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cc: Ira file Merck
Melanne
Patti

P. Roy Vagelos, M.D.
Chairman and Chief Executive Officer

Merck & Co., Inc.
One Merck Drive
P.O. Box 100
Whitehouse Station NJ 08889-0100

January 28, 1994

MERCK

Mrs. Hillary Rodham Clinton
Office of the First Lady
The White House
1600 Pennsylvania Avenue
Washington, DC 20500

Dear Mrs. Clinton:

I want to thank you for taking time from your busy schedule last Friday to talk with me and my colleagues from Merck on the subject of health-care reform. As I mentioned, we would be delighted to have you visit Merck in the near future to tour our AIDS research facilities in West Point, PA. This would be an especially portentous time for you to visit our labs, because Merck is now entering a critically important phase in its long and costly effort to develop a breakthrough treatment for AIDS.

As you may recall, then-Governor Clinton was our guest at Merck during the 1992 election campaign. He took that opportunity to learn more about our industry as well as to make a major speech unveiling his vision for health-care reform. We applauded that effort, and believe this Administration deserves tremendous credit for focusing the Nation's attention on health-care reform. Clearly, there are a number of areas of the current system where change is long overdue, particularly in the area of insurance reform and extending coverage to the uninsured.

At the same time, I want to reiterate our concerns about several provisions in the President's proposal -- including the requirement for unitary pricing, arbitrary and onerous Medicare rebates, and drug price reviews by HHS and an Advisory Council on Breakthrough Drugs. These provisions appear inconsistent with the Administration's reliance on managed care to lower costs and improve care, and also do not seem to recognize that the market is changing rapidly and dramatically in ways that are having a strong moderating impact on pharmaceutical prices, and that are lowering the profitability of our industry. These provisions, in combination with the growing pressures of the marketplace, will have a serious negative effect on our continued ability to invest in the research and development of new pharmaceutical therapies. Merck currently invests over $1.2 billion annually in the discovery and development of new pharmaceutical therapies and that represents 5% of worldwide spending by pharmaceutical companies. The proposed Medicare rebate alone, for example, if it had been the law this past year, would have cost Merck more than $300 million. To put this number in some perspective, it is equal to about

one-quarter of the substantial investment Merck made in pharmaceutical research and development in 1993. This and other pharmaceutical provisions of the plan will also seriously undermine the migration towards managed benefits by eliminating the incentives that currently exist for private sector entities to use medically sound, creative techniques to reduce health-care costs.

Accordingly, we hope you will give serious study and consideration to the potential benefits of the alternative Medicare outpatient prescription drug benefit which we shared with you last Friday. This proposal takes advantage of the great strides forward that have been made by private sector benefits managers in recent years in controlling costs, while offering improvements in patient care which are simply not possible under a pure fee-for-service approach. At the same time, it will preserve the free market climate that the pharmaceutical industry needs to continue to invest heavily in research and development which, in the final analysis, is the Nation's greatest hope for curing disease and reducing costs. I am enclosing a reprint of The New York Times Magazine article about River Blindness and *Mectizan*. The cover photograph makes the statement of need for a healthy research based pharmaceutical industry more profoundly than I ever could.

Finally, I appreciated having the opportunity to exchange views with you on whether enactment of the Administration's health-care reform proposal will lead to a major boost in sales revenues for research-based pharmaceutical companies. I hope you will have a chance to review the package of overheads on the economics of the industry which include a reference to the Lewin-VHI study, which concludes that the average pharmaceutical firm would be likely to *lose* 6.7% of its revenues under the Administration plan. Our own internal analysis supports the Lewin-VHI findings, and we believe that the claims of a massive "windfall" for the industry as the result of comprehensive health-care reform are unfounded.

I want to thank you once again for providing us an opportunity to meet with you. We sincerely hope you will be able to visit Merck's AIDS research facilities. I've asked Ms. Teel Oliver of our Washington Office to contact your office directly to discuss this possibility. It would give me great pleasure to have you see first hand the work we are doing on this difficult disease and to talk directly with some of our scientists and medical personnel.

Sincerely,

Enclosure

P. Roy Vagelos, M.D.
Chairman and Chief Executive Officer

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One Merck Drive
P.O. Box 100
Whitehouse Station NJ 08889-0100

January 28, 1994

Mr. Ira Magaziner
Mr. Chris Jennings
The White House
1600 Pennsylvania Avenue
Washington, DC 20500

Dear Mr. Magaziner and Mr. Jennings:

When we met last week, we discussed briefly some of the reasons why Merck, as a large employer, is troubled by several critical aspects of the Administration's Health Security Act. As we discussed, this is a question we have considered carefully both as an employer and as a provider of health care products. As a follow-up to our discussion, I want to provide you with some additional insight into our thinking. We appreciate very much your interest in our views and offers of a continuing dialogue.

As a company focused on discovering, developing, and marketing products to prevent, treat and cure disease, you can appreciate how the health of our employees and customers is at the forefront of our concerns. Merck maintains a comprehensive program of corporate health promotion for our 20,000 U.S. employees that includes: a flexible benefits package providing comprehensive health and dental services; a pre-employment physical accompanied by health counseling; on-site, walk in health clinics at most sites providing free health services; wellness programs that stress healthy lifestyles and exercise; a smoke-free workplace; rigorous enforcement of safety and environmental standards; and a program of supplemental benefits, including prescription drug coverage, for our retirees.

Viewed in this context, the Administration's proposal contains items of benefit to Merck. Within the Health Security Act, adoption of the Medicare out patient prescription drug benefit and the early retiree provisions promise substantial savings in Merck health care costs. In addition, although not quantifiable, the prospect of a reduction in cost shifting should also help reduce costs over the long term.

However, despite the cost savings these aspects may yield, they are overshadowed by the Corporate Alliance provisions of the plan that would establish significant barriers to Merck's ability to continue to serve as a provider of a comprehensive health program. Specifically, the plan would increase our costs by imposing a one percent payroll tax and by exposing Merck, through proposed ERISA changes, to the prospect of State add-on taxes and punitive claim resolution procedures. The plan would jeopardize our position as a

provider of comprehensive health care by ending our ability to offer health care coverage as part of a flexible benefit package, by creating the significant risk that the company would lose the ability to sponsor a Corporate Alliance altogether if our costs rose too quickly, and by ending our sponsorship of health care coverage in any Single-payer State.

In contrast, the Cooper-Grandy-Breaux plan would allow Merck to continue its current role as the provider of a comprehensive health care program for our employees. Although not to the extent of the Administration's plan, we would expect to recognize cost savings from reduced cost shifting as more and more individuals are covered by health insurance. And, although it may cost the Company money, Merck also supports the cost control mechanism of limiting the employer deduction for health insurance costs as envisioned by the Cooper plan. Such a limit would encourage responsibility and cost conscious purchasing of health insurance.

As an employer, Merck must also look at these proposals from the standpoint of our ability to continue to create high-wage jobs in the United States through continued growth and global competitiveness. From that standpoint, adoption of the Administration's proposal would be extremely detrimental to our interests as a provider of health care products.

Specifically, we believe that the Health Security Act's mandated rebates, cost control measures and new drug price reviews would inhibit our ability to invest funds in discovering new drugs and bringing them to people in need. This is not simply our opinion. The independent analysis of the Lewin-VHI study found that non-generic pharmaceutical revenues would fall 6.7 percent under the Administration's plan. This predicted fall in revenues comes despite an expected increase in utilization. A separate study, conducted by a former senior Congressional Budget Office analyst, projects a loss of revenue for the brand-name pharmaceutical industry of up to 11.2 percent.

The reduction in revenues could easily become significantly higher for a research intensive pharmaceutical company, such as Merck, that concentrates on drug treatments for chronic diseases. As an example, the new Medicare rebate alone, if it had been the law this past year, would have cost Merck more than $300 million. To put this number in some perspective, it is equal to about one-quarter of the substantial investment Merck made in pharmaceutical research and development in 1993.

From this analysis, I hope that you can appreciate how Merck, as an employer and health products supplier, favors the Cooper approach as a starting point for action. Of course, there need not be a choice between the Cooper plan and the Health Security Act. Changes can and should come in the legislative process. As a company committed to

comprehensive health care reform, we are eager to work with you in the days and months ahead to explore changes in the Health Security Act that would, in particular, preserve Merck's ability to discover cures and treatments for diseases that ravage our people and our health care budgets.

Once again let me say how much we appreciate the opportunity you have given us to play a constructive role in the process. Merck very much shares your goal of ensuring that all Americans receive the quality health care services they need and deserve. Please let me know how we can be helpful.

Sincerely,

cc: Melanne Verveer
Deputy Assistant to the President and
Deputy Chief of Staff to First Lady