

NOVATION, LLC

NOVATION OPERATING PRINCIPLES

**SUBMITTED TO THE UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, COMPETITION
AND BUSINESS AND CONSUMER RIGHTS**

August 8, 2002

Novation, LLC (“Novation”) is the joint purchasing agent of University HealthSystem Consortium (“UHC”) and VHA Inc. (“VHA”), two hospital alliances that were formed and owned and governed by not-for-profit academic medical centers and community-based hospitals. Novation is committed to operating a truly voluntary group purchasing program that provides members of UHC and VHA with full access to any health care item or service (including innovative medical technologies) from any vendor regardless of whether that vendor has a contract with Novation. As part of that commitment, Novation has worked closely with the Health Industry Group Purchasing Association (“HIGPA”) — to develop and implement an industry code of conduct. Novation also has reviewed and enhanced its own operating practices. Novation is submitting this document to the Senate Committee on the Judiciary, Subcommittee on Antitrust, Competition and Business and Consumer Rights (“Subcommittee”) to further underscore its commitment to improving certain group purchasing policies and procedures.

I. INNOVATIVE TECHNOLOGY

UHC and VHA members expect and deserve access to the most innovative and cost-effective medical technology. Novation’s business practices, including its competitive bidding process, have been — and will continue to be — aligned to ensure such access. Novation, however, is always searching for ways to better serve UHC and VHA members, and is committed to becoming a leader in enabling the development, awareness and utilization of innovative health care technology. As part of that commitment, Novation is determined to make itself, its advisory councils, and UHC and VHA members even more aware of innovative technologies. Novation is also determined to ensure that the vendors of such technology have a meaningful opportunity to participate in Novation’s contracting process.

Toward these ends, Novation will augment its current practices by (for example):

- developing and implementing a more comprehensive and defined process for evaluating innovative technology and ensuring that this process:
 - is open and fair, protects the confidentiality of innovative technology, and is not unduly burdensome, time-consuming or cost-prohibitive;

- considers innovative technology outside of the applicable contracting cycle;
- increases the involvement of UHC and VHA hospital members and, where appropriate, outside experts, in the evaluation of innovative technology;
- adheres to policies and procedures that offer a defined and objective process to address vendor grievances relating to the evaluation of innovative technology;
- increasing overall awareness of innovative technology through the creation of a forum within its Web site wherein member hospitals and vendors may provide and exchange information about innovative technology; and
- reiterating and reinforcing — to UHC and VHA members, vendors and the public at large — Novation’s commitment to operating a voluntary group purchasing program that gives members the freedom to purchase any product that they determine offers the best combination of clinical value and price, regardless of whether the product is under contract with Novation.

II. SOLE, DUAL AND MULTISOURCE CONTRACTS

Novation is committed to a member-driven, integrity-driven, public competitive bid contracting process that awards contracts to suppliers that provide the best quality products and lowest total cost – as determined by the members of VHA and UHC.

Novation is also committed to reviewing its contracting process on an ongoing basis to ensure that its utilization of sole-source contracts is appropriate and facilitates the successful introduction of innovative technology to members. Further, in recognition of the unique dynamics associated with clinical preference products¹, on a prospective basis, Novation:

- will not award a sole-source contract for a clinician preference product¹ that has an alternative that offers incremental patient care benefits or incremental safety benefits;
- will re-bid the relevant product category or make a dual or multisource award (based upon the review and recommendation of the relevant Novation clinical council or task force) in the event a new product enters the market that offers incremental patient care benefits or incremental safety benefits; and

¹Clinical preference products shall refer to any medical device or any item of medical equipment or supply used to treat a patient for any illness, injury, condition, disease or ailment about which a physician or other clinician (including nurses) could reasonably be expected to express a preference or could be expected to effect patient health or safety or worker health or safety. Relevant member councils or task forces will make the determination as to whether or not a particular product is a clinical preference product.

- will require that all recommendations to award a sole-source contract for a clinical preference product¹ receive review and approval by the relevant Novation clinical council or task force before going into effect.

III. COMMITMENT

Novation will impose no commitment requirement as a condition to participate in any base vendor group purchasing contracts or as a condition of membership or continued membership in UHC or VHA.

Any vendor's proposal that offers additional discounts in exchange for commitment levels over 75% on clinical preference products¹ will be reviewed and approved by the relevant Novation clinical council or task force before going into effect. In making this determination, the relevant council or task force shall endeavor to ensure maximum choice for member hospitals, physicians, clinicians and patients for clinical preference products¹ and to facilitate the introduction of innovative clinical preference products¹.

With respect to Novation's OPPORTUNITY[®] Spectrum Portfolios, these portfolios were originally designed and implemented to provide competitive advantages to not-for-profit hospitals by giving them access to the type of price reductions and rebates offered by vendors to for-profit hospital chains. The OPPORTUNITY[®] program — which offers “best-of-breed” product combinations from multiple vendors — also was intended to provide not-for-profit hospitals with a viable alternative to standard vendor volume and market-share discount programs that linked price reductions on one product to a hospital's agreement to buy other, less desirable products from the same vendor.

Consistent with Novation's broader commitment to operating a voluntary group purchasing program:

- hospital participation in OPPORTUNITY[®] Spectrum Portfolios is and will continue to be completely voluntary;
- participation in OPPORTUNITY[®] Spectrum Portfolios is not and will not be a precondition to a hospital joining or maintaining membership in UHC or VHA; and
- the price discounts offered by Novation under its base vendor contracts are and will continue to be available to any member whether or not the member makes any purchasing commitment or participates in OPPORTUNITY[®] Spectrum Portfolios.

In addition, on a prospective basis, Novation will:

- review its OPPORTUNITY[®] Spectrum Portfolio descriptions and contracts to eliminate language that could be construed as anti-competitive;
- eliminate any combination of clinical preference products¹ and non-clinical preference products or any combination of unrelated clinical preference items with each other in OPPORTUNITY[®] Spectrum Portfolios;
- eliminate combinations of capital equipment and consumable products in OPPORTUNITY[®] Spectrum Portfolios;
- increase the percentage of dual and multisource vendor contracts in OPPORTUNITY[®] Spectrum Portfolios; and
- pursue the implementation of lower purchasing commitment levels within the OPPORTUNITY[®] Spectrum Portfolios.

IV. CONTRACT TERM

Novation's position is that neither contract length nor other contract provisions should encumber hospital access to innovative technology. By the same token, Novation's competitive bidding process takes, on average, nine months to complete, making it highly inefficient and prohibitively expensive to re-bid contracts after only one or two years.

With this position and information in mind, Novation is reviewing all of its vendor contracts to ensure that contract terms do not erect a barrier (or a perceived barrier) to member access to innovative technology. As necessary and appropriate, on a prospective basis, Novation will modify any such contracts. In addition, Novation will preserve its existing contracting flexibility by:

- ensuring that all of its vendor contracts permit (and continue to permit) contract termination without cause, upon 90 days written notice; and
- including a provision in its vendor contracts permitting Novation to add additional vendors or to terminate and re-bid the contract in the event of the introduction of products which offer incremental patient care benefits or incremental safety benefits.

Further, in recognition of the subcommittee's concerns relating to the potential anti-competitive effects of long-term contracts, on a prospective basis, Novation will:

- limit vendor contracts to an initial term of three years or less; and
- thoroughly and objectively evaluate alternative technologies before exercising any option to renew a vendor contract.

V. PRIVATE LABEL

Novation's private-label program — NOVAPLUS™ — is member-driven, assisting hospitals in achieving standardization and additional cost savings with respect to frequently purchased, commodity products. Notwithstanding the benefits of the NOVAPLUS™ program to UHC and VHA members — and despite the fact that the NOVAPLUS™ program represents just 5 percent of member purchases through Novation — Novation will take several steps to address the Subcommittee's concerns. Specifically, on a prospective basis, Novation will:

- limit the NOVAPLUS™ program to commodity products;
- reduce the vendor administrative fees associated with private-label products while achieving equal value to members through improved price reductions or other member incentives;
- take further steps to document and communicate the benefits derived from the NOVAPLUS™ program, including product standardization, safety improvement, training efficiencies and the like; and
- enhance communications to members with regard to services and activities uniquely associated with the NOVAPLUS™ private-label brand.

VI. VENDOR FEES

Although the payment and acceptance of vendor fees is both legal, appropriate and common in other industries, in order to avoid any inference that the timing or amount of fees may affect contract awards, on a prospective basis, Novation will not accept administrative or marketing fees of any kind from vendors that are paid prior to the inception of the contract.

Novation will not accept administrative fees in the form of vendor equity.

Moreover, on a prospective basis, Novation will implement additional measures 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 are essentially the same).

Although UHC and VHA already provide their members with robust fee disclosures, Novation will explore ways to make its disclosures (including those relating to private-label products) even more transparent and user-friendly (such as providing members with password-protected electronic access to vendor fee information).

On a prospective basis, with respect to clinical preference products¹, Novation will reduce administrative fees that are above 3 percent to 3 percent while achieving equal value to members through improved price reductions or other member incentives.

In addition, for clinical preference products¹, Novation will not accept other forms of contract-related marketing fees. Vendor participation in any additional services for which fees may be charged (such as trade shows or advertising) shall be entirely voluntary and a vendor's participation (or nonparticipation) shall have no bearing upon contracting decisions.

VII. NOVATION CODE OF CONDUCT & COMPLIANCE PROGRAM

Novation's compliance program — which is monitored and enforced by Novation's Board of Directors and executive management team — is being reviewed, enhanced and customized to reflect Novation's distinct ownership structure and corporate mission. A number of the resulting policies and procedures will be more stringent than those set forth in the HIGPA code of conduct. For example, Novation's compliance program will:

- prohibit the ownership of individual equity interests by all directors, employees and their spouses and minor children in companies (such as Neoforma Inc.) in which Novation, UHC or VHA own securities, warrants, options, or debt instruments (including loans), or rights to acquire any of the foregoing;
- prohibit Novation from owning any equity interests in any vendor that sells (or can be reasonably expected to sell within the next two years) items or services to hospitals (regardless of whether the vendor has a contract with Novation);
- prohibit participating vendors from owning equity interests in Novation;
- prohibit all Novation employees (and not just those in a position to influence contracting decisions) from accepting gifts, entertainment, favors, and the like (other than those of nominal value) from vendors;
- prohibit (1) Novation employees who are in a position to influence contracting decisions in a particular product category (e.g., pharmaceuticals) and (2) their spouses and minor children from owning individual equity interests in any vendor that has a contract with Novation, has submitted a bid to Novation, or can reasonably be expected to submit a bid within the next two years in connection with that product category; and
- prohibit members of Novation's senior management (who are determined by the Novation Board of Directors to exercise pervasive influence over Novation's contracting process), their spouses and minor children from owning individual equity interests in any Novation vendor or any vendor that can reasonably be expected to submit a bid for a clinical preference product¹ within the next two years.

* * *