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**Before the House Committee on the Judiciary,
Subcommittee on Intellectual Property, Competition and the Internet**

Hearing on: “The Proposed Merger between Express Scripts and Medco”

September 20, 2011

I. Introduction

Chairman Goodlatte, Ranking Member Watt, and members of the Committee. Thank you for providing me the opportunity to testify before you today regarding the proposed Express Scripts-Medco merger, two of the largest pharmacy benefit managers (PBMs) in the United States. My name is Dan Gustafson from Gustafson Gluek in Minneapolis, Minnesota. I am an advisory board member of the American Antitrust Institute (AAI)¹ and part of an ad hoc working group of the AAI that is investigating and analyzing the impact of this proposed merger.

II. AAI's Role and Antitrust Enforcement

Our analysis has just begun and has been limited to considering publicly available materials. At the conclusion of our evaluation, we expect to author an antitrust white paper to recommend actions that the AAI believes the FTC should take with respect to this proposed merger.

Although the working group has not yet reached any conclusions and the AAI Board of Directors has not taken any position on the merger, I appear before you today at their request to identify some areas of concern that suggest further careful investigation and analysis is warranted. We hope that this information will assist the Committee as it considers this proposed merger.

¹ The AAI is an independent Washington-based non-profit organization addressing antitrust issues from a perspective of increasing competition and ensuring that competition works to benefit consumers through vigorous public and private antitrust enforcement. AAI Website, About Us, <http://www.antitrustinstitute.org/content/about-us>

It is important to note that now is the time to evaluate and analyze this proposed merger. Although some post-merger antitrust enforcement successfully corrects excessive market concentration or other anticompetitive conduct, antitrust policy in this area should focus on preventing anticompetitive conduct by foreclosing combinations that incentivize or further anticompetitive conduct. Effective merger review requires that regulatory agencies take appropriate steps at this stage—before the merger happens—to ensure that competition and consumer interests are protected.

With respect to this proposed merger, the FTC has already issued a Second Request, and the AAI applauds its continuing investigation of this matter. Although the FTC cleared the CVS Caremark merger without a Second Request, previous decisions of the Commission indicate that it believed the PBM industry to be competitive. Although the Commission has issued some broad statements about the competitiveness of the industry, we believe those statements should be reexamined in light of recent enforcement actions by state attorneys general, increased consolidation and the escalating profits of the major PBMs.

III. Industry Background

PBMs play several roles in our healthcare system. They touch most American lives in their role as managers of prescription drug benefits for third-

party payors. In this role, they integrate retail pharmacy claims processing, formulary management, and home delivery pharmacy services.²

In addition to adopting a pre-approved list of commonly prescribed prescription medications, formulary management includes managing the utilization of covered medications by balancing clinical effectiveness with costs, traditionally through clinical programs developed and maintained by plan doctors and pharmacists.³ Litigation by state attorneys general in recent years has raised concerns that the decisions made by large PBMs on these formulary issues may be improperly influenced by discounts and rebates received from manufacturers in exchange for placing higher priced medications on the formulary, and exclusive contractual arrangements that may lead to favorable treatment for higher priced drugs, irrespective of their relative utility.⁴

In recent years, many PBMs, including both Express Scripts and Medco, have acquired major specialty pharmacy businesses and, as a result, now also serve as distributors of specialty drugs. Although there is no universally accepted definition for a “specialty drug,” it usually refers to medications for the treatment of serious,

² Mark Meador, *Squeezing the Middleman*, 20 *Annals of Health Law* 77, 78-79 (2011).

³ Blue Cross Blue Shield of Massachusetts, Glossary, <http://www.bluecrossma.com/bluelinks-for-employers/glossary.html>

⁴AAI White Paper, *The FTC Should Issue a Second Request on Express Scripts’ Proposed Acquisition of Wellpoint’s PBM Business*, May 11, 2009 (“AAI 5/11/09 White Paper”), at 4.

chronic ailments that are expensive and often require special handling and control, complex administration and careful monitoring.⁵

The large PBMs have also increasingly expanded into mail order pharmacy businesses. These mail order pharmacies further the vertical integration of large PBMs and compete directly with national, regional and traditional local pharmacies.⁶ The PBMs with large mail order operations often limit distribution of certain drugs solely through the mail.⁷

IV. Proposed Merger Between Express Scripts and Medco

A. Market Concentration

Although it is premature to reach conclusions about the relevant market definitions in an antitrust context, the AAI working group is considering some market concentration issues that may raise potential concerns. The market space for PBM services is already concentrated. The top three PBMs, CVS Caremark, Express Scripts and Medco, control approximately 50% of the market when

⁵ Testimony of David Balto on Health Industry Consolidation, September 9, 2011 (“Balto 9/9/11 Testimony”), at 6; Change to Win, *CVS Caremark: An Alarming Merger, Two Years Later*, November 2009, at 6; AAI 5/11/09 White Paper, *supra*, at 9.

⁶ Allison Dabbs Garrett & Robert Garis, *Leveling the Playing Field in the Pharmacy Benefit Management Industry*, 42 Val. U. L. Rev. 33, 37, 66-68 (2007); AAI White Paper, Express Scripts’ Proposed Acquisition of Caremark: An Antitrust White Paper, February 14, 2007 (“AAI 2/14/07 White Paper”), at 2, 4, 7-8.

⁷ PBMs also offer additional services such as compliance programs outcome research, drug therapy management programs, data analysis, and distribution services. Garrett & Garis, *supra*, at 34-38; AAI 5/11/09 White Paper, *supra*, at 7.

measuring prescriptions filled or controlled.⁸ If the market concentration is measured in terms of contractual arrangements with large plan sponsors,⁹ the market is even more concentrated, with the big three PBMs controlling over 80%.¹⁰

Concentration in this market already has occurred through mergers. CVS Caremark is a result of a \$21 billion merger of CVS and Caremark in 2007 that was cleared without a Second Request from the FTC.¹¹ If Express Scripts and Medco merge, three will become two. A merged Express Scripts-Medco company will dominate the PBM services market space covering more than 150 million prescription drug consumers and 50% of the large employer market.¹² Combined with the next largest PBM, CVS Caremark, the two would cover approximately 240 million prescription drug consumers.¹³ In terms of covered lives, no other PBM, post-merger, would remotely approach Express Scripts-Medco. Even CVS Caremark would be a distant second.¹⁴

The post-merger Express Scripts-Medco company may lessen the competition between the top PBMs and smaller, regional PBMs and as a direct result, may harm consumers, plans, employers, unions, and pharmacies.

⁸ Guggenheim, *ESRX/MHS Still Faces Tough Review—We Think This Could Benefit WAG and CVS* at 3, Sept. 6, 2011.

⁹ A plan sponsor is the employer insurance company, union or other entity which purchases PBM services on behalf of its employees or members.

¹⁰ AAI 5/11/09 White Paper, *supra*, at 1.

¹¹ AAI 5/11/09 White Paper *supra*, at 2.

¹² Balto 9/9/11 Testimony, *supra*, at 6.

¹³ Balto 9/9/11 Testimony, *supra*, at 6.

¹⁴ Numbers based on <http://pbmi.com/PBMmarketshare1.asp>.

In the past, the FTC has defined this market as the provision of PBM services to large plan sponsors.¹⁵ Although that market definition is clearly relevant to the discussion of the proposed merger today, it is not the only market segment that should be examined. We also plan to consider the impact of PBM concentration on at least the specialty, mail order, and retail independent and chain pharmacy market segments.

There may be substantial concerns in the market space for distribution of specialty drugs where Express Scripts and Medco own, respectively, Curascript and Accredo, the two largest specialty pharmacy businesses.¹⁶ Specialty pharmacies provide service and treatments to consumers with complex, chronic, and often potentially life-threatening illnesses, including HIV/AIDS, Crohn's Disease, and some forms of cancer.

Specialty pharmacies also often provide the most cost-effective use of these expensive treatments, and reduced competition in this market segment could lead to reduced service and increased costs to the consumers who depend on specialty treatments and the broad counseling services provided by independent specialty pharmacies. This market segment has become increasingly concentrated and poses its own special concerns. This proposed merger would leave the post-merger company with more than a 50% share of the specialty pharmacy market segment, and may threaten competition in this area.

¹⁵ *In re Merck & Co.*, 127 F.T.C. 156 (1999); *In re Eli Lilly & Co.*, 120 F.T.C. 243 (1995).

¹⁶ Balto 9/9/11 Testimony, *supra*, at 6.

The largest PBMs also own businesses that provide mail order pharmacy operations. These mail order pharmacy operations provide a significant source of revenue because the PBM controls both the claims adjudication function and prescription dispensing function.¹⁷ Some sources suggest that a merged Express Scripts-Medco company would control almost 60% of the mail order market space.¹⁸ Although the proposed merger parties may claim that shifting prescriptions to mail order prescriptions from retail community pharmacies will lessen drug costs for consumers, their increased market power in the mail order segment may actually reduce pharmacy prescriptions and increase costs.¹⁹

Concerns also have been raised over the past several years on the lack of competition in the PBM market and deceptive conduct that harms consumers. In the past six years, a coalition of over 30 state attorneys general have brought cases against each of the big three PBMs securing over \$370 million in penalties and fines.²⁰ Over the past few years, the profits of the big three have soared over 400%.²¹

¹⁷ Garrett & Garis, *supra*, at 67.

¹⁸ Zachary French, *Express Scripts and Medco Merge Mail Order, Specialty Pharmacies, and of Less Importance, PBM Operations*, July 22, 2011.

¹⁹ PBMs determine the income received by pharmacies (by setting pharmacies' reimbursement rates) and then directly compete with pharmacies by driving prescriptions to their own mail order facilities. See Statement of the National Association of Chain Drug Stores for U.S. House of Representatives Committee on Ways and Means, Subcommittee on Health, Hearing on "Health Care Industry Consolidation," September 9, 2011.

²⁰ AAI 5/11/09 White Paper, *supra*, at 4.

²¹ National Community Pharmacists Association, *Pharmacists Can Help States Reduce Medicaid Costs, While Preserving Patient Choice*, June 16, 2011,

B. The Antitrust Concerns

There are several issues that the AAI working group will continue to investigate and evaluate.

First, could the merger reduce competition for the provision of PBM services to large plan sponsors?

Currently, CVS Caremark, Express Scripts, and Medco are, by far, the three largest PBMs serving large plan sponsors. Over 40 of the “Fortune 50” largest corporations rely on these three PBMs for PBM services.²² Because of their size and potential to offer exclusive contracts, these big three PBMs have significantly greater purchasing power than smaller PBMs for both brand and generic drugs. Their mail order and specialty operations similarly enable them to provide a wider range of services, and they have broader technological capability and better claims processing. Not surprisingly when one of the big three loses a large plan sponsor it is almost inevitably to another one of the big three.²³

Although there are numerous smaller PBMs in the market space for PBM services, smaller PBMs often face regional limitations, others serve a special niche market, such as government entities, and others do not have a full menu of services such as mail order, specialty pharmacy and the lack of claims processing

<http://www.ncpanet.org/index.php/news-releases/1016-community-pharmacists-can-help-states-reduce-medicaid-costs-while-preserving-patient-choice>.

²² Morgan Stanley Research, *Healthcare Services & Distribution: Fortune 50 and Respective PBMs*, July 28, 2011.

²³ AAI 5/11/09 White Paper, *supra*, at 5-7.

capabilities to service national accounts. These smaller PBMs also face a limited ability to secure discounts or rebates from PBM suppliers.²⁴

The Express Scripts-Medco merger reduces the number of viable providers of PBM services to large plan sponsors from three to two and may result in higher prices, less innovation, and increased barriers to entry. As noted above, the three national PBMs have significant advantages in national scope, drug purchasing, discounts and rebates, mail order distribution, specialty pharmaceuticals and administrative services. As a result, the remaining smaller, regional PBMs may be unable to constrain potential anticompetitive conduct of the large PBMs.²⁵ A key consideration in that respect is how markets are ultimately defined.

Because PBMs enter contracts with large plan sponsors that typically span several years, the ability to compete for such contracts lessens as the bigger PBMs increase their base. These contracts are renewed at a high rate.²⁶ PBMs also enter contracts with government entities—such as Medicare Part D, Tricare, and the Federal Employee Health Benefit Plan—through a competitive bidding process. PBM contracts with large plan and government plan sponsors are exclusive.²⁷

²⁴ AAI 5/11/09 White Paper, *supra*, at 7.

²⁵ AAI 5/11/09 White Paper, *supra*, at 5-7.

²⁶ AAI 5/11/09 White Paper, *supra*, at 7.

²⁷ Medscape News, The Medicare Prescription Drug Benefit: PBMs and Supporting Institutions, http://www.medscape.com/viewarticle/409818_3.

Second, would the merger pose a threat of coordinated interaction by eliminating a major competitive firm from the market?

As the PBM services segment loses major participants, the risk of coordinated interaction increases. The market is already dominated by a small number of large firms and there are substantial barriers to entry. Transparency issues make it difficult for plan sponsors to determine whether they are receiving the full benefits from their arrangement with the PBM. The lack of transparency and the length and exclusivity of contracts hamper plan sponsors' ability to negotiate meaningfully with PBMs.²⁸

As one federal court has observed, "Whether and how a PBM actually saves an individual benefits provider [plan sponsor] customer money with respect to the purchase of a particular prescription drug is largely a mystery to the benefits provider."²⁹ Even when a benefits provider receives a shared rebate from the PBM, it may not make up for the higher base price of the more expensive drugs that the PBM selects based on manufacturer rebates or exclusive supply arrangement, resulting in a net economic loss to the benefits provider. In the current climate, PBMs "introduce a layer of fog to the market that prevents benefits providers from

²⁸ Garrett & Garis, *supra*, at 61-72; AAI 5/11/09 White Paper, *supra*, at 5-7; Statement of National Association of Chain Drug Stores for Hearing on "Health Care Industry Consolidation," September 9, 2011 ("NACDS Statement"), at 4-6.

²⁹ *Pharm. Care Mgmt. Ass'n v. Rowe*, Civ. No. 03-153, 2005 WL 757608, *2 (D. Me. Feb. 2, 2005), *aff'd* 429 F.3d 294 (1st Cir. 2005).

fully understanding how best to minimize their net prescription drug costs.”³⁰

Further consolidation could threaten to make this problem worse.

Third, could the proposed merger lead to increased prices in the distribution of certain specialty pharmaceuticals?

Specialty pharmaceuticals, which are generally more costly than traditional pharmaceuticals, are an increasingly important area of concern for cost-conscious plan sponsors and a major source of revenue for PBMs. The cost of specialty drugs in the aggregate is rising rapidly—increasing by nearly 20 percent in 2010 and the cost of all specialty drugs is expected to reach as high as 27.5 percent of the cost of all medications covered by pharmacy benefits by 2013.³¹ By 2016, 8 of the top 10 prescription drugs are expected to be considered specialty drugs.³²

Specialty pharmacies manage the highly expensive treatments of the most dynamic, complex, and serious illnesses and the service they provide is both distinct and significant. Specialty pharmacies traditionally educate patients on effective treatment utilization, monitor side effects and partner with physicians to identify ineffective medications and recommend treatment changes. Specialty pharmacies also play an active role in providing continuity of patient care to ensure that costs are minimized and health outcomes improve.³³

³⁰ *Pharm. Care Mgmt. Ass’n v. Rowe*, Civ. No. 03-153, 2005 WL 757608, *2 (D. Me. Feb. 2, 2005), *aff’d* 429 F.3d 294 (1st Cir. 2005).

³¹ Express Scripts, *2010 Drug Trend Report: A Market and Behavioral Analysis* (April 2011), at 91.

³² Medco Health Solutions, *2011 Drug Trend Report* (2011), at 35.

³³ Change to Win, *supra*, at 6; Balto 9/9/11 Testimony, *supra*, at 6; NACDS Statement, *supra*, at 6-7.

This proposed merger needs to be investigated to see whether it poses a threat to competition in this important area of primary care because each of the major PBMs has acquired specialty pharmaceutical companies in the recent years. Some critics have suggested 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.³⁴ These restricted networks disrupt the continuity of care and degrade health outcomes by forcing patients to switch away from their pharmacy of choice. The major PBMs also regularly mandate that patients purchase large supplies of expensive medication. Not uncommon in the treatment of these complex conditions, many patients may find after purchasing that they are not responsive to the drug, their treatment regimen needs to be adjusted or that they cannot tolerate the drug. Having already purchased a large prescription of non-refundable medication, even minor adjustments to improve the effectiveness of treatment may result in thousands of dollars in wasted medication in addition to the cost of the replacement drug that they need.³⁵

Because the proposed merger would give Express Scripts-Medco a much larger role as a PBM, it will expand its control of patient data and realize an increased ability to use this data to move patients to its own pharmacy operations. This concern is real in light of CVS Caremark's demonstrated ability to use data

³⁴ NACDS Statement, *supra*, at 6-7; Balto 9/9/11 Testimony, *supra*, at 6.

³⁵ Lehigh Valley Women's Journal, Administrators of Pharmaceutical Industry "Steering" Profits to Themselves, and Refusing to Give Patients a Choice, Sept. 14, 2011.

received in its PBM capacity to boost sales of its CVS pharmacies.³⁶ Because the relationship with a clinical pharmacist has been repeatedly shown to improve medication compliance and health outcomes, a market free of anticompetitive conduct by PBMs to steer patients in-house would support the services that most effectively promote the health of the patient. This proposed merger, however, will likely limit patient choice and lessen clinical service because of the favoritism that the benefit manager exhibit towards its own mail-order operations.³⁷

The proposed merger would create the largest mail order pharmacy in the United States, accounting for nearly 60% of all mail order scripts processed.³⁸ PBMs can direct prescriptions to their own mail order facilities instead of to competitors.³⁹ PBMs channeling prescriptions through their own mail order operations may maximize their own gains—at increased price to the plan sponsor—by selecting drugs on which they receive superior rebates from manufacturers.⁴⁰ The opportunity for this kind of potentially anticompetitive, self-dealing, which harms consumers, will be enhanced by the creation of a dominant PBM in the mail order pharmacy market and the elimination of one of its only two real competitors.

³⁶ Change to Win, *supra*, at 6; Balto 9/9/11 Testimony, *supra*, at 6; NACDS Statement, *supra*, at 6-7.

³⁷ Change to Win, *CVS Caremark: An Alarming Merger, Two Years Later* (Nov. 2009).

³⁸ NACDS Statement, *supra*, at 7.

³⁹ Meador, *supra*, at 84.

⁴⁰ Garrett & Garis, *supra*, at 67.

In addition to expanding its ownership of specialty pharmacies and mail order operations, the major PBMs continue to expand exclusive distribution arrangements with pharmaceutical manufacturers. Further analysis is required to determine whether these acquisitions and distribution alliances have led to decreased service and consumer choice in providers, as well as substantial increases in the prices of several specialty drugs.⁴¹ In the past, Express Scripts has imposed substantial price increases after becoming the sole distributor of certain drugs. For example, the price of H.P. Acthar Gel, a drug for treating children with a rare form of epilepsy, jumped from \$1,600 a vial to \$23,000 a vial after Express Scripts was given sole distributorship rights.⁴²

By securing sole access to over 50 percent of the specialty market, Express Scripts-Medco could have increased leverage to restrict network access and enter into exclusivity arrangements with drug manufacturers.⁴³ The proposed merger thereby could increase the potential for Express Scripts-Medco to engage in anticompetitive conduct and threatens to increase specialty drug prices and limit access to critical medications.

Fourth, will the proposed merger increase the exercise of monopsony power to reduce the local delivery of pharmaceutical services?

We should be concerned that the major PBMs may already possess the ability and incentive to exercise market power over retail independent and chain

⁴¹ Meador, *supra*, at 77-84.

⁴² AAI 5/11/09 White Paper, *supra*, at 9.

⁴³ Balto 9/9/11 Testimony, *supra*, at 6; Milt Freudenheim, *The Middleman's Markup*, New York Times, April 19, 2008.

pharmacies because reimbursement from PBMs is a major source of revenue for retail pharmacies.⁴⁴ The proposed merger could enable these major PBMs to push compensation to the retail pharmacies below competitive levels, ultimately leading to lost jobs and diminished service for their consumers.

An adverse impact on the delivery of pharmaceutical services at the retail level should be sufficient by itself to raise serious concerns and motivate the government regulators to closely scrutinize the proposed merger. In recent years, federal and state regulatory agencies have become more sensitive to the exercise of buyer power as raising a potential antitrust concern. The Antitrust Division has brought cases against both health insurers and agricultural processors based on the impact on doctors and farmers respectively. In the recent *George's Foods* enforcement action, the DOJ sued to enjoin a merger of two of the three largest chicken processors in the Shenandoah Valley area, which were “the only competitive buyers for grower services” in the area, solely based on the impact on chicken farmers.⁴⁵ Thus, the exercise of such buyer power should be a primary focus of any further review.

C. Potential Efficiencies Must Also Be Investigated

There should also be careful consideration about whether the proposed merger will lead to increased efficiencies that are specific to this proposed merger and that cannot be achieved by means not related to a merger. In the context of

⁴⁴ NACDS Statement, *supra*, at 3-7; Garrett & Garis, *supra*, at 46.

⁴⁵ *United States v. George's Foods, LLC*, No. 5:11-cv-00043 (W.D. Va.)

this proposed merger, any efficiency claims should be supported by existing business documents and demonstrable outcomes.

Cognizable efficiencies should not be associated with anticompetitive reductions in output or service. For example, if reducing excess capacity of mail order pharmacy services as the result of the merger is a potential efficiency, the companies should demonstrate that the existing mail order capacity has not historically contributed to lower health care costs for plan sponsors and that reduction in capacity would not also entail substantial job losses.⁴⁶ Competition also has the ability to create efficiency, and the merging entities must show that the same efficiencies cannot be realized through existing, continued competition.⁴⁷

The FTC and this Committee should also work to make sure that any suggested cost savings will result from scale efficiencies and not the exercise of monopsony power and focus on whether, and to what extent, these claimed cost savings will actually be passed on to the PBMs' customers and, therefore, consumers. A fruitful area of investigation may be to determine why profits of the PBMs have increased at such a substantial rate during a time of industry consolidation which promised increased efficiencies. Does this suggest that the merged firms will retain a good portion of any future cost savings? Such profit retention (as opposed to passing on such savings) is consistent with a market place that exhibits less, not more, competition.

⁴⁶ Barclays Capital, *Medco-Express Scripts Antitrust: Part II*, Sept. 12, 2011, at 9.

⁴⁷ *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 61-63 (D.D.C. July 31, 1998).

V. Conclusion

Thank you for providing me the opportunity to present my views of the proposed merger of Express Scripts and Medco. The proposed merger raises serious concerns that call for further careful study and evaluation, including the risks to competition in the PBM services to large plan sponsors, specialty pharmacy operations, mail order pharmacy operations and retail pharmacy markets, as well as to consumers and patient health care. The AAI looks forward to providing you its white paper once it has been completed.