Testimony

United States Senate Committee on the Judiciary

Hospital Group Purchasing: Has the Market Become More Open to Competition?

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STATEMENT OF MARK MCKENNA
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SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY, AND CONSUMER RIGHTS
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Good afternoon Chairman DeWine, Ranking Member Kohl, and distinguished members of the Committee. It is my pleasure to be with you once again to discuss the benefits that Novation¡¦s group purchasing program provides to more than 2,200 health care organizations in all 50 states and the District of Columbia. As you know, these organizations include many of our nation¡¦s finest community-based, not-for-profit hospitals and a majority of its academic medical centers, many of them state-owned.

Last year, Novation exchanged a wealth of information with the Subcommittee about hospital group purchasing in general and about Novation¡¦s business practices in particular. We emphasized three things.

First, that Novation¡¦s owners ¡X VHA and UHC ¡X are cooperatives created by hospitals, owned by hospitals, and governed by hospitals. That distinguishes Novation¡¦s group purchasing program in two important ways: it is (and always has been) entirely member-driven, and it is (and always has been) entirely voluntary. When Novation enters into a vendor contract, the only party that makes a commitment is the vendor. The vendor commits to sell its products to hospital members at agreed-upon prices. The members commit to nothing. They are under no obligation to buy anything at anytime from anyone.

Second, we emphasized that member hospitals receive tremendous financial and clinical benefits by participating in Novation¡¦s group purchasing program. We estimate that in 2003 alone, the discounts and rebates negotiated by Novation will save participating hospitals over $1 billion. And, in addition, because VHA and UHC are cooperatives, member hospitals receive substantial cash distributions each year that further reduce their purchasing costs. Between 1997 and 2002, for example, VHA returned more than $400 million in cash to its member hospitals.

Third, Novation emphasized that our competitive bidding and vendor contracting process is open, fair, flexible and ¡X once again ¡X member-driven.

Recognizing Novation¡¦s unique offerings and market leadership, the Subcommittee urged Novation to take the lead in helping develop an industry code of conduct, promoting best practices, and making certain changes in its operations. You made it clear that you wanted to ensure that smaller vendors had an opportunity to participate in group purchasing programs, and that member hospitals had ready access to innovative technology. We heard you. Novation¡¦s goals have always been consistent with those of the Subcommittee: to offer hospital members the freedom to choose among a wide variety of high quality products at favorable prices and to give all vendors, regardless of size, a full and fair opportunity to participate in Novation¡¦s group purchasing program.

In close collaboration with the Subcommittee, Novation adopted a comprehensive, progressive set of Operating Principles last August. We agreed to make significant changes in seven core areas:

„X Innovative Technology;
„X Sole, Dual and Multi-Source Contracts;
„X Commitment;
„X Contract Term;
„X Private Label;
„X Vendor Fees; and
„X Code of Conduct and Compliance.

Today, less than one year later, I am proud to report that Novation has made substantial progress in all seven areas. Indeed, in many cases, we have taken steps that are not only consistent with the letter of the Operating Principles, but go well beyond its four corners. Before turning to Novation¡¦s progress in each of the seven areas covered by the Operating Principles, I would like to take a moment or two to put this progress into context.

Background

As I noted at the outset, Novation is owned by two legal cooperatives: VHA and UHC. VHA is a cooperative that is owned, governed and controlled by non-profit community hospitals; and UHC is a cooperative that is owned, governed and controlled by academic medical centers, including many state-owned institutions. Together, VHA and UHC represent over 2,200 health care organizations in all 50 states and the District of Columbia.

VHA and UHC are idea-generating and information-disseminating enterprises that help their members pool resources, create economies of scale, and improve clinical operating efficiency. Consistent with this mission, VHA and UHC offer their members group purchasing programs. For purposes of these programs, VHA and UHC act both directly and through Novation, which was created by them to increase the purchasing power of their members.

Vendor Contracting

Novation¡¦s group purchasing program generally work as follows. First, using a wide variety of VHA and UHC member surveys, as well as substantial input from Novation¡¦s 23 member councils (comprised of clinicians and health care professionals from member hospitals), Novation identifies those health care items and services that are needed by VHA and UHC member hospitals. Novation then obtains bids from vendors using a competitive bidding process. This process is well-publicized within the vendor community and is designed to comply with the stringent requirements of the state academic medical centers that belong to UHC. After responsive bids are received, they are rigorously evaluated by Novation „o both in terms of quality and cost „o with extensive input once again from VHA and UHC member hospitals through councils, task forces and surveys. Finally, the winning bidders are selected and the resulting contracts are executed.

As I will discuss in a few moments, in addition to this traditional process, which occurs during regularly scheduled bid cycles, Novation has developed mechanisms that are designed to ensure two things. First, they are designed to ensure that where new and innovative technology enters the market, VHA and UHC members are made aware of this technology in an expedited fashion. Second, they are designed to ensure that if requested by a vendor and approved by the relevant Novation member council, such technology is placed under contract by Novation regardless of whether Novation is in, or is between, its regular bid cycles.

Member Access to Contracts

Once a contract with a particular vendor has been executed, VHA and UHC members may ¡§access¡¨ that contract. That is, member hospitals may purchase the items and services covered by the contract directly from the vendor at issue at the prices agreed upon in the contract. Importantly, VHA and UHC members are not required „o as a condition of membership or otherwise „o to purchase goods or services under any Novation-vendor contract. To the contrary, members are free to purchase all, some or none of their supplies and services under such contracts.

I would like to use a very simple hypothetical, which I will return to again later, to help demonstrate this extremely important point. Assume that there is a bed sheet vendor, which we will call Vendor A. Vendor A enters into a three-year contract with Novation on January 1, 2003. Under this contract, Vendor A agrees to sell bed sheets to VHA and UHC members for $10 each. Now assume that six months later, a second vendor, Vendor B ¡X which does not have a contract with Novation ¡X offers bed sheets directly to a UHC member hospital for $9 each. The UHC hospital is free to purchase such sheets from Vendor B. The hospital also is free, of course, to purchase bed sheets from Vendor A, or, for that matter, from any other vendor of bed sheets.

At Novation, this is true regardless of the product, regardless of the vendor, and regardless of the contract. And this is true regardless of whether the contract is or is not included in (1) Novation¡¦s OPPORTUNITY program, (2) Novation¡¦s NOVAPLUS private-label program, or (3) any other Novation program.

Benefits to Members

Of course, because Novation represents thousands of health care organizations, it typically is able to negotiate better prices from a given vendor for a particular product than any individual hospital, acting on its own, could obtain. As I mentioned a moment ago, Novation estimates that this year alone, the discounts and rebates negotiated by Novation will save participating hospitals over $1 billion.

I should emphasize, however, that aggregating purchasing power is not the only way that Novation saves member hospitals money. Developing and drafting invitations to bid, soliciting responsive bids from prospective vendors, analyzing bids to determine which offer the best combination of clinical value and price, and negotiating contract terms with successful bidders, is a complex process that requires specialized personnel. It also is time consuming and costly. Hospitals avoid these considerable costs by having Novation furnish these various services on their behalf.

Hospitals are able to avoid these costs because VHA and UHC are funded, in large part, through the administrative fees that vendors pay to VHA and UHC under Novation-vendor contracts. These administrative fees, which usually are based on a percentage of the value of member hospital purchases, cover Novation¡¦s clinical evaluation and contract bidding, analysis and negotiation costs „o costs, once again, that member hospitals would otherwise be forced to incur. This funding structure enables hospitals to apply precious resources „o resources that would otherwise be diverted to cover supply chain management costs „o to patient care.

In addition, as I mentioned a moment ago, VHA and UHC are cooperatives. It is common for cooperatives to be funded by fees paid by vendors wishing to do business with cooperative members and to return their net revenue to these members. UHC and VHA are good examples. Each year, VHA and UHC distribute 100 percent of their net revenue ¡X the vast majority of which is generated by administrative fees ¡X to their hospital members. These distributions, which take the form of cash and patronage equity certificates, serve to further reduce the overall supply chain management costs of member hospitals.

Group Purchasing in Non-Health Care and Public Sectors

Not surprisingly, given the benefits involved, group purchasing is not unique to health care. It is common, for example, in the farming, building, hardware, restaurant and other industries. Nor is group purchasing unique to the private sector. Indeed, the benefits of aggregating purchasing power are well-recognized by both state and federal governments.

For example, at the state level, there have been dozens of recent group purchasing initiatives involving pharmaceuticals. The Minnesota Multistate Contracting Alliance for Pharmacy, for example, is a coalition of over 40 states seeking to standardize, consolidate and competitively bid for state requirements for pharmaceutical supplies and services. Similarly, at the federal level, the Departments of Veterans Affairs and Defense have combined their purchasing power to jointly contract for drugs and, according to the General Accounting Office, they have been able to procure significant discounts as a result. See DOD and VA Health Care, Jointly Buying and Mailing Out Pharmaceuticals Could Save Millions of Dollars, GAO/T-HEHS-00-121 (May 25, 2000).

Novation Operating Principles

With this background in mind, let¡¦s turn now to Novation¡¦s Operating Principles and the progress that Novation has made over the last year in implementing them. As I noted a moment ago, the Operating Principles address seven areas. Let¡¦s start with innovative technology.

Innovative Technology

As the Operating Principles correctly observe, VHA and UHC members ¡§expect and deserve access to the most innovative and cost-effective medical technology.¡¨ In order to ensure such access, the Operating Principles note that Novation is ¡§always searching for ways to better serve VHA and UHC members, and is committed to becoming a leader in enabling the development, awareness and utilization of innovative health care technology.¡¨

I am happy to report that Novation has lived up to this commitment, and then some. Shortly after adopting the Operating Principles, Novation created a new department dedicated solely to the identification and evaluation of new and emerging technology. Several months later, Novation launched its web-based ¡§Technology Forum.¡¨ The Forum invites vendors to post information about their new products and devices on Novation¡¦s web site. In this way, both VHA and UHC members, as well the general public, have access to continually-updated descriptions of new products. The Forum also permits a vendor, between Novation¡¦s regular bid cycles, to ask Novation to place its product under contract.

Novation also has been reaching out to vendors of potentially innovative technology proactively, both during and between bid cycles. Through its technology pipeline program, Novation monitors the marketplace for emerging medical technology. Where we identify such technology, we contact the vendor and encourage it to do two things. First, we encourage the vendor to post information about its product on the Technology Forum. Second, in appropriate cases, we encourage the vendor to submit a request for contract consideration to Novation.

I am pleased to report that in just seven months, vendors have posted information on the Technology Forum relating to more than 50 different products. In addition, between the Technology Forum and Novation¡¦s technology pipeline outreach program, Novation has entered into 19 contracts with vendors outside of the regular bidding cycle and a dozen more contracts are currently under review.

Novation also has developed and implemented a more defined and objective process for addressing vendor grievances. Today, Novation immediately acknowledges receipt of all grievances and provides a detailed response within 90 days. This process has yielded meaningful results. For example, one vendor filed a grievance when it did not receive a contract for its product. Novation¡¦s review of this grievance gave rise to a more complete exchange of information and, ultimately, a contract award for a technologically innovative product.

Sole, Dual & Multisource Contracts

The next section of the Operating Principles concerns sole, dual and multisource contracts. Novation made two basic commitments in this area.

First, Novation agreed that, on a prospective basis, it would not award a sole-source contract for a clinical preference product unless two conditions were met: one, there had to be no alternative product that offered incremental patient care or safety benefits; and two, any sole source contract had to be reviewed and approved by the appropriate Novation clinical counsel or task force.

Novation has complied with this provision in full. Since adopting the Operating Principles, Novation has awarded just one sole-source contract for a clinical preference product ¡X IV catheters. In that case, Novation determined that there were no alternative products offering incremental patient care or safety benefits and the award was reviewed and approved by Novation¡¦s Nursing Council and IV Catheter Task Force. In addition, Novation previewed the award with members of the Subcommittee¡¦s staff. I should also note that the successful bidder in this case offered prices that, in the aggregate, were more than 28 percent lower than the next lowest bid.

Second, Novation agreed that, on a prospective basis, it would re-bid a product category or make a dual or multisource award if, in the view of the relevant Novation clinical council or task force, a new product had entered the market that offered incremental patient care or safety benefits. On 10 occasions since the Operating Principles were adopted, Novation has made a dual or multisource award for a clinical preference product because a new product entered the market that offered incremental patient care or safety benefits. Significantly, in six of these cases, the product category had been sole-sourced prior to adoption of the Operating Principles.

Commitment

The third section of the Operating Principles relates primarily to Novation¡¦s OPPORTUNITY program and, more specifically, to Novation¡¦s OPPORTUNITY Spectrum Portfolios. Before turning to Novation¡¦s progress in this area, I would like to spend a moment or two putting the discussion of the OPPORTUNITY program into context.

The OPPORTUNITY program was created in 1996 at the request of member hospitals. These hospitals were seeking greater cost savings in order to compete locally with for-profit hospital chains. In particular, smaller hospitals were looking for ways to earn additional price reductions that were not driven by volume. The OPPORTUNITY program provides such a mechanism by tying price reductions not to the volume of purchases that a member makes from a particular vendor but to the proportion of such purchases in comparison to purchases from vendors that do not participate in the OPPORTUNITY program.

I would like to emphasize, as I did earlier, that no VHA or UHC member is required to purchase any product from any vendor under any Novation contract. With respect to the OPPORTUNITY program, this bedrock principle manifests itself in two ways. First, no VHA or UHC member is required to participate in the OPPORTUNITY program in the first instance. Second, if a member chooses to participate in the OPPORTUNITY program, the member is not required to purchase any product under any contract that Novation has negotiated with any vendor participating in the program.

Once again, I would like to use a simple hypothetical to help demonstrate this important point. Let¡¦s assume, once again, that there are two vendors of hospital bed sheets, Vendor A and Vendor B. Both normally sell their products for $10 each. Vendor A enters into a contract with Novation. Under the contract, Vendor A agrees to sell bed sheets to VHA and UHC members at a discounted price of $9. Under these circumstances, as we have discussed, the only party that has committed to do anything is Vendor A, which has agreed to sell bed sheets to members of VHA and UHC for $9 apiece. The members of VHA and UHC, on the other hand, have committed to nothing.

Now let¡¦s assume that Vendor A decides to participate in the OPPORTUNITY program. As part of its participation, Vendor A agrees that if a VHA or UHC member chooses to purchase 75 percent of its bed sheets from Vendor A, that member will get an additional $1 discount off the already discounted $9 price. Under these circumstances, VHA and UHC members simply have one more option. That is, if a member chooses to participate in the OPPORTUNITY program, the member not only is eligible for the discounted $9 price for bed sheets (under the base contract between Novation and Vendor A), but the member also is eligible for the further discounted $8 price if the member chooses to purchase 75 percent of its bed sheets from Vendor A.

Again, however, by choosing to participate in the OPPORTUNITY program, a member has not committed to do anything. Once again, the only party that has committed to do anything is Vendor A, which has agreed not only to sell bed sheets to all VHA and UHC members for $9 apiece, but also to sell bed sheets for $8 apiece to any VHA or UHC member that, one, chooses to participate in the OPPORTUNITY program and, two, chooses to purchase 75 percent of its bed sheets from Vendor A.

Now let¡¦s turn to the OPPORTUNITY Spectrum Portfolios, specifically. These Portfolios were assembled from Novation¡¦s existing contract base. The selection process was handled by a special task force comprised of representatives from VHA and UHC member hospitals. This task force included a Chief Financial Officer, directors of materials management, and senior personnel from various nursing, pharmacy, radiology and laboratory departments. The process was guided by a value analysis facilitator, three separate member surveys, and feedback from the Novation Nursing, Materials and Peri-operative Councils. The task force considered a wide variety of options over a

several month period before making its final selection. In general, member hospitals expressed a strong preference for the inclusion of highly utilized contracts in order to permit cost savings without the extensive disruptions and expenses often associated with product conversions.
With this background in mind, let¡¦s turn back now to the Operating Principles, which include four provisions relating either to Novation¡¦s OPPORTUNITY Spectrum Portfolios or to related issues.
First, the Operating Principles provide that Novation will impose no commitment requirements as a condition of participating in any base vendor contracts or as a condition of membership or continued membership in VHA or UHC. Novation has complied with this provision of the Operating Principles and will continue to do so.
Second, the Operating Principles provide that any vendor proposal that offers additional discounts in exchange for commitment levels in excess of 75 percent on clinical preference products will be reviewed and approved by the relevant Novation clinical council or task force before going into effect. Novation also has complied with this provision of the Operating Principles and will continue to do so.
Third, the Operating Principles provide (1) that hospital participation in OPPORTUNITY Spectrum Portfolios will be voluntary, (2) that such participation will not be a precondition to a hospital joining or maintaining membership in VHA or UHC, and (3) that the price discounts offered by Novation under its base vendor contracts will continue to be available to any member whether or not the member makes any purchasing commitment or participates in OPPORTUNITY Spectrum Portfolios. Once again, Novation has complied with this provision of the Operating Principles and will continue to do so.
Fourth, and finally, the Operating Principles provide that, on a prospective basis, Novation will:
„X review its OPPORTUNITY Spectrum Portfolio descriptions and contracts to eliminate language that could be construed as anti-competitive;
„X eliminate combinations of clinical and non-clinical preference products in the OPPORTUNITY Spectrum Portfolios;
„X eliminate combinations of capital equipment and consumable products in the OPPORTUNITY Spectrum Portfolios;
„X increase the percentage of dual and multisource vendor contracts in the OPPORTUNITY Spectrum Portfolios; and
„X pursue the implementation of lower purchasing commitment levels within the OPPORTUNITY Spectrum Portfolios.
By their terms, the OPPORTUNITY Spectrum Portfolios are set to expire in early 2005. Novation has decided, however, to implement a replacement for this program next year. The new program will comply with all of the above provisions of the Operating Principles. Furthermore, although the Operating Principles only require Novation to act on a prospective basis, since August of last year, Novation has made several changes to the existing OPPORTUNITY Spectrum Portfolios.
In March 2003, for example, Novation notified all members and vendors participating in the OPPORTUNITY Spectrum Portfolios that, effective immediately, Novation was proactively removing any language in any member or supplier participation agreements that might be construed as anti-competitive.
Also in March 2003, Novation notified all participating GPO members that, effective April 1, 2003, Novation was eliminating the requirement that members participating in the OPPORTUNITY Spectrum Portfolios purchase capital equipment in order to meet the requirements of the program.
Two months later, in May 2003, Novation notified all participating GPO members that, effective immediately, Novation was eliminating any penalties associated with a member dropping out of the program and, as a result, would no longer require restitution of previously earned incentives.
Finally, Novation¡¦s member councils have reviewed all contracts in the current OPPORTUNITY Spectrum Portfolios and determined which, if any, cover clinical preference products. With respect to two of these products ¡X specialty interventional urology and pulse oximetry products ¡X Novation

has added lower, 75 percent purchasing levels to the portfolios.

Contract Term

The next section of the Operating Principles concerns the term of Novation-vendor contracts. This section imposes five obligations on Novation.

First, the Operating Principles provide that Novation will preserve its existing contracting flexibility by ensuring that all of its vendor contracts permit contract termination without cause upon 90 days written notice. Every new contract that Novation has executed since adoption of the Operating Principles has included a 90-day termination without cause provision, and Novation will continue to include this provision in each of its vendor contracts.

Second, the Operating Principles provide that Novation will preserve its existing contracting flexibility by including a provision in vendor contracts permitting Novation to add vendors or terminate and re-bid the contract if Novation identifies a product that offers incremental patient care or safety benefits. Every contract that Novation has executed since adoption of the Operating Principles has included this provision, and Novation will continue to include this provision in each of its vendor contracts. I would also note that both during and between regular bid cycles Novation¡¦s new Technology Forum and pipeline outreach programs ¡X which I discussed a few moments ago ¡X not only permit, they encourage, the consideration of products that offer incremental patient care or safety benefits.

Third, the Operating Principles provide that, on a prospective basis, Novation will limit vendor contracts to an initial term of three years or less. Since August 2002, Novation has not entered into any contracts with an initial term of more than three years.

Fourth, the Operating Principles provide that, on a prospective basis, Novation will thoroughly and objectively evaluate alternative technologies before exercising any option to renew a vendor contract. Since adopting the Operating Principles, Novation has developed and is implementing policies to ensure the thorough and objective evaluation of alternative technologies before Novation enters into or extends any vendor contract.

Fifth, and finally, the Operating Principles provide that ¡§[a]s necessary and appropriate,¡¨ and on a prospective basis, Novation will modify contracts that have terms that ¡§erect a barrier (or a perceived barrier) to member access to innovative technology.¡¨ Following the adoption of the Operating Principles, Novation set up a process designed to ensure that all new contracts, as well as contracts coming up for extension, do not have language that erects such a barrier. In addition, as I discussed a few moments ago, Novation has proactively removed such language from OPPORTUNITY Spectrum Portfolio documents.

Private Label

The next section of the Operating Principles concerns Novation¡¦s NOVAPLUS private label program. Once again, before turning to these provisions, I would like to take a moment to provide some background information on this program.

The NOVAPLUS portfolio, which is the only brand of health care products developed by hospitals for their own financial benefit, includes approximately 1,500 commodity items, such as disposable pillows, elastic bandages and ice packs. These products have three distinguishing characteristics: one, they are identical to their supplier-branded equivalents; two, they are used by VHA and UHC members in large volumes; and three, they are offered at extremely favorable prices.

Novation also places a premium on the quality of the products in the NOVAPLUS portfolio. Toward this end, Novation carefully selects its NOVAPLUS manufacturing partners and evaluates their products and services through a rigorous quality assurance process. For example, Novation's quality assurance/regulatory affairs team conducts regular inspections of vendor manufacturing plants for all NOVAPLUS products.

Finally, the NOVAPLUS program does not benefit only VHA and UHC members. The brand also has helped smaller manufacturers, with less market recognition, to compete effectively with manufacturers many times their size. Indeed, in several cases, NOVAPLUS products have eclipsed

leading national brands as the market share leader within VHA and UHC member organizations.
With this background in mind, let¡¦s turn back to the Operating Principles, which impose three basic obligations on Novation with respect to the NOVAPLUS program.
First, Novation agreed, on a prospective basis, to limit the NOVAPLUS program to commodity products. Novation has complied with this provision. In addition, although not required by the Operating Principles, Novation has reviewed each and every existing medical-surgical contract in the NOVAPLUS program portfolio, identified three that cover clinical preference products, and arranged to have these products removed from the program.
Second, Novation agreed, also on a prospective basis, to reduce NOVAPLUS vendor fees while achieving equal value to members through improved price reductions or other member incentives. Since adopting the Operating Principles, all new NOVAPLUS program contracts and contract extensions have provided for, or, in a handful of cases, have been amended to provide for, combined administrative and licensing fees of six percent or less.
In addition, although not required by the Operating Principles, Novation is reviewing all NOVAPLUS program contracts that were executed prior to August 8, 2002 and have not come up for re-bid or extension. Where such a contract calls for a fee of greater than six percent, Novation is working with the relevant vendor to reduce the fee to six percent (or less). To date, Novation has reduced the fees in nine such agreements, and an additional six amendments are awaiting signature.
Third, Novation agreed, again on a prospective basis, to take further steps to document and communicate to member hospitals the benefits of the NOVAPLUS program. For example, after adopting the Operating Principles, Novation undertook 26 price studies covering 511 medical-surgical products. Novation compared the prices that hospitals were paying for these products to what they would have paid under the NOVAPLUS program. Novation found that participating hospitals would have saved, on average, 14 percent had they purchased the products at issue through NOVAPLUS. Novation has communicated the results of these studies to VHA and UHC members. In addition, through its maintenance of Novation¡¦s robust web site, which includes a section devoted to the NOVAPLUS program, as well as other publications and outreach efforts, Novation is ensuring that VHA and UHC members are aware of the program¡¦s benefits.
Vendor Fees
The next section of the Operating Principles addresses the vendor fees that are paid to Novation. As I discussed at the outset, these fees serve two critical cost-saving functions for VHA and UHC members.
First, they fund the vast array of supply chain management services that Novation furnishes to member hospitals. Indeed, every dollar in fees that vendors pay to Novation is a dollar in costs that member hospitals do not have to expend on supply chain management and, therefore, is a dollar freed-up to improve patient care.
Second, because VHA and UHC are cooperatives, the difference between the amount of vendor fees that Novation receives and Novation¡¦s supply chain management costs is returned to VHA and UHC member hospitals, further reducing their supply costs. As I mentioned at the outset, between 1997 and 2001, VHA alone returned $250 million in cash to its member hospitals.
With this in mind, let¡¦s turn now to Novation¡¦s implementation of the five provisions in the Operating Principles relating to vendor fees.
First, Novation agreed, on a prospective basis, that it would not accept vendor fees prior to the inception of a contract or in the form of vendor equity. Novation has complied with these provisions and will continue to do so.
Second, Novation agreed, on a prospective basis, that it would take steps to further ensure that vendor fees are not a determinative factor in the award of contracts under Novation¡¦s competitive bidding process, except in those situations where the quality and pricing of competing products is essentially the same. After adopting the Operating Principles, Novation modified its bid assessment process to conduct two decision criteria award matrix ¡X or ¡§DCAM¡¨ ¡X assessments per bid. The first

assessment includes vendor fees as an evaluated factor; and the second assessment does not. This revised process ensures that fees will only be a factor where, consistent with the requirements of the Operating Principles, the quality and pricing of competing products are essentially the same.
Third, the Operating Principles provide that Novation will explore ways to make fee disclosures to VHA and UHC members even more transparent and user-friendly. Toward this end, Novation and the GPOs have spent months developing secure internet databases listing vendor contract fee provisions that are not fixed at three percent or less. These databases, which are being rolled out in phases, will be updated on an ongoing basis and are available to GPO members 24 hours a day, 365 days a year.
Fourth, the Operating Principles provide that with respect to clinical preference products, Novation, on a prospective basis, will reduce administrative fees that are above three percent to three percent, while achieving equal value to members through improved price reductions or other member incentives. Since adopting the Operating Principles, Novation has not entered into any contract for a clinical preference product providing for vendor fees in excess of three percent.
In addition, although not required by the Operating Principles, Novation is reviewing vendor contracts that were executed prior to August 8, 2002. To date, Novation has reviewed contracts in 408 out of a total of 468 medical-surgical product categories and will complete its review of the contracts in the remaining 60 categories on or before December 31, 2003. Where Novation determines that such a contract includes a clinical preference product and provides for fees in excess of three percent, Novation is contacting the relevant vendor to negotiate additional price reductions or other member incentives, along with a reduction of the fee.
Fifth, and finally, the Operating Principles provide that with respect to clinical preference products, Novation will not accept other forms of contract-related marketing fees and that vendor participation in any additional programs for which fees may be charged (such as trade shows or advertising) will be voluntary and a vendor¡¦s participation (or non-participation) will have no bearing upon contracting decisions.
With respect to the first point, none of the clinical preference product contracts in the 408 product categories that Novation has reviewed include marketing fees of the type covered by this provision. Novation will determine whether any of the contracts in the remaining 60 product categories provide for such fees and, if so, the contracts will be amended to eliminate such fees. With respect to the second point, since adoption of the Operating Principles, vendor participation in programs for which fees have been charged has been entirely voluntary and such participation (or non-participation) has had no bearing upon contracting decisions.
Novation Code of Conduct & Compliance Program
The final section of the Operating Principles concerns Novation¡¦s compliance program. As Novation noted in the Operating Principles, at the time they were adopted Novation¡¦s compliance program was being reviewed, enhanced and customized. Toward this end, in the Fall of 2002, Novation appointed a Corporate Compliance Officer and Novation¡¦s Board of Directors appointed a Board-level Corporate Compliance Committee.
The Compliance Officer and Corporate Compliance Committee, together with Novation¡¦s Board of Directors and senior management, have taken an active and energetic role in ensuring the implementation of the Operating Principles. Among other things, Novation has (1) designated a Compliance Manager in nine different areas (including each of the areas addressed in the Operating Principles), (2) trained every employee with respect to Novation¡¦s revised business ethics policies, and (3) trained every employee involved in vendor contracting with respect to the Operating Principles and the various policies and procedures that Novation has developed relating to the Principles.
Finally, the Operating Principles provide that Novation will prohibit Novation and its employees and directors from owning certain types of equity interests. These provisions, which go beyond those required by the HIGPA Code of Conduct, have been implemented through a written certification process involving all Novation employees and all members of Novation¡¦s Board.

Conclusion

In conclusion, let me say that I am quite proud of the progress that Novation has made in implementing the Operating Principles that the company adopted less than one year ago. We have opened up new doors to innovative technology. We have increased the flexibility of our contracting process. We have expanded and enriched Novation¡¦s product offerings. We have eliminated perceived barriers to member choice. And we have emphasized and reemphasized that such choice is a bedrock Novation principle.

Although I am proud of this progress, I should make it clear that we at Novation recognize that our job is not done. Not by a long shot. Implementing the Operating Principles has required, and will continue to require resolve, structure, resources and, above all else, diligence. On behalf of VHA and UHC members, I can promise you that Novation has the resolve, is developing the structure, will devote the resources, and is committed to doing whatever it takes to get the job done.

Thank you.