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United States Senate

COMMITTEE ON THE JUDICIARY

WASHINGTON, DC 20510-6275

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February 2, 2012

The Honorable Jonathan D. Leibowitz
Chairman
Federal Trade Commission
600 Pennsylvania Ave., N.W.
Washington, D.C. 20580

Dear Chairman Leibowitz:

I am writing to you concerning the proposed merger between Express Scripts and Medco, two of the nation's largest pharmaceutical benefits managers ("PBMs"), which is now under review at the Federal Trade Commission. Our Subcommittee on Antitrust, Competition Policy and Consumer Rights held a hearing on this proposed merger on December 6, 2011. I write to summarize the findings of our investigation into this transaction. In brief, without reaching any final judgment as to the legality of this proposed merger under the antitrust laws, I believe this proposed merger presents serious competition concerns which should be examined carefully by the FTC, and that your agency should approve this merger only if you find that it is not likely to substantially harm competition in the markets affected.

PBMs are crucial players in the healthcare industry, and have a tremendous effect on the prices health plan sponsors, and ultimately consumers, pay for drugs. By one estimate, 90% of individuals with prescription drug coverage receive benefits through a PBM, and PBMs handle about two-thirds of all prescriptions written in the U.S.¹ PBMs play a vital role as middlemen in negotiating the prices health plan sponsors pay for drugs and set the prices that pharmacies are reimbursed for drugs. They also determine which specific drugs make it onto formularies eligible for reimbursement.

This merger, if consummated, would combine two of the nation's three largest PBMs. The merger would result in the combined Express Scripts/Medco PBM having 155 million covered lives, over 70 million more than the next largest PBM, CVS/Caremark.² The combined firm would

¹ Kaiser Family Foundation, *Follow the Pill: Understanding the U.S. Commercial Pharmaceutical Supply Chain* 13-14 (March 2005), available at <http://www.kff.org/rxdrugs/upload/Follow-The-Pill-Understanding-the-U-S-Commercial-Pharmaceutical-Supply-Chain-Report.pdf>

² Written Testimony of David Balto, Esq., on behalf of Consumers Union, Consumer Federation of America, National Consumers League, U.S. Public Interest Research Group, and the National Legislative Association on Prescription Drug Prices to the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights, for Hearing on the "Express Scripts/Medco Merger: Cost Savings for Consumers or More Profits for the Middleman," December 6, 2011 (hearing referred to hereinafter as "December 2011 Express Scripts/Medco Senate Antitrust Hearing" and testimony referred to hereinafter as "Balto Senate Written Testimony") at p. 5.

administer 1.14 billion prescriptions annually³, and handle 41% of all prescriptions administered by PBMs.⁴

Both Express Scripts and Medco also own significant mail order pharmacies, and mail order alone accounts for nearly one-fifth of all prescription drug sales in the United States. The merging companies have a very large share of this business, collectively accounting for about 60% of all mail order sales.⁵ In addition, the combined company will control more than 50% of the lucrative specialty pharmacy business, that is, the pharmacies that sell drugs used in the treatment of rare and challenging ailments.⁶ While specialty drugs are only 2% of all prescriptions, specialty pharmacies account for 20% of all pharmaceutical spending.⁷

The merging parties argue that this merger will enable them to serve their customers better and more efficiently, ultimately to the benefit of consumers. The CEO of Medco asserts that “[e]ach company employs a fundamentally different business model, and combining the best attributes of both will create an enhanced capability to lower prices and improve quality care for patients.”⁸ Nonetheless several consumer groups and pharmacy trade associations have alleged that serious competition concerns will arise from the merger.

The effects of this merger are likely to be most pronounced with respect to large “plan sponsors,” that is, the large organizations that establish health care plans that require broad PBM service offerings, often on a national scope, such as health insurance plans, large employers, unions, and government entities. The three largest PBMs currently control more than 80 percent of the large health plan sponsor market. After the merger Express Scripts/Medco would have a market share of approximately 50% of that market.⁹ As of July 2011, Express Scripts, Medco, and CVS/Caremark, the “big three,” provided PBM services to 42 of the nation’s Fortune 50 companies.¹⁰

Reducing the number of PBM competitors that are able to meet the unique needs of large health plan sponsors from three to two raises significant competition concerns. Serious questions have been raised as to whether such a reduction in competitive alternatives will lead to higher fees charged by PBMs to large plan sponsors. The merger’s critics also contend that the remaining PBMs will have substantially less incentive and competitive pressure to pass through to the plan sponsors a substantial part of the negotiated savings and rebates the PBMs obtain from drug manufacturers.

³ Pharmacy Benefit Management Institute (“PBMI”) (citing 2010 data compiled by Atlantic Information Services) available at <http://www.pbmi.com/PBmarketshare2.asp>

⁴ Anne Wilde Mathews, “Man Behind the Megamerger: Penny Pincher George Paz,” *Wall Street Journal*, Aug. 9, 2011, page B2.

⁵ Atlantic Information Services Health, *Selected PBMs by Mail-Order Volume*, available at <http://aishealth.com/archive/ndbn062411-04>

⁶ Balto Senate Written Testimony, at p. 9.

⁷ See Pembroke Consulting, *2010-2011 Economic Report on Retail and Specialty Pharmacies*

⁸ Written Testimony of David B. Snow, Jr., CEO, Medco for December 2011 Express Scripts/Medco Senate Antitrust Hearing at p. 11.

⁹ November 30, 2011 Letter from Dan Gustafson, Advisory Board Member, and Bert Foer, President, American Antitrust Institute, to FTC Chairman Leibowitz (“November 2011 AAI Letter”), at page 1. See also Steven M. Davidoff, *Confronting Antitrust Issues in a Giant Merger*, *New York Times DealBook* blog, July 22, 2011, available at <http://dealbook.nytimes.com/2011/07/22/dealing-with-antitrust-issues-in-a-giant-merger/>

¹⁰ See Morgan Stanley Research, *Healthcare Services & Distribution: Fortune 50 and Respective PBMs*, July 28, 2011. According to this study, ESI and Medco provide services in whole or in part to 29 of the Fortune 50.

Express Scripts and Medco argue that there are other PBMs beyond the big three that can serve the needs of large plan sponsors. However, the big three PBMs are substantially larger than their “second tier” competitors. This enables them to obtain volume discounts that other PBMs cannot obtain. The big three also offer a range of services in high volume – from mail order, to specialty pharmacies, to enhanced claims processing capabilities, among other things – that their smaller competitors do not offer. Moreover, plan sponsors face significant switching costs to move from one PBM to another. Finally, it is not clear that the smaller PBMs have the capacity to absorb a significant number of new large plan sponsors.¹¹ In sum, it seems unlikely that there are significant competitive alternatives to the big three PBMs for large plan sponsors.¹² Indeed, even Medco’s CEO admitted as much in an investor phone conference in July 2010. When asked if “everyone’s always focused on your two primary competitors [that is, Express Scripts and CVS/Caremark],” Mr. Snow replied that “[at] the best and finals I go to, I’m not seeing a lot of secondary PBMs in the mix at all. I’m really not. You may see a name pop up here and there, but that’s not really common at all.”¹³

One of the principal benefits that the PBMs contend they bring to the health care system is that, by representing numerous health plans, they are able to gain increased buying power with drug companies to drive drug prices down. However, given the already massive buying power of Express Scripts and Medco (with Express Scripts covering 90 million lives and Medco 65 million)¹⁴, it seems highly unlikely that the merger will result in any substantial increase in buying power to attain such cost savings. The merging parties admitted as much at our Antitrust Subcommittee hearing. In responding to my question “when you get to be as big as you are already . . . I am assuming what [savings] you are getting now is just as much as [the drug companies] are willing to give you based on your size as it presently exists,” George Paz, CEO of Express Scripts, stated that “Yes . . . the majority of the synergies in this transaction are not coming from the supply chain. They are coming from efficiencies.” Likewise, David Snow, CEO of Medco, replied “That is correct” to my statement that “significantly increasing discounts over what you are getting right now is really not why you are doing this deal.” So it is clear that obtaining greater drug price discounts from manufacturers cannot be an argument to justify this merger.

¹¹ As the American Antitrust Institute points out, Catalyst is the rare example of a “second tier” PBM that serves two Fortune 50 companies. But it appears unlikely it has the capacity to further compete in the large health plan market. With 18 million covered lives, as compared to the 155 covered lives of the combined company, or 70 million for CVS/Caremark, “Catalyst would have to increase its claims processing capacity by almost 50 percent to absorb even 5 percent of the business of a post-merger Express Scripts-Medco company.” November 2011 AAI Letter at p. 3. Indeed, Catalyst itself has supported this view. In its 2010 SEC filing, Catalyst stated that “[t]he industry is highly consolidated and dominated by a few large, profitable, well-established companies with significant financial and marketing resources, purchasing power and other competitive advantages *that we do not have. Scale is a particularly important factor* in negotiating prices with pharmacies and drug manufacturers.” Catalyst Health Solutions, Inc., SEC Form 10-K, December 31, 2010, at p. 20 (emphasis added).

¹² The merging parties argue that it is competitively significant that United Healthcare, currently Medco’s largest customer, will not renew its contract with Medco when it expires at the end of 2012. However, the merger’s critics question whether United’s in-house PBM, Optum Rx, will truly be a competitive alternative beginning in 2013. United will face serious challenges in “carv[ing] out drug plans from employers that use a rival insurer for other benefits because rival health insurance companies may be reluctant to give United Healthcare access to their patient data.” November 2011 AAI Letter at p. 3. Additionally, the impact of United’s Optum Rx a year from now is too speculative to mitigate the significant effects of reducing the number of large PBMs competing for large plan sponsors.

¹³ Medco Second Quarter 2010 Earnings Call, Bloomberg Transcript, at p. 12.

¹⁴ Balto Senate Written Testimony at p. 5.

The fact that Express Scripts and Medco combined would have substantial market power in both specialty pharmacies (where the combined company would possess a more than 50% market share) and mail order pharmacies (where the combined company would possess a market share of about 60%) raises additional serious concerns. With respect to specialty pharmacies – that is, pharmacies used for drugs to treat the most serious illnesses that often require special handling and administration – the merger’s critics have alleged that PBMs have engaged in exclusive distribution arrangements designed to exclude rivals. They argue that it is “a common business practice for these PBMs to prevent other pharmacies from dispensing specialty drugs and to force patients to use the PBM’s mail order facility, thereby foreclosing competition from rival pharmacies.”¹⁵ This merger may give the combined PBM increased market power to demand exclusive distribution arrangements with large manufacturers, freezing out other competitors.¹⁶ In the alternative, the concern exists that its competitors will have to contract with the combined PBM to gain access to these specialty drugs. Given the high prices and profits to be made from specialty drugs – estimated to be 2% of all prescriptions, but 20% of pharmaceutical spending and growing¹⁷ – the FTC should scrutinize this issue very closely.

The merger’s critics also argue that the combined company’s dominance in mail order could give it the market power to force consumers into using mail order services for their prescriptions. The Subcommittee received substantial testimony from the merger’s critics that mail order may be more costly, may result in significant waste, and cause consumers to lose the service and counseling they obtain from traditional pharmacies. Retail pharmacies also allege that the combined Express Scripts/Medco PBM would gain expanded access to patient data that each PBM has separately, and that the combined company would have the incentive and ability to use this data to move patients to its own mail order operations, all to the harm of patients and traditional pharmacies.¹⁸

The Subcommittee received extensive testimony from pharmacies – both independently owned community pharmacies and chain drug stores – regarding what they believe to be the dangers to competition from this merger. PBMs set the reimbursement rates that pharmacies receive when they dispense drugs to patients covered by health plans administered by those PBMs. Pharmacies believe this deal will increase the bargaining leverage of the combined Express Scripts/Medco PBM so that the combined PBM will be able to significantly reduce their reimbursement. Given that the combined PBM will have 155 million covered lives, pharmacies will be in no position to decline to do business with Express Scripts/Medco patients, but will, they argue, be left in a “take it or leave it” position.

The pharmacies – especially the community pharmacies – assert that their ability to stay in business is seriously threatened by the danger of the combined Express Scripts/Medco reducing reimbursement rates. At our hearing, Sue Sutter, the owner of three community pharmacies in

¹⁵ AAI Letter at p. 4.

¹⁶ Express Scripts denies the merger will give it the added ability to have exclusive distribution rights for specialty drugs, and asserts that drug companies themselves “determine how limited or exclusive drugs are distributed.” George Paz, CEO, Express Scripts, Responses for the Hearing Record for December 2011 Express Scripts/Medco Senate Antitrust Hearing (hereinafter “Paz Responses for the Record”), Answer 5(b) to Questions from Sen. Kohl.

¹⁷ See Pembroke Consulting, *2010-2011 Economic Report on Retail and Specialty Pharmacies*. Express Scripts itself points out that “[w]hile only 1% of plan sponsors’ members utilized specialty drugs, the average price in 2010 was \$ 2,080 per prescription.” Paz Responses for the Record, Answer 5(a) to Questions from Sen. Kohl.

¹⁸ Express Scripts disputes these arguments, and asserts that “whether to allow, encourage or favor mail order is a plan sponsor decision.” Paz Responses for the Record, Answer 3(b) to Questions from Sen. Kohl.

Dodge County, Wisconsin, stated that her pharmacies “operate at a 2 to 3% net profit margin before taxes.” Reducing reimbursement rates “could single-handedly put pharmacies” out of business, she testified.¹⁹ Pharmacies also fear that the combined PBM will have the incentive to steer patients to its mail order businesses, further threatening retail pharmacies.²⁰

Of course, we recognize that antitrust law is not designed to protect any competitor or group of competitors, but rather competition and consumers. Should this merger enable the combined Express Scripts/Medco PBM to reduce reimbursement payments to pharmacies, and should these declining reimbursement rates to pharmacies be passed on by the combined PBM to plan sponsors (and ultimately to consumers in the form of lower health insurance costs), this could be an argument asserted in favor of this transaction. However, substantial doubt exists as to whether any declines in reimbursement rates would in fact be passed on to plan sponsors. First, the decline in competitor PBMs for large plan sponsors discussed above will significantly reduce the competitive pressure on the combined Express Scripts/Medco PBM to pass on such savings. Second, there is considerable doubt that PBM mergers in the past have resulted in any savings being passed on to plan sponsors.²¹ While the promise that reduced reimbursement payments will in fact be passed on to plan sponsors is very speculative, the evidence we received at our hearing is that the threat to pharmacies is very real.²² I urge the FTC to carefully evaluate whether it is likely that the combined PBM will pass on to plan sponsors any reduction in reimbursements paid to pharmacies as a result of this deal.²³

Furthermore, consumers gain substantial quality and service benefits from traditional pharmacies. Patients rely on these pharmacies for counseling and advice, for example with respect to drug interactions.²⁴ Patients go to pharmacies for drugs to treat acute conditions when it is infeasible to wait for such drugs via mail order. In rural areas, elderly and ill patients rely on community pharmacies that are the only alternatives to lengthy drives to larger cities. If this merger

¹⁹ Written Testimony of Susan Sutter, on behalf of the National Community Pharmacists Association to the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights, for December 2011 Express Scripts/Medco Senate Antitrust Hearing (hereinafter “Sutter Senate Written Testimony”) at p. 2.

²⁰ *Id.*, at p. 3. The merging PBMs argue that use of mail order saves costs. However, Sutter argues community pharmacies dispense more generics than PBM’s mail order facilities, so that shifting patients to mail order will actually be more costly. She stated that “evidence demonstrates that mail order pharmacies consistently dispense more costly brand-name drugs and fewer generics than community pharmacies.” *Id.* Further, there was substantial evidence introduced at the hearing of significant wastage resulting from mail order pharmacies, such as unneeded prescriptions being delivered to patients despite requests to stop the deliveries, prescriptions being delivered to the addresses of deceased patients, and deliveries of multiple prescriptions. *Id.* Once delivered, these prescriptions must be discarded, causing significant and unneeded cost to the health care system.

²¹ See Balto Senate Written Testimony at p. 12.

²² Under the joint Justice Department/FTC Merger Guidelines, “[e]fficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means.” Justice Department FTC Horizontal Merger Guidelines, ¶ 10 at p. 30 (Aug. 19, 2010).

²³ In this regard, I urge the FTC to be cognizant of the findings of the Department of Health and Human Services Office of Inspector General of problems with lack of transparency regarding PBM contractual relationships with manufacturers so that plan “sponsors may not always have enough information to oversee the services and information provided by PBMs.” The HHS OIG also found, significantly, that some plan sponsors “reported that their PBMs collected fees from drug manufacturers that were not always passed on to the [Medicare] Part D program.” Report of the Department of Health and Human Services Office of Inspector General, “Concerns with Rebates in the Medicare Part D Program,” (March 2011) at p. ii and p.17-19.

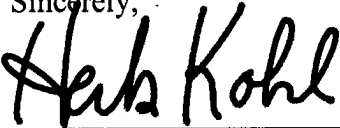
²⁴ Sue Sutter testified that “[o]ur pharmacists speak with every patient, review every medication order, and work to assure that all of our patients are achieving their intended medication goals.” *Id.* at p. 4.

would in fact imperil the ability of these pharmacies to remain in business, then this harm to the quality of pharmacy services consumers receive is an injury cognizable under antitrust law.²⁵

In sum, my Subcommittee places the highest priority in maintaining vigorous competition in the prescription drug marketplace. Competition is the key to restraining prices and holding down the costs of prescription drugs to health plans, to the federal government, and to consumers. PBMs hold the promise of using volume purchasing to restrain costs, but we must be cognizant of the concentrated nature of this marketplace and carefully scrutinize any further concentration in this industry. In particular, we must ensure that the gain in market power the combined entity will achieve will not come at the expense of higher drug prices for health plan sponsors and millions of American consumers.

Express Scripts's proposed merger with Medco will unquestionably create a giant PBM that is substantially larger than any competitor, and will result in the combined entity having a dominant market share in mail order and specialty pharmacies. It will reduce choices for PBM services to health plan sponsors, especially large employers. And it has the potential to have profound effects on the ability of both community and chain drug stores to compete. I therefore urge the FTC to carefully examine this proposed merger, and only approve it should the Commission determine that the transaction is not likely to substantially lessen competition in violation of the antitrust laws. I further urge the FTC to impose all necessary conditions on this deal to protect competition and consumers, should you decide to allow it proceed. The stakes for American consumers, health plan sponsors, and our nation's network of local pharmacies arising out of this transaction are very high and thus this acquisition is worthy of the most serious review at your agency.

Thank you for your attention to this matter.

Sincerely,

HERB KOHL
Chairman, Subcommittee on
Antitrust, Competition Policy
and Consumer Rights

²⁵ Under the Joint Justice Department FTC Horizontal Merger Guidelines, in addition to price effects, "Enhanced market power can also be manifested in non-price terms and conditions that adversely affect consumers, including reduced product quality, reduced product variety, reduced service, or diminished innovation." Justice Department FTC Horizontal Merger Guidelines, ¶ 1 at p. 2 (Aug. 19, 2010).