

# Center for Regulatory Effectiveness

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October 18, 2010

Mr. Laurence D. Wilson  
Director  
Chronic Care Policy Group  
7500 Security Boulevard  
Room C5-02-17  
Baltimore, MD 21244-1850

**Re: CMS DMEPOS Competitive Bidding Program Violates Established Rules  
for Combinatorial Auctions**

Dear Mr. Wilson:

In 1961, the publication of William Vickrey's paper, *Counterspeculation, Auctions and Competitive Seal Tenders*, gave rise to applying the field of game theory to auctions. Building on Vickrey's work, which centered on auctions for one good, economists expanded game theory to address auctions of combinations of products, known as combinatorial auctions.

The theory behind various types of auctions has been studied by economists for fifty years. During this time, a well documented body of literature has been established which provides auction operating procedures that result in optimal economic outcomes.

After reviewing CMS' DMEPOS competitive bidding rules, many leading economists have concluded that the program violates established economic principles. As one paper explains:

*The main prediction from our model is that while the CMS format will achieve price reductions on some goods, this will most likely occur at the expense of increased prices on other goods.<sup>1</sup>*

The US government utilizes auctions to price a wide range of goods including communications spectrum, timber, offshore drilling rights, and Treasury securities. The private sector, of course, also uses auctions in a diverse array of applications ranging from eBay to New York University Law School's Auction Based Registration Algorithm for course registration.

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<sup>1</sup> Katzman, B. and McGeary, K.A., (2008) "Will Competitive Bidding Decrease Medicare Prices?" Southern Economic Journal, vol. 74, Issue 3, p. 841.

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CRE is not aware of any auction program in existence which violates accepted auction principals as seriously as does CMS' DMEPOS competitive bidding program. Please see the letter from Representative Stark<sup>2</sup> to Administrator Berwick transmitting a letter signed by over 160 academicians criticizing the rules governing the DMEPOS bidding program.<sup>3</sup> The academicians' letter explained that, unless fixed, CMS's approach to the DMEPOS competitive bidding would lead to a situation "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."

CRE is in the process of preparing a report which will demonstrate the validity of the letter's conclusions.

In the mean time, to prevent harm Medicare beneficiaries and taxpayers, we request that while CMS is re-examining Round 1 bidders for possible fraud, that you use this period to assess the agency's bidding rules for non-compliance with established auction principals and postpone the Round 1 program until the agency's auction rules are revised to conform with accepted principals.

Sincerely,

Jim Tozzi  
Member, Board of Advisors

cc: Mr. Austan Goolsbee, PhD., Chairman, Council of Economic Advisers  
Ms. Carol Blackford, Deputy Director, Chronic Care Policy Group

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<sup>2</sup> <http://thecre.com/pdf/28-sep-2010-chairman-stark-letter-on-medicare-bidding.pdf>

<sup>3</sup> <http://thecre.com/pdf/comments-of-concerned-auction-experts-on-medicare-bidding.pdf>