The Honorable Kathleen Sebelius  
Secretary, Department of Health and Human Services  
Hubert H. Humphrey Building  
200 Independence Avenue, S.W.  
Department of Health and Human Services  
Washington, D.C. 20201

Donald Berwick, M.D.  
Administrator, Centers for Medicare and Medicaid Services  
Hubert H. Humphrey Building  
200 Independence Avenue, S.W.  
Department of Health and Human Services  
Washington, D.C. 20201

Dear Secretary Sebelius and Administrator Berwick,

I am writing to express my serious concern about the Centers for Medicare and Medicaid Services’ (CMS’) implementation of the durable medical equipment (DME) competitive acquisition program, and I ask CMS to make certain changes to the program before moving forward with its implementation. My concern focuses on the details of how CMS has crafted the program, and how that construction is counter to the recommendations of many leading economists and others who are experts in the area of auctions such as competitive bidding.

I have attached a September 26, 2010 statement signed by 166 economists, computer scientists, and operation researchers with expertise in the theory and practice of auctions. The letter details four key areas of concern. Unless CMS makes the changes recommended by these experts, I have doubts that the competitive acquisition program, as currently designed by CMS, will achieve Congress’ original and continuing concern of lowering costs while preserving quality.

Congress originally authorized CMS to implement the DME competitive acquisition program as part of the Medicare Modernization Act of 2003. In 2008, Congress required CMS to delay the program to fix problems that had become apparent. When Congress accelerated Round 2 of the competitive bid program earlier this year as part of the Patient and Provider Accountable Care Act, it was done under the belief that CMS had addressed problems and would be able to move forward confident that beneficiary access to quality services at lower prices would be achieved.
With the September 26, 2010 statement of these experts, however, it has become apparent that CMS’ design of the competitive acquisition program will not achieve the objectives that Congress has had for this program. As a result, I strongly recommend that CMS make the detailed changes to the competitive acquisition program in the initial nine areas before implementing.

I believe CMS should take seriously the unanimous recommendations of this large number of independent outside experts. CMS should take the time to make the recommended changes to the DME competitive bid program to avoid unintended consequences.

As custodians of the Medicare program charged with ensuring appropriate access, CMS has the administrative authority to delay implementation of the bid program. The Economists’ statement demonstrates the fatal flaws in the policy decisions that have been made – it demonstrates that the bidding program will simply not work because of fundamental design flaws, harming beneficiaries. Therefore, CMS should delay implementation of Round 1 of the bid program until a bid program is crafted that is consistent with Congress’ expectations, and consistent with the parameters detailed by leading experts in the field.

Thank you for your leadership on health care issues, and I appreciate your attention to this important matter.

Sincerely,

Bruce Braley
Member of Congress

Attachment – Statement of 166 Economists
The Honorable Pete Stark  
Chairman  
Subcommittee on Health  
Committee on Ways and Means  
239 Cannon Building  
Washington, DC 20515

Dear Chairman Stark:

We are economists, computer scientists, and operation researchers with expertise in the theory and practice of auctions. We write to express our concerns with the Medicare Competitive Bidding Program for Durable Medical Equipment operated by the U.S. Department of Health and Human Services. We believe that competitive bidding can be an effective method of controlling Medicare costs without sacrificing quality. However, the current auction program has flaws that need to be fixed before it can achieve the objectives of low cost and high quality.

Four main problems

The first problem is that the auction rules violate a basic principle of auction design: bids must be binding commitments. In the Medicare auction, bidders are not bound by their bids. Any auction winner can decline to sign a supply contract following the auction. This undermines the credibility of bids, and encourages low-ball bids in which the supplier acquires at no cost the option to sign a supply contract.

The second problem is a flawed pricing rule. As is standard in multi-unit procurement auctions, bids are sorted from lowest to highest, and winners are selected, lowest bid first, until the cumulative supply quantity equals the estimated demand. What is odd is that rather than paying winners the clearing price (the last-accepted bid), the auction pays winners the unweighted median among the winning bids. This is unique in our collective experience. The result is that fifty percent of the winning bidders are offered a contract price less than their bids. This median pricing rule further encourages low-ball bids, since a low bid guarantees winning, has a negligible effect on the price and gives the supplier a free option to sign a supply contract. Even if suppliers bid their true costs, up to one-half of the winning suppliers would reject the supply contract and the government would be left with insufficient supply. Others may accept the contract and cross-subsidize public patients with the revenue from private patients, or just take a loss. This pricing rule does not develop a sustainable competitive bidding process or healthy supplier pool.

The third problem arises from the use of composite bids, an average of a bidder’s bids across many products weighted by government estimated demand. This provides strong incentives to distort bids away from costs—the problem of bid skewing. Bidders bid low on products where the government overestimated demand and high on products where the government underestimated demand. As a result, prices for individual products are not closely related to costs. Bid skewing is especially

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1 The views expressed here are our own and do not represent the views of any organization. For additional information please contact Peter Cramton, University of Maryland, pacramton@gmail.com.
problematic in this setting, since the divergence between costs and prices likely will result in selective fulfillment of customer orders. Orders for low-priced products are apt to go unfilled.

The fourth problem is a lack of transparency. It is unclear how quantities associated with each bidder are determined. These quantities are set in a non-transparent way in advance of the auction. Bids from the last auction event were taken in November 2009, and now more than ten months later, we still do not know who won contracts. Both quality standards and performance obligations are unclear. This lack of transparency is unacceptable in a government auction and is in sharp contrast to well-run government auctions such as the Federal Communications Commission spectrum auctions.

This collection of problems suggests that the program over time may degenerate into a "race to the bottom" in which suppliers become increasingly unreliable, product and service quality deteriorates, and supply shortages become common. Contract enforcement would become increasingly difficult and fraud and abuse would grow.

Key features of a good auction design

Competitive bidding techniques have improved dramatically over the past twenty years and especially in recent years. Complex auctions like the Medicare competitive bidding program can be designed to achieve the objectives of low cost and high quality with little implementation risk. Successful government auctions emphasize transparency, good price and assignment discovery, and strategic simplicity. The result is sustainable long-term competition among suppliers which reduces costs while maintaining quality.

We recommend that the government fix the flaws in the current auction program and develop a new design that emphasizes the key features of successful designs. Implementation of the current design will result in a failed government program. There is no need for a bad outcome. With state-of-the-art auction methods and careful implementation, the auction program can succeed in reducing costs while maintaining quality—a win-win for both taxpayers and Medicare beneficiaries.

Respectfully submitted,

[The following are economists, computer scientists, and operation researchers with expertise in the design of auctions and market mechanisms. Information on each of us, including our auction-related research, can be found with an internet search of name and affiliation.]

Dilip Abreu
Princeton University

Itai Ashlagi
MIT

Susan Athey
Harvard University

Lawrence M. Ausubel
University of Maryland

Chris Avery
Harvard University

Ian Ayres
Yale University

Kerry Back
Rice University

Patrick L. Bajari
University of Minnesota

Sanjeev Baliga
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Michael Ball
University of Maryland

David Baron
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Michael Baye
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Kenneth Bimbrough
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