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Medical device makers see red over health care plan in Washington

By Mary Duan

[Peak Surgical Inc.](#) of Palo Alto says it's about a year away from breaking even. But Peak CEO John Tighe is worried about the debate going on in Washington, D.C., over America's Healthy Future Act of 2009, and how that could impact the future of his company.

It's a discussion that weighs heavily on medical device makers in Silicon Valley. Northern California has more than 1,000 companies and tens of thousands of employees working in the life sciences industry.

Peak Surgical, a venture-backed maker of plasma surgical tools, got FDA approval last year and announced Oct. 5 a distribution agreement for its tonsil and adenoid tool with [Medtronic Inc.](#) The agreement includes access to a line of credit for general working capital purposes and will help accelerate its growth even further.

The health care reform bill is expected to cost \$900 billion over a 10-year period starting in 2010, funded in no small part by fees on pharmaceutical, medical device and clinical laboratory companies.

Medical device companies alone may be asked to kick in \$4 billion a year, with each company's portion based on its share of U.S. sales of devices from the previous year. A company's first \$5 million in sales would not be counted, and sales between \$5 million and \$25 billion would be valued at half of the total.

"We're a small company, and so it doesn't affect us as much as it will the big medical device companies, but there is a fear that it will slow growth and add an extra layer of cost," Tighe said. "We're supposed to be profitable by the first quarter of 2011, but the fees could mean we could need additional funding and it could delay profitability."

Tighe's company may be on the small end, but all sizes of Silicon Valley medical companies and trade organizations are watching the bill as it winds its way through the Senate Finance Committee. They're also writing letters, lobbying Congress and speaking out about what high taxes mean for profitability, jobs, growth and future investments in new companies and emerging technology.

The pros and cons

Proponents of the fees point to the fact that health care reform will result in more patients being insured, and more insurance will lead to better treatment, more procedures and more prescriptions, thus increasing market share for those companies paying the tax.

But more than a dozen Silicon Valley and Bay Area CEOs signed a letter sent by trade organization BayBio on Sept. 18 to Senate Finance chair Max Baucus, D-Mont. The letter stated that extracting revenue from profitable life sciences companies will act as a tax on the entire industry and affect the robust pipeline of therapies and technologies being developed. Further, the taxes could have the unintended consequence of increasing costs for hospitals, physicians, patients and consumers.

One of the most significant issues, though, is the idea that the tax would be levied against companies that aren't profitable, a move some CEOs say could substantially stifle innovation.

“Our point is to say, OK, if we need to contribute something, it has to be put in a rational format. It's not rational to tax companies that aren't making a profit, and the taxes on revenues need to be understood. Right now, they don't even know how to capture it,” said John Bishop, CEO of the publicly traded [Cepheid Inc.](#), a Sunnyvale molecular diagnostics company that develops, manufactures and markets systems and tests for genetic analysis in the clinical, industrial and biothreat markets. Bishop's opinion is that the current iteration of the bill is “a rush to cram something through” without appreciating its overall impact.

“A tax on a company struggling to achieve profitability means that company would be pushed even further from profitability. Some may never get there,” Bishop said. “In order to get there, they would reduce their labor force and put more people out of work and put more people out there looking for health care coverage.”

[Varian Medical Systems Inc.](#) CEO Timothy Guertin is even more blunt in his assessment: The tax is a bad idea, he said, and it won't do what politicians want it to do.

A 30-year veteran of the health care industry, Guertin said he understands and supports reform's ultimate goal to provide coverage for the more than 40 million uninsured Americans, but to pay for it by increasing taxes on corporations means those corporations will compensate by raising prices or cutting back on employees. Neither is desirable.

Higher costs eventually will result in hospitals passing costs on to consumers, Guertin said.

Guertin's solution, were he asked to come up with one, would be to control the rising costs of health care so the U.S. is competitive on the world stage, and provide the uninsured a benefit that offers a low premium — say, Medicare coverage plus 10 percent — that allows for a pay-as-you-go model.

The system also should provide incentives to keep people well.

“The only time health care providers get paid is when you get sick,” he said.

Ajit Singh, CEO of digital pathology company [BioImagene Inc.](#), uses a form of breast cancer treatment as an example of why reform is needed. A diagnostic test is used to decide whether the drug Herceptin can be used to treat certain tumors. But 18 percent of those tests result in a false positive. Herceptin is administered in those cases at a cost of \$80,000 per patient per year. Better diagnostic tools would eliminate prescribing that drug to patients who don't need it. Singh said that's only one example of how reform can save money without passing the cost on in the form of a corporate tax.

“The current reform environment speaks positively to tools that will reduce cost and improve effectiveness, which speaks to our charter,” Singh said. “But if even a small percent of a tax comes to our space, it will be an impediment. The innovation we need to fund can be created by the efficiencies we create.”

Big Silicon Valley players could lose

Some of the local heavyweights that could be affected by the proposed tax:

Varian Medical Systems Inc.

2008 revenue: \$2.1 billion

Products: Radiotherapy, stereotactic radiosurgery, and brachytherapy equipment

Intuitive Surgical Inc.

2008 revenue: \$875 million

Products: Robotically assisted, minimally invasive surgery systems

Dionex Corp.

2008 revenue: \$378 million

Products: Instruments for chemical analysis

Align Technology Inc.

2008 revenue: \$304 million

Products: System for treating teeth

Omniceil Inc.

2008 revenue: \$252 million

Products: Medication control and patient safety devices

Accuray Inc.

2008 revenue: \$210 million

Products: System to treat solid tumors

Cepheid

2008 revenue: \$170 million

Products: Molecular testing devices for analyzing DNA

Natus Medical Inc.

2008 revenue: \$162 million

Products: Products used to screen, diagnose and treat ailments in newborn babies

Vivus Inc.

\$102 million

Treatments for diabetes, obesity and sexual health issues