To: Auction Experts
From: Peter Cramton
Subject: Medicare Competitive Bidding Program
Date: Monday, 20 September 2010

Dear Colleagues,

Click here for a brief comment (via Dropbox) to the House Ways and Means Health Subcommittee on the Medicare Competitive Bidding Program for Durable Medical Equipment. I would be grateful if you would agree to be a signatory of the comment. As you will see the program has some basic and obvious flaws. Indeed, your reward for reading the short comment is seeing a peculiar pricing rule for multi-unit auctions—set the price at the *median* winning bid, rather than the highest accepted bid. Remarkably CMS (the agency that administers the auction) has been working for over ten years on this auction program. CMS has conducted several auction events in particular regions of the U.S. to test the program. The tests have demonstrated serious problems, but CMS has chosen to hide the problems and make minor and ineffective changes in response (e.g., changing the pricing rule from unweighted *average* winning bid to unweighted *median* winning bid).

There is some urgency to this, since the House Subcommittee will have a hearing on this matter the week of September 27, and I have been asked to testify. I would be grateful if you could reply in the next two days (Wednesday, September 22). A simple "yes" or "no" response is all that is required.

Many thanks!

All the best,
Peter

P.S. For those who would like some additional information on the program, you may be interested in the following:

0. A brief note on the current problems and the need for action.

1. The Request for Bids Instructions. The median pricing rule is defined in Section E (bottom of page 4 and top of page 5). "The single payment amount for an item furnished under a competitive bidding program is equal to the median of the bids submitted for that item by suppliers whose composite bids for the product category are equal to or below the pivotal bid for that product category, see 42 CFR §414.416." [Products are assigned to product categories. A composite bid for a category is the demand-weighted average of a bidder's bids on individual products within the category. This is what creates the bid skewing issue.]

2. The Federal Register, which presents the final rule together with a discussion for its rationale. The winner determination and pricing are discussed on pages 18041-18047. The median pricing rule and its rationale appear in pages 18045-18047. On the rationale, I excerpt the most relevant text below: "We believe that setting the single payment amount based on the median of the contract suppliers' bids satisfies the statutory requirement that single payment amounts are to be based on bids submitted and accepted. This will result in a single payment for an item under a competitive bidding program that is representative of all acceptable bids, not just the highest or the lowest of the winning bids for that item."

"While this was our proposed approach, we solicited comments on other methodologies for setting the single payment amount, including using an adjustment factor as part of the methodology for setting the single payment amount. This was the methodology we used for the competitive bidding demonstrations..." (p. 18045) [A price adjustment was used in the earlier trials of the program, but it is no longer used.]

"Finally, we considered taking the maximum winning bid for each item. However, this approach would have led to program payment amounts that were higher than necessary because some suppliers were willing to provide these items to beneficiaries at a lower cost." (p. 18046)

3. Katzman and McGeary (2008) study the earlier trials and show the bid skewing problem as well as other problems in these trials.

4. Request for Bids Bidding Form, so you can see what a bid looks like.

5. Eligibility Requirements, so you can get a sense of bidder qualification.

6. Quality Standards, so you can see the limited information on quality standards and performance obligations.

Professor Peter Cramton
Economics, Tydings Hall
University of Maryland
College Park MD 20742-7211

pcramton@gmail.com www.cramton.umd.edu voice/fax +1 240 396 1043