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When a Buyer for Hospitals Has a Stake in Drugs It Buys

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Dr. Tom Ferguson was puzzled when a patient on an IV drip of the antibiotic gentamicin suddenly experienced a sharp fall in blood pressure and a racing pulse. Then it happened to a second patient.

When a third patient began to shake uncontrollably just 10 minutes after beginning her gentamicin IV, Dr. Ferguson, an infectious disease specialist in Texas, knew what to do: stop giving the medicine, and find out who made it. In this case, the antibiotic came from American Pharmaceutical Partners.

After other doctors reported that the company's gentamicin had made some patients sick, American Pharmaceutical pulled the drug from the market in 1999.

It would not be the last of American Pharmaceutical's troubles. Yet the company has grown rapidly into one of the nation's leading suppliers of injectable generic drugs. One reason: it has what so many medical-supply companies covet — a national contract with Premier Inc., one of the hospital industry's biggest buying groups, serving more than 1,500 hospitals.

Premier officials say they select products for their quality and low prices. But Premier also had a financial interest in seeing the drug company succeed.

Premier helped to set up American Pharmaceutical in 1996, then steered hospital business to it. For this help and an initial \$100 investment, Premier received American Pharmaceutical stock that was worth \$46 million when the company went public last year. Premier says it also receives a percentage of the money that hospitals spend buying American Pharmaceutical's drugs.

If American Pharmaceutical has helped Premier, it has also been good for two former Premier executives. William J. Nydam, once an executive vice president of Premier, received stock options as an American Pharmaceutical director. He has since left Premier, but his options were worth \$1.2 million at the stock's initial offering price.

Palmer Ford, who worked for Premier's venture capital unit, received an undisclosed number of American Pharmaceutical options for consulting work after he had left the buying group, Premier said.

In its brief history as a drug maker, the company has recalled or withdrawn 20 drugs and the government has warned it three times to fix serious quality control problems. A Food and Drug Administration official said the company "had probably more problems than the average firm but it sounds like they worked them out."

Federal authorities are also investigating whether American Pharmaceutical and its parent company, American BioScience, in which Premier also has a stake, conspired with a major drug maker to keep a cheaper generic cancer drug off the market — a charge the companies deny.

That Premier could help turn a company with virtually no assets six years ago into one that raised \$144 million in its initial public offering in December underscores the buying group's enormous market power. It also illustrates the potential conflicts of interest that exist in the world of medical-supply commerce, where billions of dollars worth of goods and services change hands each year with little public oversight.

Hospital buying groups are middlemen, negotiating contracts with suppliers of products and services. But unlike most other purchasing agents, these groups are not financed by the hospitals that buy products, but by the companies that sell them, raising questions about whose interests the buying groups serve. The two biggest groups, Premier and Novation, account for \$34 billion in annual sales, covering about half of the nation's nonprofit hospitals.

Premier or its investment fund has also held financial interests in more than 20 medical supply and service companies, about 10 of which, like American Pharmaceutical, had at one time or another contracts or business ties with Premier.

Premier denies that its financial holdings affect who gets contracts. In the case of American Pharmaceutical, Premier's goal was "to encourage the success of a new company providing a new channel of generic drugs," said James K. Gardner, a lawyer representing Premier, in a letter to The New York Times. Premier says it is happy with the company's performance.

Mr. Gardner added that Premier's relationship to American Pharmaceutical was not the norm. "It would be totally inaccurate and misleading to portray this relationship as representative of Premier's business practices as a whole," he said.

But Senator Herb Kohl, a Wisconsin Democrat and chairman of the antitrust subcommittee, called Premier's ties to American Pharmaceutical — which he first learned about from The Times — "scandalous."

"They're not to enrich themselves in any way," Senator Kohl said. "They should have no conflict of interest. None at all."

The senator's subcommittee plans a hearing next month to examine the financial links between hospital buying groups and suppliers. Those links, and the potential conflicts of interest that they raise, were the subject of a recent inquiry by The Times.

"These buying groups were created to keep health care costs down," said Larry R. Holden, president of the Medical Device Manufacturers Association, a Washington-based trade group of mostly small businesses. "If they have done some of the things that you say they've done, how in that business model are we saving the health care consumer money?"

A Drug Maker's Rise: Untested Partner Is Transformed

On July 7, 1997, Premier announced briefly that it had struck a deal with American Pharmaceutical Partners to sell drugs to Premier's hospitals. The statement did not mention Premier's financial interest in either American Pharmaceutical, based in Los Angeles, or its controlling shareholder, American BioScience.

Nor did Premier say that its new supplier existed back then mostly on paper. As a small drug broker, it made no drugs, owned no factories and had few assets.

Moreover, American Pharmaceutical was named one of Premier's elite "corporate partners" — companies that were able to sell their products to Premier hospitals under favorable terms. That status was held then by just seven global companies like Johnson & Johnson ([news/quote](#)) and Merck ([news/quote](#)). Both of those had revenues in the billions of dollars. American Pharmaceutical had a mere \$85,000 in net sales the previous year.

In selecting such an untested company, Premier was putting its faith in the drug company's chief executive, Dr. Patrick Soon-Shiong, a surgeon who had little background in the generic drug trade.

Dr. Soon-Shiong had gained fame briefly in the mid-1990's with miraculous-sounding results from an experimental treatment for Type 1 diabetes, the most devastating form of that disease. Several national news organizations reported that his star patient, 38-year-old Steven Craig, appeared to be much better after receiving a transplant of insulin-producing pancreas cells.

Premier, mindful that hospitals might benefit from such a breakthrough, had its venture capital unit invest about \$4 million in the doctor's research companies in 1996.

But some researchers and diabetics began questioning Dr. Soon-Shiong's results — questions that continued as years went by.

Dr. Andrew J. Drexler, director of Mount Sinai's Diabetes Center in New York, said, "He was never able to reproduce it."

Mr. Craig, after several years of praising his treatment, put the barrel of a gun to his head in 1998 and pulled the trigger. His widow, Peggy Craig, said that he was despondent over his poor health.

Dr. Soon-Shiong defended his research in a brief interview, saying Mr. Craig "made a major contribution to mankind."

While the medical research continued, Premier and Dr. Soon-Shiong came up with a quicker path to success — selling generic drugs to hospitals. Beginning in 1996, American Pharmaceutical began to broker drugs for companies like Fujisawa USA. Fujisawa hired American Pharmaceutical partly because it knew that Premier, as a part owner, "could guarantee us or ensure we would get more business with Premier," a Fujisawa USA executive vice president, Theron E. Odlaug, said in court papers.

Another drug company, Sicor Inc., paid American Pharmaceutical as much as 10 percent of its net sales to Premier hospitals. That relationship ended in litigation that was settled out of court.

American Pharmaceutical was only a "toll taker," Craig Lea, a Sicor vice president, said. The company, in his view, was simply selling "access" to Premier hospitals. "That is what it was," he said. "It was access. You got a chance to get in the door."

By 1998, American Pharmaceutical had sufficient funds to buy two money-losing plants owned by Fujisawa of Japan.

Quality Problems Arise: An Antibiotic Is Withdrawn

American Pharmaceutical thought it could turn those plants around. A memo seeking to raise money for American Pharmaceutical cited, among other things, its close ties to Premier as evidence that it might do better than Fujisawa had.

That proved prophetic. American Pharmaceutical, one Wall Street analyst recently noted, took just six months to reverse what had been nine consecutive years of operating losses reported by Fujisawa.

While Premier may have helped jump-start American Pharmaceutical — Premier got more drug company stock based on sales — American quickly adopted a strategy of selling to other buying groups, including the biggest, Novation. As it did with Premier, American Pharmaceutical paid Novation fees that were a percentage of hospitals' purchases of its drugs. Neither group would say how much it was paid.

But if sales were good, American Pharmaceutical had to deal with manufacturing problems, some inherited from Fujisawa. Just weeks before American Pharmaceutical took over the Fujisawa plants in June 1998, federal regulators began receiving reports of patients getting sick from the antibiotic gentamicin. By the end of the year, the Centers

for Disease Control and Prevention would call the outbreak an epidemic traceable to one Fujisawa plant.

In November 1998, American Pharmaceutical voluntarily withdrew its gentamicin. It blamed the adverse reactions on hospitals' giving patients too much of the drug too quickly, a problem noted by the F.D.A. But the agency also found "unusually high" levels of potentially dangerous endotoxins in some lots, and inspectors said the drug company had failed to investigate thoroughly why patients were getting sick. American Pharmaceutical said the drug's endotoxin levels were within allowable limits.

American Pharmaceutical resumed selling gentamicin in June 1999, but after nine more patients became ill, the company withdrew the product again, the F.D.A. said. Another company also withdrew its gentamicin — it, too, had sickened patients.

To learn why some gentamicin had elevated levels of endotoxins, the F.D.A. visited a Chinese company that had supplied materials to Fujisawa, American Pharmaceutical and the other company. The Chinese plant was found to be seriously substandard.

American Pharmaceutical's gentamicin problems stopped after it switched suppliers.

But the company's troubles with the F.D.A. did not end. During one F.D.A. inspection in 1999, the agency discovered that American Pharmaceutical had manufactured some Adenoscan — used to dilate blood vessels during heart tests — in chipped and leaking glass vials.

The agency inspectors regarded the situation as so serious that they considered taking legal action, but American Pharmaceutical recalled the product instead.

There were other recalls. For one widely used obstetrical drug, oxytocin — given to speed labor and to control postpartum bleeding — hospitals reported that the American Pharmaceutical drug appeared subpotent, F.D.A. records show. In some cases, the hospitals said, women endured long labors or heavy bleeding. The company recalled one shipment in late 1999, but said the product was within specifications.

Last October, the F.D.A. threatened for the third time to seek a court order to shut an American Pharmaceutical plant if it failed to improve certain quality controls.

Jack C. Silhavy, American Pharmaceutical's general counsel, said: "We, like virtually every other manufacturer of pharmaceutical products in the United States, from time to time voluntarily recall certain product lots." The company has spent \$35 million to upgrade its facilities and added more than 50 people to work on quality control, he said. The F.D.A. recently gave the company a clean bill of health.

A Separate Inquiry: Was Generic Drug Kept Off Market?

In 2000, another agency, the Federal Trade Commission, began its own inquiry into American Pharmaceutical. The F.T.C. wanted to know whether the drug maker and its parent colluded with Bristol-Myers Squibb ([news/quote](#)) to keep inexpensive generic versions of Bristol's life-extending cancer drug, Taxol, off the market.

Just as Bristol's exclusive right to market Taxol was about to expire in 2000, American BioScience filed what one rival, Ivax ([news/quote](#)), called a "sham" lawsuit that temporarily blocked other companies from selling generic versions of the drug. American BioScience said it was trying to protect its own patent on a Taxol product that had not yet come to market.

Bristol, American BioScience and American Pharmaceutical all deny any wrongdoing, and they are contesting legal claims against them. A lawsuit by the Cobalt Corporation ([news/quote](#)), a Milwaukee insurer, says it had to pay excessive claims for patients treated with Taxol.

William Zaferos, Cobalt's spokesman, expressed surprise when told that Premier held a financial interest in American BioScience and American Pharmaceutical.

"If your philosophy is to hold down the price of health care," he said, "then there would seem to be a tremendous amount of irony when you're putting your money into a company that is bent on keeping prices high."

Cross-Pollination: Board Seats at a Supplier

Helping to oversee American Pharmaceutical and its parent company were two Premier officials — Mr. Nydam, on American Pharmaceutical's board, and Mr. Ford, on American BioScience's board. Mr. Nydam left Premier in November 1999, and Mr. Ford left in January 2000. Neither man agreed to be interviewed for this article.

Premier says its executives may sit on corporate boards and earn options, but they are supposed to turn them over to Premier. But Premier officials say they learned that Mr. Nydam and Mr. Ford had received American Pharmaceutical options personally only after The Times began asking about them. Premier says it is "inquiring further into the matter."

Premier, which retains a seat on American Pharmaceutical's board, would not divulge the nature of Mr. Ford's consulting or the value of his options.

A recent biography of Mr. Ford released by his current employer cited his role in Premier's "venture investments" in American Pharmaceutical and American BioScience.

Premier, a private for-profit company, said its stock in American Pharmaceutical would benefit its 890 owner hospitals. The 700 nonowner hospitals that buy through Premier are not entitled to any disbursements.

Premier also acknowledged recently that two additional executives had received options from two other companies in which Premier had a financial interest. Premier said it had since reached a financial settlement with one of those executives and was investigating the other; both have left Premier.