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Insights

Plan Sponsors Take Note: New Litigation Brings Attention to Potential Fiduciary Risk for Group Health Plan Sponsors

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In a widely publicized lawsuit filed in February of this year, former Johnson & Johnson ("J&J") employee Ann Lewandowski sued the pharmaceutical giant for allegedly breaching its fiduciary duties under the Employee Retirement Income Security Act of 1974 ("ERISA"). The lawsuit seeks class action certification on behalf of all participants in J&J's health plan, and names the company, its benefits committee, and three officers in the human resources department as responsible for the breach.

The crux of Lewandowski's complaint is that J&J substantially overpaid for prescription drugs covered under J&J's group health plan, thereby increasing the prices paid by plan participants. According to the complaint, not only did participants pay too much at the pharmacy counter, but employees also saw increases in their share of medical premiums, deductibles, copays, and coinsurance due to these inflated drug costs.

This lawsuit again brings to light a problem that has garnered increasing attention on a national scale in recent years: the high cost of pharmaceuticals in the United States. Those costs are driven in part by tactics in the Pharmacy Benefit Manager ("PBM") space known as "spread pricing" and rebating. In simple terms, spread pricing involves the PBM inflating the price of drugs over the actual wholesale costs and pocketing the difference as profits. Rebates, paid by drug manufacturers to ostensibly lower the cost of brand name and generic drugs, are often kept by PBMs rather than being passed through as savings to benefit plan or participants. In addition, new Transparency in Coverage regulations have now brought some of these practices out into the open, creating additional scrutiny on plan fiduciaries to understand what they are paying for in PBM arrangements.

What is the Plan Sponsor's Obligation?

Under ERISA Section 404, a plan fiduciary must, among other things, act solely in the best interests of plan participants, exercising "care, skill, prudence, and diligence" that a prudent person acting in a like capacity familiar with such matters would utilize. This includes utilizing prudence in selecting and monitoring plan service providers, such as a PBM. These are the fiduciary duties that Lewandowski alleges were breached by J&J. According to the compliant, J&J's benefits committee did not take proper measures to ensure its pharmacy costs were reasonable, and did not use prudence in selecting its PBM and negotiating more favorable contract terms.

Many industry experts believe that this is the first of many fiduciary lawsuits to come in the medical and pharmacy space, particularly due to new transparency requirements. With this in mind, ERISA plan sponsors should consider the following actions to limit exposure to fiduciary liability.

1. **Know the terms of your PBM contract.** The focus here should be on the average wholesale price of drugs, the required dispensing cost, how such costs are determined, and what contractual discounts are provided.
2. **Understand how your PBM is compensated.** Ask whether the PBM retains some or all of the available manufacturer revenue (including drug rebates). Require the PBM to disclose all revenue sources and amounts, so that the plan fiduciaries can determine whether the plan is paying reasonable compensation for the PBM's services.
3. **Consider PBM transparent pricing models.** With increasing attention on pharmaceutical pricing, transparent PBM arrangements are becoming more common. A transparent pricing model is one where the PBM is paid a per-employee-per-month fee and/or other lump sum fees for its administrative services and retains no additional revenue outside of those fees.
4. **Work with your advisor or consultant to periodically review market options.** Knowing what is available in the market and for decisionmaking in choosing the plan's service providers, including PBMs, is the best approach to avoiding claims of fiduciary breach. Outline all of the factors involved in the decision, whether financial or otherwise. Having gone through the due diligence of looking at PBM market options, plan sponsors will be able to show the rationale for their PBM decision based on actual pricing data and other relevant factors.

The benefits industry saw a similar trend over the last decade or more with hidden fees charged by retirement plan service providers. In those cases, plan sponsors who diligently reviewed all revenue sources in their service provider contracts were best positioned to avoid and defeat expensive fiduciary liability claims.

If you have questions or would like to learn more about your obligations as plan fiduciaries, please reach out to Catherine M. Stowers or any member of Krieg DeVault's Employee Benefits and Executive Compensation practice group.

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