees paid by Maryland to constitute its profit, while ESI's first self-reported breakdown of receipts shows no profit, though ESI subsequently confidentially disclosed to DBM its average profit per claim, and in its brief ESI claims that its accounting method does not readily break down to reflect separate profit margins for individual clients. (Catalyst Ex. 83, pg. 11; Joint Ex. 39; Tr. 911-912, 989-990.)

103. Overall, even though ESI's financial proposal under the static pricing model is determined by GRS to be almost \$50 million less than Catalyst's over the five (5) year term of the contract, on October 19, 2010, one of the members of the Evaluation Committee expressed reservations over the certainty of the desired price savings projected for ESI, sharing an e-mail with other Evaluation Committee members stating as follows:

While ESI's overall bid is ... less than Catalyst:

- Administrative fees - ESI is ... more than Catalyst. ... These are fixed costs based on enrollment so as enrollment

goes up, ESI's fees will go up. These are contractual fees and therefore will not be manageable through any control of the State, i.e., plan design changes, etc.

- Dispensing Fees - ESI will be paying the pharmacies ... less than Catalyst ... This could be a concern with ESI's ability to maintain its network of pharmacies.
- Admin & Dispensing Fees - Combined the State will be paying ... more in fees to ESI than to Catalyst. Again, the majority of those fees would be to ESI itself not the pharmacies. These are for the most part fixed costs and therefore not controllable or manageable from any plan design change.
- Rebates - Catalyst is guaranteeing ... more than ESI in rebates. While both companies may achieve more Catalyst appears to be putting more at risk. While the rebates are variable, the guarantee is a minimum and fixed at that level.
- Ingredient Cost - This is where ESI provides the reduction in cost to the State. ESI ingredient costs before rebates are ... less than Catalyst. But these costs can be variable based on a product of the market, formulary management, generic utilization, etc. I understand that there is a guaranteed discount off AWP, but that is a minimum. Both ESI and Catalyst may do better than their discount proposed. For example, both vendors may achieve an actual discount of 20%. While ESI may have proposed a 17% and Catalyst a 16% discount, actual results are greater than both guarantees, but based on actual achievement there would be no difference in cost to the State if both achieved a 20% actual discount. The State might be able to control these costs through plan design changes etc.

in order to keep costs down.

I guess what I'm trying to say is that ESI is giving greater discounts in a variable area with a greater minimal guarantee in the AWP discounts, but charging more in fixed fees, which the State will not be able to change.

So is ESI's ... lower cost acceptable even though ESI is charging ... higher fixed fees which the State will have to pay, maintaining those fees for itself and having pharmacies receive ... less in dispensing fees? (Catalyst Ex. 28; Tr. 185-188, 200-205, 223-228.)

104. DBM guidelines for proposal evaluation specifically caution members of Evaluation Committees regarding risks inherent in failing to recommend award to the low price bidder, stating:

Potential problems in not seeking to award a contract to a qualified offeror with a very low financial offer price:

1. This low priced offeror may file a protest against the proposed award of the contract to any other offeror....

2. Even if the lowest priced offeror does not file a protest ... DBM will question why the award wasn't made to the lowest priced offeror. ... What it comes down to, is that if any evaluation committee and procurement officer conscientiously determine an offeror to be qualified, and that offeror has a very low price, absent some very compelling reason that offeror should be recommended for the award. ...

In most instances however, if an offeror is technically qualified and is ready and able to perform the contract for a price that is substantially below that of other offerors, the agency typically award [sic] the contract to this offeror.

This statement will probably lead to cries of the offeror seeking to "low ball" the bid price and trying to "buy the contract".

Generally, when such terms are used they have a negative connotation. In other words we shouldn't let offerors do this. However, the opposite is true. If we have determined that the offeror is technically capable of doing what we want, and has an acceptable approach to do so, and has the reliability and integrity that shall assure good faith performance, there is no reason to not take this offeror up on its offer and "smile all the way to the bank." (Catalyst Ex. 8, pgs. 12-15; Tr. 466.)

Catalyst contends that the financial emphasis set forth in the foregoing Instructions may have given members of the Evaluation Committee the false impression that financial factors outweighed technical factors in the evaluation process. (Tr. 448-450, 458-471, 643-644.)

105. Second and final BAFO responses were received by DBM on November 12, 2010. (Joint Ex. 40.)
106. On November 12, 2010, the Procurement Officer directed an e-mail to the members of the Committee in which he stated, "Though I have not yet read through the 2nd BAFO documents with roughly an estimated \$47 million higher expense, I have yet to be convinced that Catalyst Rx is the better choice, given the current economic/budget climate." (Catalyst Ex. 29.) The State's "economic/budget climate" is not one of the evaluation factors expressly set forth in the RFP, but the Procurement Officer testified that that general factor is implied as a significant consideration in every procurement evaluation. (Tr. 218-222, 255.)
107. GRS analyzed the BAFOs and reported its conclusions to the Procurement Officer at the end of the day on November 18, 2010, the day before the final meeting and vote of the Evaluation Committee, which was conducted by phone conference. That financial analysis consists of a simple table itemizing the evaluated cost of each proposal but not an explanation of precisely how the calculations were made.

(DBM Ex. 6; Joint Ex. 43; Tr. 474.)

108. The final meeting of the Evaluation Committee took place by telephone conference call lasting at least one-half (1/2) hour on November 19, 2010 and included GRS representatives as DBM's expert pharmacy consultants. (Tr. 725.) The Procurement Officer is unable to recall all of the issues discussed during that half-hour telephone conference, but memorialized the topics in a half-page of hand-written notes which indicate that the following items were addressed: (1) that the low dispensing fees offered by ESI were of "little value to pharmacies;" (2) the extent to which transfer of the contract could lead to pharmacy disruption; (3) identification of those personnel from Catalyst that DBM contract managers wished for ESI to retain or not retain; (4) DBM's inability to audit drug costs passed down by pharmaceutical manufacturers to Catalyst through its aggregating consortium; and (5) alternative cost management practices that should be pursued, like promoting generics. (Catalyst Ex. 71, Tr. 431-441.)

109. At the conclusion of the aforementioned conference call, the Evaluation Committee unanimously determined to recommend award of the contract to ESI. (Joint Ex. 43, Tr. 448.)

110. Later that day following the final meeting of the Evaluation Committee on November 19, 2010 and prior to transmission by the Procurement Officer of any formal recommendation for award, one of the members of the Evaluation Committee notified the Secretary of DBM by informal e-mail as follows:

We just had our final evaluation meeting for the prescription drug RFP and Catalyst will not be getting the new contract; Express Scripts will. With this award comes some amount of disruption (GRS is running that for us) with regard to the formulary (list of preferred drugs). However, Express Scripts is ... cheaper over the five year contract than Catalyst's proposal and is ... cheaper

than what we are currently paying to Catalyst ... so it's a no-brainer. Express Scripts is one of the big three and are more than capable. (Joint Ex. 44; Catalyst Ex. 30.)

111. GRS did perform a network disruption analysis and advised the Procurement Officer on December 1, 2010 as follows:

... the bottom line is this:

- 1) There should be no generic disruption. All generics should adjudicate the same under the new ESI formulary as they did under the Catalyst formulary.
- 2) Here's the bad news: There will be 484 participants that have a preferred brand script today that will be considered "non-preferred" under the new ESI formulary.
- 3) Here's the GOOD news: There will be 1,976 participants that have a non-preferred script today that will be considered "preferred" under the new ESI formulary.

So overall, the number of folks positively impacted by the change is much larger than the number negatively impacted by the change. (Joint Ex. 45; Catalyst Ex. 31.)

112. On December 7, 2010 the Secretary of DBM approved the Procurement Officer's recommendation of Award of the previous day. (Tr. 487, 691.) The Procurement Officer's recommendation letter to the DBM Secretary summarizes the previous year's procurement evaluation conclusions as follows:

Express Scripts, Inc. is recommended for award. The Procurement Officer and the Evaluation Committee, with the assistance of Gabriel, Roeder, Smith & Company as the State's benefits consultant, find that Express Scripts' proposal is the most advantageous to the State. Express Scripts was ranked #2 technically, and #1 financially. The overall recommendation of

the Evaluation Committee is that the technical superiority of Catalyst Rx (ranked #1 technically) did not outweigh the lower financial price of Express Scripts.... In making the most advantageous offeror determination, technical factors were given equal weight with price factors, as stated in the RFP. As the Procurement Officer, I concur with the Committee's recommendation. More details regarding the evaluation and the recommendation are provided below....

Express Scripts was ranked #1 overall (technically #2, financially #1).

While Express Scripts' proposal was ranked #2 technically, Express Scripts is a proven vendor in the PBM industry, with extensive experience with large-scale PBM service contracts, including State and Federal accounts. Express Scripts, through its technical proposal, oral discussions, and responses to cure letters demonstrated that it is very capable of being able to handle the State of Maryland account and was not far behind Catalyst Rx in the overall technical ranking. Catalyst Rx was ranked #1 technically, based primarily on its positive past performance with the State as the incumbent PBM contract, excellent account management team, and its status as an in-State vendor....

Express Scripts was ranked #1 financially, with roughly a \$47 million price difference between it and the #2 financially ranked offeror, Catalyst Rx (2.9% higher cost with Catalyst Rx). In comparison to the current contract with Catalyst Rx and that contract's stated guarantees, Express Scripts' proposal equates to roughly a 9.0% savings over the current contract....

In comparison to Catalyst Rx's financial proposal, Express Scripts would charge significantly higher administrative fees (almost twice the amount), paper claim processing fees, and drug utilization review fees. However, Express Scripts achieves overall cost savings by charging

significantly lower dispensing fees at retail facilities (roughly half of Catalyst Rx's retail dispensing fees) along with lower ingredient costs and a lower Medicare Part D subsidy support fee. While there was some concern amongst the Evaluation Committee that Express Scripts' lower dispensing fees may cause some disruption amongst retail facilities, Express Scripts has stated that these retailers are currently dispensing with these fees, and Express Scripts does not anticipate any retailer disruption due to the proposed dispensing fee amounts....

While the financial "gap" between Express Scripts and Catalyst Rx is not a high percentage (less than 3%), the actual dollar amount is significant (roughly \$47 million). Given the current economic climate, it is difficult to justify an additional estimated cost of over \$47 million (over the five year contract period) to select the highest technically-ranked offeror, when the lower priced offeror is known to be very capable of providing the required services given its experience in the industry. Therefore the Procurement Officer and the Evaluation Committee agree that Express Scripts' proposal is the most advantageous to the State, and Express Scripts is recommended for award. (Joint Ex. 46; Catalyst Ex. 32.)

113. Approval of this procurement was placed as an Agenda Item for BPW consideration and approval on March 29, 2011, with a projected five (5) year cost of \$2,365,374,436, but BPW determined to defer consideration pending the outcome of the instant appeals. (Joint Ex. 48.) That cost estimate is around \$800 million more than the total price calculated by the Evaluation Committee using the static financial model which is not in dispute in this appeal because its use was not protested prior to proposal submission date.
114. Between February 25 and September 9, 2011, Catalyst filed five appeals before the Board arising from eight protests to DBM stating various bases of complaint over the proposed

recommendation of ESI for contract award.

115. By written Order and Opinion following pre-trial motions hearing, Appellant's Motion for Summary Decision on the issue of Catalyst's claimed entitlement to reciprocal preference was denied by the Board on October 4, 2011.

116. Full evidentiary trial proceedings were conducted on the consolidated appeals commencing October 24 and concluding October 31, 2011, with Briefs, Replies, and transcript references noted through November 30, 2011.

Decision

This is a challenging procurement. The magnitude of the fixed costs to be paid by the State to the selected offeror here is substantial. The total amount of the State's future liability to its PBM is presently undetermined but assured to be immense. Maryland's PBM provider directly and immediately impacts the medical health, safety and well-being of a couple of hundred thousand people. The financial stratum supporting purchase and delivery of pharmaceuticals is large, multi-layered and complex. The final two proposals detailed above are highly competitive and closely ranked, in some respects based upon distinct points of differences of delivery of specified services. The PBM industry in totality continues to evolve rapidly and is marred by a history of making significant profits, sometimes accruing as the result of arguably deceptive practices. The State is well advised to move with care and caution in committing payment obligations to its pharmacy benefits manager.

The natural starting point for the Board's analysis is to address first Catalyst's argument that ESI's proposal should not have been evaluated at all because ESI failed to meet the minimum requirements of the RFP. Specifically, it is undisputed that the RFP requires an eligible offeror to be registered as a PRA, and ESI is not a PRA. It is also uncontested that the Evaluation Committee failed to note this deficiency during its evaluation

because ESI proposed to use a wholly owned subsidiary, ESUMC, to provide the PRA services mandated by the contract award resulting from this RFP, a discrepancy which was not recognized until after award recommendation. As a matter of law, ESI and ESUMC are not the same. They are different corporate entities, though ESI owns and controls ESUMC.

Catalyst is correct in bringing pertinent Maryland law to the attention of the Board in this regard. By statute, a PBM which is itself a PRA is subject to mandatory review by the MIA every three years, while a PRA which is not a PBM, like ESUMC, is examined at the discretion of MIA only every five years. Is the assurance of this elevated level of scrutiny by MIA the reason that, at least in the sense of strict interpretation of the contract language, the RFP seems to specify that the offeror itself must be a PRA?

Certainly the State may, by provisions set forth in the RFP, impose more stringent requirements of offeror eligibility than those obligations that are set by statute. Indeed, this RFP contains many examples of contractor qualification limitations beyond those minimally established by law alone. However, testimony at the hearing evidences the conclusion that this was not DBM's intention in drafting Sec. 2 of the RFP, stating, "Qualified Offerors must provide proof of ... certification as a private review agent." Instead, the Procurement Officer testified, "The intention was to meet the law, and the law required certain certifications, certain registrations in order to do business in Maryland as a PBM. We did not intend to go beyond the law. We did not intend to restrict the law in any way. It was just - the intention was to follow what the law required." This sworn testimony as to DBM's rationale in requiring the offeror to have PRA certification is not refuted.

Despite the express RFP reference to the responsibility of the offeror to be a certified PRA, the Board finds that an

offeror may legitimately satisfy this requirement by employing as its PRA a wholly owned subsidiary fully controlled by the offeror. Although ESI and ESUMC are not the same, ESUMC is an appendage of ESI. Therefore ESI's offer to the State to perform the PRA functions of this RFP through ESUMC renders its offer in compliance with minimum eligibility qualifications of RFP Attachment J-1. Thus, DBM is obliged to evaluate ESI's proposal.

It should be emphasized that this determination to allow a subsidiary to satisfy RFP requirements is not allowed by the Board for ESI alone. To the extent that principles of equity may be transferable to the dispute at hand, appellant may be fairly said to have unclean hands in this regard because Catalyst too proposes to use affiliated corporate entities to perform portions of the contract obligations specified in the RFP, including for example, its entire mail order processing facility. Indeed, the procurement officer testified that it is perfectly permissible under the terms of the RFP for the entire PBM contract to be outsourced by subcontract to various entities wholly separate and apart from the offeror. Surely the use of a subsidiary corporation as its PRA should not bar ESI from submitting a proposal in response to the RFP.

The Board recognizes that a distinction exists between those specified minimum certification and registration requisites of a legitimate and qualified offeror, as contrasted to the general authorization to subcontract portions of the work prescribed by the contract. Sec. 2 of the RFP establishes the licenses required for an offeror to be deemed eligible to submit a proposal. But the PRA registration requirement of Sec. 2 pertains to the offerors' duty to perform a certain job function, specifically, DUR. So the comparison of ESI's use of ESUMC to conduct DUR is apposite to Catalyst's proposed use of its subsidiary, Immediate Pharmaceutical Services, Inc., to process its mail orders.

In addition to the foregoing *dicta*, the Board also notes that to the extent that MIA regulation of a PBM which is a PRA may be slightly stronger than a separately organized PRA, ESI is still certified as both a PBM and a TPA, so the MIA retains full authority directly to examine and sanction ESI's conduct irrespective of whether it is registered directly as a PRA. Furthermore, because ESUMC is a wholly owned subsidiary of ESI, any compliance issues identified with respect to PRA activity can be policed through ESUMC as an arm of ESI and ESI thereby compelled to effect changes in ESUMC as directed by the MIA under risk of suspension of ESUMC's certification, which would cause ESI to be in breach of its contract obligations.

Finally, if the Board determined otherwise and thereby eliminated ESI from competition for using its subsidiary as its PRA, ESI would be unfairly prejudiced by being denied the opportunity to cure that defect. DBM should be allowed and encouraged to foster robust competition among potential providers of PBM services, instead of being compelled to eliminate prospective proposals based upon unintended restrictions on award eligibility resulting from a procurement requirement being interpreted more strictly than intended. To sum, while the Evaluation Committee should have noted in March 2010 during its initial considerations the distinct legal separation of ESUMC from ESI, rather than discovering that prospective defect a year later, there is simply more smoke than fire with respect to this element of appellant's complaints. ESUMC is part of ESI.

Before departing from this opening point of dispute between the parties, the Board also notes that the requirement of PRA certification set forth in Sec. 2 of the RFP is immediately followed by an explanatory note, "The minimum qualifications that relate to the Offeror's experience must be met by the Offeror itself (i.e., the legal entity)...." At first blush, this explanation may appear to resolve the PRA certification question

in favor of Catalyst's request to disqualify ESI from consideration for failure to meet minimum proposal requirements, but upon more careful inspection, the contrary conclusion is warranted. The RFP expressly requires the "Offeror itself (i.e., the legal entity)..." to satisfy minimum qualifications *only* with regard to factors "that relate to the Offeror's experience." PRA certification does not relate to the offeror's past experience. Instead, deliberate amendment to the RFP permits offerors to apply for and receive certification as a Maryland PRA within a set time *after* contract award. Therefore by the implication of silence as to factors not related to experience, the RFP does not mandate that the offeror itself must be a PRA. Use of a subsidiary is permitted.

Having established the necessity of full consideration of both of the proposals here in competition, the Board next addresses the principal question central to these appeals, namely, whether DBM's evaluation was arbitrary, capricious, or an abuse of discretion. (AGS Genasys Corp., MSBCA 1325, 2 MSBCA ¶158 (1987); Astro Painting and Carpentry, Inc., MSBCA 1777, 4 MSBCA ¶355 (1994); Delmarva Community Services, Inc., MSBCA 2302, 5 MSBCA ¶523 (2002); Caremark PCS, MSBCA 2544, 2548, and 2568 (2007).) It is beyond the authority of the Board to supplant its judgment for that of the agency that will bear the responsibility of contract management after award and as a result, considerable deference must be extended by the Board to the exercise of reasonable discretion by the Evaluation Committee that reviewed these proposals. (Hensel Phelps Construction, MSBCA 1167, 1 MSBCA ¶68 (1984); Eisner Communications, Inc., MSBCA 2438, 2443 and 2445, 6 MSBCA ¶560 (2005); ACS State Healthcare, LLC, MSBCA 2474, 6 MSBCA ¶564 (2005).)

On the subject of overall sufficiency of the agency's actions during the nine months that these substantial proposals were being considered and evaluated by DBM, appellant asserts

that the procurement record is deficient. It is true that the written record on such a large, expensive, and complex procurement could have been fuller; and the evident reliance by the Evaluation Committee on undocumented conclusions and recommendations made by DBM's expert consultants at GRS and its subcontractors is somewhat troubling. So is the failure of some members of the Evaluation Committee to conform to the requirements of DBM's own procurement evaluation "Instructions" to: "Make all substantive comments in writing on the Evaluation Sheets. These comments are official documents and become part of the procurement record...."

Even though the evaluators' checklist sheets should have been tendered to the procurement officer for inclusion in the procurement file, that defect is non-fatal. COMAR 21.05.01.07 does not mandate that such detail be made a part of the official procurement record. The adequacy of the written record extant here and produced to appellant and the Board is sufficient to satisfy the minimum obligations of Maryland law and regulation. The Board therefore determines not to afford appellant the ultimate relief it seeks based merely upon its claim of deficient records maintenance. Instead we turn to the substantive merits of the various aspects of the technical proposal evaluation that occurred here.

It appears to the Board from the written and oral evidence of activity relating to the technical evaluations as reflected by the testimony and records adduced at hearing, that Catalyst was fairly treated. In fact, the Evaluation Committee ranked Catalyst ahead of ESI on five of the six primary evaluation factors set forth in the RFP. ESI ranked ahead of Catalyst in only one of the primary evaluation factors, that one being weighted fifth most important out of the six factors specified. To sum, on the technical evaluation of the competing proposals, Catalyst prevailed and was unquestionably determined by the DBM

Evaluation Committee during the first phase of review to be the favored candidate for contract award.

Rather than leaving the Board's review and comments on the technical phase of the evaluations citing merely the foregoing final conclusions rendered by the Evaluation Committee after full consideration and discussion, the Board should next analyze and address specifically each of the grounds set forth in appellant's protests and appeals. The first of these pertains to ESI's proposal to use its proprietary BGA to classify drugs as generic or brand name.

The Evaluation Committee initially deemed ESI's BGA to be in violation of proposal requirements and the procurement officer therefore sent cure letters to ESI which pointed out this early alleged identification of a point of non-compliance with the RFP. ESI directly addressed the question in response to those repeated inquiries and ultimately the Evaluation Committee came to a better understanding of the limited nature and necessity of the BGA proposed by ESI. Moreover, the Evaluation Committee cannot be said to have been arbitrary or capricious in reaching its ultimate decision to consent to the use of ESI's BGA. Quite the contrary, allowance of ESI's proposed BGA was first rejected and thereafter permitted only after the Evaluation Committee was satisfied that ESI had no motive to re-classify drugs inappropriately because no profit could accrue to ESI as a result of drug re-classification through its BGA, that DBM would have full audit rights to verify the same, that all PBMs must use some form of BGA, and that ESI's BGA is engaged only as a secondary classification method to be employed for a miniscule number of pharmaceuticals. To sum, this aspect of ESI's proposal was fully vetted by the Evaluation Committee, which initially did not understand the issue but ultimately reached a thoughtful decision after thorough consideration.

The disparate contract performance guarantees with respect to timeliness of filling mail order prescriptions is another issue presenting some difficulty in evaluation, in part because consideration of the proposals offered by ESI and Catalyst is a bit like comparing apples to oranges. Deciding that one is better than the other depends entirely on one's subjective point of view. Initially the State sought assurance of 100% compliance with the requirement of filling clean mail order scripts within two business days of receipt. Catalyst confidently promised to meet that threshold without fail, and offered to allow the imposition of \$5,000 in liquidated damages for each quarter for which that standard of perfection may not be achieved. That amount of liquidated damages is only one of numerous performance guarantees for which Catalyst agrees to allow a \$5,000 fine to be assessed against it on a quarterly basis in the event of contract breach, if determined to be appropriate by the DBM contract manager, who ordinarily seeks to cure contract performance problems first by amicable resolution rather than unilateral imposition of a financial penalty. Of course, liquidated damages are not automatically assessed, but generally employed by the State only as a secondary recourse or as a consequence of substantial, repeated, or deliberate breach.

ESI offers much higher liquidated damages of up to \$610,000 per quarter per breach of each classification of assured measurable standard of contract performance for which liquidated damages are permitted, up to a total of \$3,050,000 per quarter. Catalyst on the other hand offers only \$5,000 per fiscal quarter per breach. Counsel for ESI accurately calculates the total amount of potential liquidated damages annually placed at risk by Catalyst to be capped at just under \$1 million as compared to slightly over \$3 million as the total quarterly liability for liquidated damages available against ESI. Counsel for Catalyst, on the other hand, correctly observes that as a result of ESI's

assurance to achieve the scheduled rate of prompt mail order delivery not to all orders, but for only 95% of the mail order prescriptions it receives, ESI is expressly seeking permission to be extraordinarily late in filling as many as 3,670 prescriptions per year before DBM is empowered to assess against it the first dime of liquidated damages.

DBM solicited divergent approaches to the question of contract enforcement by performance guarantees, and it received them from ESI and Catalyst. The Evaluation Committee reviewed the offers and decided to assign a weakness to ESI's proposal for departing from the 100% compliance standard set forth as the starting point for proposals, to which Catalyst agreed without exception or request for modification. This was a well-reasoned and appropriate determination that inured to the significant elevation of the value of Catalyst's proposal viewed in comparison to ESI's. Hence there is no cause for Catalyst complaint on this point.

The procurement officer stated at the hearing that, using the provisions set forth in Attachment A to the RFP, specifically, Sec. 4.3, the general remedies section, DBM could impose financial sanctions against ESI for failure to meet a 100% standard of timely delivery of mail order prescriptions; but that belief is misplaced. Notwithstanding the order of priorities of controlling documents specified in Attachment A to the RFP to be used to resolve interpretation disputes concerning contract ambiguities, with respect to timeliness of filling mail order scripts, there is no ambiguity. The State may not on the one hand during procurement discussions and consideration receive and approve ESI's proposal to meet only 95% of a contract requirement and thereafter seek to impose a stricter requirement during contract performance, enforced by withholding a financial penalty. While it may be correct that in the event of failure to fill mail order scripts at all, DBM could conceivably invoke the

general remedies provision of Sec. 4.3 for violation of AR-76, as a matter of law it could not impose liquidated damages against ESI for violation of the approved 95% timeliness standard alone, unless ESI fails to meet that known and measurable threshold mark accepted by the State and thereby incorporated into the contract.

Several additional issues are also raised by appellant to emphasize the strengths of the Catalyst proposal over ESI's. They include protecting the confidentiality of Maryland medical information and the related issue of security of PBM computerized records. The RFP prohibits its PBM from selling or otherwise sharing with a third party medical prescription information or other related data without written approval by the State. Catalyst agreed to that prohibition, while ESI initially sought permission to share anonymous claims intelligence. However, ESI was specifically informed by DBM that the State declined to authorize the sale of even anonymous information about state plan beneficiaries. ESI promptly accepted that restriction and dropped its request, so the confidentiality question is moot.

Like the BGA component of the technical evaluation as more fully described above, the issue of adequacy of computer security is also one which caused the Evaluation Committee some concern at the outset of proposal examination, but that concern was eased and ultimately deemed of little importance or consequence after it was thoroughly examined. In 2008, ESI was the victim of an attempt at criminal extortion by a person who claimed and demonstrated to have secured unauthorized access to ESI's massive confidential computer files and demanded payment from ESI under threat of release of that private information for criminal or other unauthorized use. This was fully disclosed to DBM in ESI's 2010 proposal.

Of course this crime is of grave concern on several levels, including the need to undertake a thorough review of ESI's computer security devices, practices, and policies which should

have been in place to prevent such an occurrence or threat. So with some initial skepticism, the adequacy of ESI records systems in this regard was naturally subjected to critique and the demand for upgrade or other reform to prevent any recurrence of such a problem. In the final analysis, it was recognized by the Evaluation Committee that the 2008 extortion attempt seems to have caused ESI to make significant improvements to its records systems. Though Catalyst justifiably castigates ESI for its delayed action notifying its members of a security breach, ultimately the Evaluation Committee reviewing this aspect of ESI's proposal in precise detail was persuaded that the reform initiatives implemented by ESI vindicated whatever defect made possible the past invasion of its confidential records and therefore gave ESI credit for having newly designed effective software security measures in place.

Somewhat less forthcoming from ESI is its disclosure to DBM of various lawsuits to which ESI, like other major players in the PBM industry, is and has been a party defendant over the years. In particular, ESI should have directly and specifically notified DBM with an attachment to its proposal that in May 2008 it entered into a Settlement Agreement with a number of Attorneys General, including the Maryland Attorney General, agreeing to pay \$9.5 million to settle and dispose of allegations that ESI had engaged in unlawful drug switching. ESI did not volunteer that information, except by referencing a third party custodian holding public records divulging the settlement. At about the same time as the multi-state litigation, ESI also agreed to remit to the State of New York the sum of \$27 million. Though these settlements are large, they are also placed into proper perspective by noting that other PBMs during that time frame consented to pay penalties of \$41 million, and even as much as \$137 million and \$155 million.

ESI should not have rested with the bare minimum of the disclosures mandated in the RFP by conceding merely that *qui tam* actions are filed from time to time and anyone can check ESI's public documents on record with the SEC, including its 10-Q and 10-K. The information set forth in those filings was not affirmatively concealed by ESI, but it was not affirmatively put forward either. All litigation involving ESI should have been voluntarily and proactively identified at the same time as its proposal submissions.

Despite criticism by Catalyst on this point, however, nothing that ESI disclosed or failed to disclose rises to a level of fault or impropriety that would justify disqualification of ESI's proposal. In addition, to the extent that any downgrade in evaluation was contemplated after the Evaluation Committee finally became fully aware of past litigation involving ESI, it is likely that the Committee also bore in mind that part of the Catalyst team of PBM service providers, namely, its aggregator, Medco, was also a party to similar litigation. This is so even though, unlike ESI, Medco is not a direct offeror of PBM services to Maryland but instead merely a partner in Catalyst's purchasing consortium.

It is unfortunate that the Evaluation Committee did not fully discover ESI's settlement of claims against it for deceptive trade practice until after the Maryland award recommendation was finalized on December 7, 2010. Following that date, DBM no longer held a neutral evaluation posture but instead quickly progressed to the status of defending a recommendation decision that had been finished and was immediately thereafter made the subject of litigation. But as set forth above, all of that information has now finally come to light and DBM has determined that it does not change its selection decision.

In the absence of some demonstrated departure from law or other governing legal standard, the responsibility of determining

fitness and suitability for contract award is for DBM and BPW. The role of this Board is not to substitute its views for those of others empowered directly to evaluate procurement offers. Instead, our limited charge is to review independently what was done by the pertinent state agency to assure legal sufficiency and fairness. Since the December 2010 recommendation of award of the contract to ESI, as a continuing component of assessment of ESI's responsibility for contract award, DBM has continued to monitor integrity elements of ESI's offer to serve as the State's PBM, and DBM to date has found no cause for retracting its decision to advance to BPW its selection of ESI as contract awardee. No sufficient cause has been shown to permit this Board to interfere with the ongoing procurement process toward BPW approval.

The potential of network disruption is another concern to the Board, but is one which, unlike ESI's past litigation history, appears to have come also to the thorough attention of the Evaluation Committee in timely and repeated fashion. Without publicly disclosing the precise amounts of the guaranteed average dispensing fees proposed by ESI to be paid to pharmacies that fill prescriptions for beneficiaries of the State's pharmacy plan, the Board notes that ESI proposes a reduction in its payments to retail pharmacies, and that it is reasonably foreseeable that such reductions could cause network disruption. However, little evidence was introduced on this point of contention beyond the actual guaranteed maximum payment amounts offered by the proposers, which are purposefully concealed from public release in the instant Opinion because of the Confidentiality Order entered in this proceeding concerning a procurement that remains pending, with specific financial information protected as proprietary and therefore subject to restricted inspection.

Four separate elements of thought in tackling this problem are the components of the Board's review of the Evaluation Committee's analysis of the prospect of network disruption. First, both of the proposals being considered propose to lower the amount of the pharmacy dispensing fees now being paid. ESI's proposed guaranteed maximum average dispensing fee is simply a larger reduction than the reduction proposed by Catalyst. So the two proposals both pose risks; it is only a matter of degree that ESI may be deemed more problematic than Catalyst. Second, because the State reimburses the PBM for the dispensing fees it pays to retail pharmacies, a lower dispensing fee is desirable to reduce the total contract costs incurred by the State, but is merely a pass-thru of the charges paid to pharmacies by the PBM. Third, ESI asserts that it does not share DBM's suspicion of the potential of future pharmacy network disruption, because ESI claims that it is currently paying the dispensing fee amounts that it is proposing it will continue to pay in the future, and that at present its national network includes over 60,000 retail pharmacy locations. That knowledge and assurance certainly came as a great relief to DBM evaluators.

Finally, and most importantly, the RFP seeks to avoid any possibility of network disruption by requiring the State's PBM to satisfy certain measurable specifications for convenient location of retail pharmacies for nearly all of the beneficiaries of the State's pharmacy plan, no matter what the dispensing fee may be. While it is not new, this approach is insightful and effective. Under the terms of the RFP, the State's PBM is obliged to assure that its members will have convenient access to numerable retail pharmacy locations. No matter how the PBM decides to achieve this contractual mandate, the State will be liable only for the amount of the dispensing fees actually paid, and will not be obligated to reimburse its PBM for more than the guaranteed averages proposed. Presumably, if retailers cannot be persuaded

to continue to service the requisite locations, the PBM will have to make whatever modifications to its dispensing fees to which it may be compelled by retailers to consent, and the PBM will be thereafter bound to absorb that additional cost without further charge to or reimbursement from the State.

As suggested above, the foregoing approach to guarantee pharmacy network access is sensible and wise. It cannot be said that the Evaluation Committee ignored this element of the proposals. Quite the contrary, it was considered and discussed on multiple occasions from the first through the last meeting of the Committee, and even afterwards. "Size of network" and "network disruption" are central components of the Committee's deliberations, identified as the top two sub-factors of the second most important evaluation factor specified in the RFP, namely, "pharmacy network." The Evaluation Committee carefully considered this element of ESI's proposal and ultimately concluded that the future adequacy of the available pharmacy network is sufficiently assured by the RFP specifications requiring convenient access to retail locations.

Having completed the technical evaluation, concluding that Catalyst submitted the superior proposal, the Evaluation Committee proceeded to examine the financial submissions of both Catalyst and ESI. The RFP requires that equal weight be given to the financials as that afforded to the technical components of the proposals. On this point, Catalyst complains that DBM's "Instructions to an Evaluation Committee" contains misleading and one-sided emphasis on cost, causing the false impression that financial considerations outweigh technical elements in this procurement evaluation for which technical and financial factors are supposed to be given equal weight. In particular, the Instructions state, "even if the lowest priced offeror does not file a protest ... DBM will question why the award wasn't made to the lowest priced offeror ... if any evaluation committee and

procurement officer conscientiously determine an offeror to be qualified, and that offeror has a very low price, absent some very compelling reason that offeror should be recommended for the award."

Reading this advice in a vacuum, it certainly appears that DBM is instructing all of its evaluation committees to give greater weight to financial than technical aspects of procurement proposals. But the Instructions do not exist in a vacuum. They must be read and interpreted in the context in which they were distributed to the Evaluation Committee members. Cost is a very critical element to any purchasing decision, including government procurements. Recommending the expenditure of more resources than that which would otherwise have been required by selection of the lowest priced proposal compels any State agency to be prepared to justify that spending decision to BPW and the people of Maryland. That is all that is implied by the language of the Instructions which Catalyst claims to be misleading.

While the Board is sympathetic to Catalyst's point that the foregoing provision in DBM's Instructions guide could be misinterpreted to undermine the necessity of rating technical as an equal factor as financial considerations, we simply do not concur with the position that the entire procurement process is rendered defective because the Committee was instructed to review, recognize, and value cost differences. The Evaluation Committee is correctly advised to seek best value for the State by considering cost. That evidence alone fails to support a finding that financial considerations were thereby greater weight than the technical aspects of the competing proposals. It is not improper for the State to emphasize cost as an important but equivalent component to technical in ranking these procurement offers, and that appears to be what was done.

Similarly, Catalyst argues that DBM's prejudice in favor of the financial over the technical aspects of the proposals is

demonstrated by the procurement officer's recorded observation near the end of the evaluation process when he relayed to Evaluation Committee members in an e-mail, "with roughly an estimated \$47 million higher expense, I have yet to be convinced that Catalyst Rx is the better choice, given the current economic/budget climate." The evaluation factors set forth in the RFP do not expressly include consideration of "the current economic/budget climate," which Catalyst contends was not only improperly allowed, but given superior weight to the factors stated in the RFP as the only permissible bases for recommending contract award.

Naturally, the State and ESI seek to minimize the import of the foregoing innocent and accurate offhand remark by the procurement officer, while Catalyst asserts that if more weight is intended to be given to the financial as compared to the technical proposal because of "the current economic/budget climate," that consideration needs to be expressly stated in the RFP. It would have been a simple matter for DBM to have written the RFP to provide for and disclose to proposers that during procurement evaluation, more weight would be given to cost than to the technical components of a proposal. Instead, the RFP stated and assured proposers that equivalent weight would be afforded to the technical as to the financial component, so that is exactly what must be done.

This procurement is not and was never intended to be based upon a low-bid award determination. It is a competitive sealed proposal with technical and financial elements to be given equal weight. Conditioning any preference to select the lower priced proposal because of the "current economic/budget climate" seems to suggest that the weight afforded to financial vs. technical aspects of a proposal may shift depending on the status of the State's projected budget deficit or surplus. That may be a natural perspective to assume, but it is simply impermissible,

unless provided for by being included in the evaluation factors expressly established by the terms of the RFP.

Having made this point, the Board is not convinced that DBM's legitimate concerns over contract costs improperly or unfairly outweighed its valuation of the technical aspects of the proposals. Determination of the worth to the State of the technical superiority of Catalyst's proposal is a subjective evaluation. There is no evidence of confusion on the part of the procurement officer or the Evaluation Committee members that anyone did not realize that this procurement requires that financial and technical elements be given equal weight throughout the evaluation. The procurement officer's acknowledgement of the need to be able to justify the recommendation for award was simply an iteration of the obvious, namely, that a determination not to select the lower priced proposal requires that there be a legitimate rationale and worth for the extra expense. It comes as no surprise to any of the proposers that the State is unable to afford unnecessary expenditure without cause.

The Board understands Catalyst's likely frustration at the unexpected turn of events that occurred when the Evaluation Committee progressed from the technical to the financial segment of proposal evaluation. Catalyst came through the technical evaluation phase as the undisputed winner, though ESI was rated as a close second. Upon examination of the financial packages, it also became immediately evident to the Evaluation Committee that with respect to the fixed fee elements of the pricing proposals, Catalyst's pricing is substantially lower than ESI's. The monthly PMPM administrative fee proposed to be charged by ESI is nearly twice the expense proposed by Catalyst. In addition, Catalyst offers to the State a better deal on rebates and DUR. But ESI offers the superior guarantee of lower ingredient expenses and this charge item represents the overwhelming bulk of total contract costs, so even a few percentage points difference

between the offerors on ingredient pricing is more than enough to make up for the lower charges offered by Catalyst on other cost items.

Catalyst claims that savings associated with ESI's offer are illusory. Reliable comprehensive comparison of these pricing proposals is challenging because of the complexity of calculating and projecting a fair estimate of the actual future liability of the State for its pharmacy costs. The Board is given the understanding that this RFP allows its PBM to pass on to the State for reimbursement only the amount of the actual ingredient costs of the prescriptions filled, and only up to the maximum cost allowed based upon the PBM's guaranteed discount from AWP. For example, assume that a PBM offers a 1/2 overall guaranteed discount from AWP and a drug has an AWP of \$300. As a result of the discount guarantee, if the PBM expends \$200 to acquire that drug, the State is liable to pay the PBM only \$150. Suppose next that a competing PBM offers a guaranteed discount of 2/3 reduction from AWP on the same drug. Because of the better guaranteed maximum State liability to the PBM, the cost of reimbursement to the competing PBM is capped at a lower ceiling, namely, \$100. So the PBM with the greater guaranteed discount from AWP might be presumed automatically to be the lower priced offeror. But such a presumption would be in error.

Extending the same simplistic hypothetical as set forth above, suppose now that the first PBM has negotiated a purchase price for that particular drug at a cost of only \$50, while the second PBM, presumably determined to offer the preferred price based only on the greater discount rate, pays \$75. The second PBM may offer the superior guaranteed maximum price by discount from AWP, but in this instance the offeror of the less favorable guarantee is actually less expensive for that particular drug, because the State has to reimburse its PBM only for its out-of-pocket costs, which may be less than the guaranteed maximum

price. In this pricing variation, the State would pay \$75 to the PBM offering the better guarantee of 2/3, but only \$50 to the PBM offering the lesser guarantee, based on actual costs incurred. The discount from AWP becomes meaningless. Moreover, it may be that proposals offering a greater discount guarantee may simply reflect the lesser risk aversion of that offeror as compared to a competitor, not actual cost savings.

In this procurement, it is undisputed that ESI offers the greater discount guarantee from AWP, slightly more than Catalyst on this critical pricing component. But in costs actually incurred, at least for the period 2008-09, the average expenditures on ingredient costs incurred by Catalyst is lower than ESI in all three tiers of drug classification. That means that during that period of time, regardless of the superior maximum price guarantee offered by ESI, the State may have paid less to Catalyst than to ESI in order to fill the same prescriptions.

For those who may suspect that the foregoing hypothetical may be unrealistic, it is important to bear in mind that in the real world scenario, PBMs must hope and expect to be able to acquire pharmaceuticals from manufacturers at a cost lower than what the PBM assures the State will be its maximum reimbursement liability. If and when it cannot achieve that goal, the PBM loses money on each purchase that cannot be made for a price less than the reimbursement exposure ceiling establishing the maximum cost that may be passed along to the State, as expressed by the PBM as a guaranteed percentage discount from AWP.

Under modern public procurement practices, PBMs are commonly barred from retaining the "spread" between the guaranteed price and the price actually paid. So, in accordance with the pricing structure established by the RFP here at issue, the PBM loses money if it cannot purchase pharmaceuticals at less than its guaranteed reduction from AWP even though it does not make

additional money when purchases are achieved for less than the cap. It is vital to the sustainability of the PBM therefore that it vigorously negotiates for the lowest pricing available, and one may reasonably expect that, at least for any PBM that is able to avoid bankruptcy, the ingredient costs it pays its suppliers are consistently lower than the maximum guaranteed price it offers its clients like the State of Maryland.

To sum, the ingredient costs actually paid by the PBM are at least as important as the discount guarantee because in most instances that expense may establish the cost paid by the State. Those drugs that cannot be acquired by the PBM for an amount less than the guaranteed maximum must be purchased at a loss to the PBM. All of this is merely to imply that expert calculation of the evaluated pricing proposals here in competition is critical to accurate cost projections. Looking only at the guaranteed minimum discount from AWP, one may easily project the maximum cost exposure to the State for purchasing pharmaceutical ingredients using assumptions like frequency, volume, and type of drug acquisition; but that is different than estimating likely total cost because it does not adequately reflect what the State may actually pay its PBM. To estimate total cost, actual ingredient costs incurred for the proposers' formulary at the rates assigned to various drugs based on frequency of filling prescriptions must be integrated into the evaluation of the financial impact of the price caps set by the guaranteed discount from AWP.

DBM relied upon GRS experts to project and compare prices for this PBM contract in concluding that there is a cost differential of nearly \$50 million between ESI and Catalyst. It is evident to the Board that the members of the Evaluation Committee reasonably deferred frequently to the work and recommendations of GRS, which ultimately made the determination, using calculations derived from the accepted static financial

model, that ESI was thus cheaper than Catalyst by almost \$10 million per year. This is the principal reason that DBM is recommending award of the PBM contract to ESI even though Catalyst is ranked higher on the technical elements of the proposals.

To use an oft quoted simile from the iconic film, "The Wizard of Oz," the Board, like the Evaluation Committee, must rely upon the assumption that DBM's expert PBM consultants at GRS did indeed "look behind the curtain" in rendering the evaluated price calculations supporting the projection of a five-year price differential of almost \$50 million in favor of ESI. Though the precise mode of tabulation of ingredient cost estimates is not fully disclosed in written GRS reports or any oral testimony concerning that work, the Board cannot conclude that DBM was arbitrary or capricious for relying upon its expert consultant's arithmetic, conclusions, and advice.

All parties recognize that the formula used to render the final price tabulations is uncontested here because no protest was filed prior to proposal submission date of March 12, 2010, but at the same time, the actual cost of contract performance presented to BPW is about \$150 million more per year than the figures identified using the assumptions set forth in the RFP's static financial model developed by GRS, adopted by DBM and accepted by all offerors. The \$800 million five-year difference between the model total and the sum projected to BPW is surely cause enough for DBM to verify all cost estimates and the Board does not doubt that such considerations have continued to take place even though the evidence eligible for Board review terminates with the agency's final determination and recommendation to BPW.

DBM performed a side-by-side comparison of the pricing figures proposed by Catalyst and ESI itemized in Attachment K-4, the Financial Proposals, which are identified as part of Catalyst

Ex. Nos. 11 and 20 and further analyzed in Joint Exhibit 31. The precise information set forth therein cannot be recited here without publicly disclosing sensitive, private, confidential cost and related proposal information that is the subject of Board Confidentiality Orders which prohibit even the attorneys in these appeals from sharing that confidential information with their own clients. Surely a sophisticated expert analysis was performed by GRS as DBM's expert PBM consultants analyzing the financial proposals. Though the method of cost calculation is not disclosed in this proceeding and therefore cannot be subject to informed review, the facts presented to the Board include the conclusions of that analysis reflecting a price difference of nearly \$50 million in favor of ESI, and no evidence is before the Board sufficient to question or criticize that calculation. Therefore the Board cannot conclude that any aspect of this procurement process was arbitrary or capricious. As a result, it would be well beyond the authority of the Board to sustain these appeals. In the end, the decision must be made by BPW, based upon DBM's recommendations as DBM has relied upon the PBM pricing experts at GRS.

All of the foregoing analysis may be rendered moot by virtue of a final pricing verification problem evident in the proposal submitted by Catalyst. Specifically, DBM's ability to audit all costs presented by the State's PBM is a vital and central element of this entire procurement, which is based primarily on notions of transparency and pass-through pricing. It was not until late in the course of considering these proposals that the Evaluation Committee discovered that DBM is unable to audit the ingredient costs offered by drug manufacturers to Catalyst, because Catalyst is not in privity of contract with drug manufacturers. Instead, Catalyst relies upon a purchasing consortium, including its own subsidiary, CAPS, as well as a separate corporate entity, Medco,

to fulfill its drug acquisition requirements from pharmaceutical manufacturers.

There is nothing wrong with aggregating purchases to enhance discounts available for large volume acquisition, but as a consequence of this PBM business model, Catalyst does not know what drug manufacturers charge. Catalyst uses CAPS to purchase from Medco. Catalyst can and did offer to DBM full auditing rights for all transactions to which it is a party, including the relationship between CAPS and Medco, but Catalyst cannot consent to allow any audit or disclosure of costs incurred between drug manufacturers and Medco. By comparison, ESI purchases directly from drug manufacturers, while Catalyst's control of pharmaceutical acquisition is one step removed down the stream of commerce between manufacture and customer purchase. As indicated above, this barrier to auditability was not identified by the Evaluation Committee until the eleventh hour final BAFO phase of proposal evaluation, but it represents a substantial impediment to the State's verification of contract compliance by Catalyst.

Finally, by pre-trial ruling on October 4, 2010, the Board denied appellant's request for Summary Decision on the basis that Catalyst should have been but was not afforded reciprocal in-state bidding preference in procurement evaluation. While the limited identification of available uncontested issues of material fact evident at that time prevented the award of relief to Catalyst, and the same was therefore denied by that determination for the reasons set forth in the Board's prior Order and Opinion on that issue, the Board reserved the possibility of reversing its determination of Catalyst's potential entitlement to reciprocal preference based upon additional evidence adduced at trial, specifically, evidence that the State of Missouri has a law, policy, or practice of affording in-state preferences in procurements conducted by that State. However, because no further evidence on that point was offered at

trial, the Board's prior Order stands unaffected. DBM's determination to deny Catalyst any reciprocal in-state bidding preference is sustained.

For all of the foregoing reasons, these appeals must be DENIED.

Wherefore it is Ordered this _____ day of January, 2012 that these appeals be and hereby are DENIED.

Dated:

Dana Lee Dembrow
Board Member

I Concur:

Michael J. Collins
Chairman

Ann Marie Doory
Board Member

Certification

COMAR 21.10.01.02 **Judicial Review.**

A decision of the Appeals Board is subject to judicial review in accordance with the provisions of the Administrative Procedure Act governing cases.

Annotated Code of MD Rule 7-203 **Time for Filing Action.**

(a) Generally. - Except as otherwise provided in this Rule or by statute, a petition for judicial review shall be filed within 30 days after the latest of:

- (1) the date of the order or action of which review is sought;
- (2) the date the administrative agency sent notice of the order or action to the petitioner, if notice was required by law to be sent to the petitioner; or
- (3) the date the petitioner received notice of the agency's order or action, if notice was required by law to be received by the petitioner.

(b) Petition by Other Party. - If one party files a timely petition, any other person may file a petition within 10 days after the date the agency mailed notice of the filing of the first petition, or within the period set forth in section (a), whichever is later.

* * *

I certify that the foregoing is a true copy of the Maryland State Board of Contract Appeals decision in MSBCA 2759, 2762, 2768, 2780, and 2784, appeals of Catalyst, Rx under DBM Solicitation No. F10B0400006.

Dated:

Michael L. Carnahan
Deputy Clerk