Sen. Kohl's Follow-Up Questions for the Record for Hearing on "The Express Scripts/Medco Merger: Cost Savings for Consumers Or More Profits for the Middlemen?"

For David Balto

1. (a) Express Scripts and Medco contend that there are many other PBMs that compete to serve as pharmacy benefits managers for the nation's largest employers and plan sponsors. Do you believe PBMs other than Express Scripts, Medco and CVS Caremark can truly compete for the business of large national employers? Why or why not?

No, second tier PBMs cannot compete in a significant enough fashion for the business of large national employers to serve as a price constraint and competitive influence on Express Scripts, Medco, and CVS Caremark ("the big three").

Large national employers require a PBM that provides a national network of pharmacies. Only the top tier PBMs harness the bargaining power sufficient to demand affordable prices for pharmaceuticals. PBMs outside of the big three lack the negotiating leverage and, as a result, cannot secure comparable levels of rebates. This difference in bargaining power is also present in negotiations with pharmacies, and only the big three PBMs can secure reimbursement rates low enough to control costs at a scale large enough to satisfy the large plan sponsors. Large national employers also seek PBMs that offer a comprehensive set of services. This includes programs designed to limit waste and abuse, programs driven at facilitating regulatory safety protocol, and state-of-the-art technology that tracks the complete profile of the plan beneficiaries. Lastly, a PBM must be a certain size to manage the sheer volume of beneficiary information. Only the big three are large enough to manage the practical demands of administering the prescription drug benefit portion of large health plans.

(b) What would be the consequences for large employers of the loss of competition between Express Scripts and Medco should their merger be approved?

Large employers would be left facing higher prices and less service in the PBM market. The California Public Employees' Retirement System quote from my testimony encompasses this reality: "You can count the PBMs that can serve the organizations of this size on a couple of fingers, maybe three, and they frequently are subject to lawsuits and investigations." Without Medco in this calculation, the number is down to two.

There are a number of effects that large employers are likely to experience after the merger, the brunt of which will ultimately be borne by the end-user – the consumer. Plan sponsors will see an increase in their drug costs – or perhaps better put, a decrease in the savings secured – once the top tier PBMs face less competition. As evidenced by their increasing profits, PBMs are not afraid to keep a windfall portion of the savings they negotiate for themselves. The only constraint on PBMs passing on a bare minimum of savings to the plan sponsors was competition among the big three. Once this competition is lessened, it is likely the PBMs will filter less of the money back to the plans, and more back to themselves.

The top tier PBMs will also increase their efforts to direct distribution through its own channels. This will further marginalize the impact of community pharmacies and specialty

pharmacies, and will render the consumer with virtually no choice in their health care. Community pharmacists and specialty pharmacists both serve integral roles as care providers, and offer a hands-on approach that mail-order simply cannot provide. For those patients suffering from chronic or complex diseases that require difficult-to-administer medicine, the loss of these institutions as care providers will be harmful. The long-term result will be poor administration of vital drugs, which will lead to poorer health and, ultimately, an increase in health care expenses.

Large employers will also likely experience a decline in the provision on ancillary services, such as Medco's highly praised Therapeutic Resource Centers, and Express Scripts "prescription drug adherence plans."[1] It is clear the two companies have an incentive to create these programs and plans now – competition in the market compels them create new ways to serve customers. However, post-merger, this incentive will be dramatically decreased. Not only will the merger fail to encourage more programs, the reduction in competition will likely remove the primary motivation for creating these programs now.

This harm will occur without a procompetitive justification to counterbalance the effects. When pressed by Senator Kohl at the hearing, CEO George Paz confirmed that "significantly increasing discounts over what you are getting right now is really not why [ESI is] doing this deal, and [ESI is] not nearly as certain that this deal will result in far more discounts from suppliers, that there are other ways this will pay off." Senator Kohl challenged the notion that ESI and Medco would really have anything more than a marginal increase in bargaining power after merging, since they both already secure optimal pricing from pharmaceutical manufacturers. Instead, ESI and Medco rest the justifications for this merger on arguments of synergies resulting from merging "back office" operations, and implementing programs that will help reduce waste. Combining administrative chores simply do not help customers, and certainly do not pose nearly enough benefit to outweigh the grave competitive harm.

2. On November 11, the New York Times reported that Medco instructed drug stores to not fill prescriptions for the generic version of the blood pressure drug Lipitor for six months beginning December 1, when Lipitor's patent expired. According to the story, Pfizer, the manufacturer of Lipitor, negotiated with PBMs for large discounts to prevent pharmacies from dispensing the generic version of Lipitor. On November 30, the New York Times reported that the CVS Caremark PBM had instructed pharmacies that the generic form of Lipitor would not be covered for 29 prescription drug plans it managed for Medicare Part D.

We understand that Medco has taken issue with the first Times story, and claims that Medco was acting at the direction of one client. The later Times story notes that Medco has now instructed pharmacists to use the generic version of Lipitor, but that Medco's own mail order service will use Lipitor as its "house generic."

In the last few days my staff has received a number of reports from some pharmacists that Express Scripts and other PBMs were directing them to fill prescriptions with Lipitor rather than its generic alternative. One pharmacist reported to us that, because Lipitor is more expensive

[1] Written Testimony of George Paz, Chairman and Chief Executive Officer of Express Scripts Inc., before the Senate Judiciary Committee Subcommittee on Antitrust, Competition Policy, and Consumer Rights, Hearing on the Proposed Merger between Express Scripts and Medco, December 6, 2011, at 5.

than the generic, "the healthcare system is paying a minimum of $ 63.26 more each time the brand [name drug] is dispensed instead of the generic."

What do you make of these reports? Do PBMs have an incentive to block pharmacies from filling prescriptions with lower priced generics as this will reduce the discounts or rebates the PBMs collect from drug manufacturers? How do consumers fare when these type of deals are made? And will this merger make this situation worse?

This well-timed report perfectly illustrates two important points central to the analysis of this transaction: 1) the big three PBMs have inherent and unavoidable conflict of interest between their responsibilities to broker for the best prices on behalf of beneficiaries and their desire to maximize revenue through the vertically integrated PBM, mail-order, and specialty businesses; and 2) they wield considerable market power, and can dictate the terms of formularies and reimbursement to ensure they make as much money as possible, without regard as to whether this is the best price for consumers.

The most likely explanation for the Lipitor situation is that Medco had negotiated for a large rebate from Pfizer in exchange for pushing Lipitor. Medco also likely secures a price below market rate, allowing it to assert that it has negotiated a cost-saving price for consumers. However, as the New York Times story illustrates, the end result is plan sponsors, and ultimately consumers, pay more for drugs so that PBMs can reap windfall profits.

PBMs always have an incentive to drive consumers to the drugs for which they have negotiated the highest rebates. This high-profile example is just one instance in an epidemic of large PBMs sacrificing the consumer for their own financial gain. The merger will only exacerbate this problem. Currently, the behavior of the big three PBMs is often anticompetitive but often reined in by competition in the market. Once this competitive constraint is removed, there will be virtually no check against PBMs wielding their bargaining power for their own benefit, and leaving consumers with no choice but to continue to pay exorbitant prices for health care.

3. According to industry estimates, after this merger the combined Express Scripts/Medco will control about 60% of the mail order business. Should we worry about this high level of concentration in the mail order marketplace? Why or why not?

A mail order industry concentration of 60% is cause for significant concern. This limits patient choice, reduces mail order firms' incentive to bargain fairly, and jeopardizes the service and care that patients require from their pharmacies. A merger resulting in such a high market concentration is always cause for concern, especially in industries in which entry by competitors is unlikely. In this case, given the PBMs' exclusive use of its own mail order pharmacies, entry would be unlikely, or irrelevant.

The concern is amplified by the fact that this concentration will be in the hands of the very entities that negotiate drug prices and determine when pharmaceutical substitutions will be made. PBMs face an inherent conflict of interest when they are tasked with negotiating lower reimbursement rates for pharmaceuticals but also are incentivized to increase mail order use, or to substitute certain drugs as a result of their favorable rebate agreements with pharmaceutical

manufacturers. This conflict of interest has led to numerous state enforcement actions, including *States Attorneys General v. Caremark, Inc. et al* (D.D.C. 2008), *States Attorneys General v. Express Scripts, Inc.* (D.D.C. 2008), and *United States ex rel. Hunt, Gauger, Piacentile, et al. v. Merck-Medco Managed Care, L.L.C., et. al.* (E.D.P.A. 2000). In each of these cases, joined by numerous states against the merging parties and the only other remaining top tier PBM, the states alleged that the PBMs had defrauded patients, clients, and the United States through a series of practices, including cancelling or destroying prescriptions, failing to perform pharmacists' services required by law, switching patients' prescriptions to different drugs without the knowledge or consent, and creating false records and billing patients for drugs they never ordered. These cases are clear evidence that PBMs succumb to the conflict of interest inherent in operating the mail order pharmacies, and cannot be trusted as honest brokers for the patients they purport to represent.

The merger will increase the economic incentives for the combined firm to continue these practices, and will augment their ability to do so. With such a high concentration of the mail order market residing in so few firms, customers will have no real choice. Furthermore, as I noted in my testimony, the big three PBMs all require beneficiaries to use the PBM-owned mail order pharmacy. Patients are captive the deceptive practices, and can only rely on post-hoc, inefficient litigation as a means of combating the fraud and deception rampant in the system.

4. In his testimony, Mr. Streator contended that it is the health plan sponsors that instruct the PBMs how to design pharmaceutical benefit plans, and the PBMs are merely acting at the direction of the plan sponsors. What is your response to this argument? And will this merger reduce the leverage of plan sponsors to insist on specific aspects of plan design, but rather be left more in a "take it or leave it" position?

From my understanding, Mr. Streator's depiction of the PBM/plan sponsor relationship is flawed. PBMs create benefit plans and push plan sponsors towards the products it is most trying to sell. The PBMs set the prices, and offer contract terms with limited flexibility. The New York Times article discussed in question #2 is directly to this point. The story states that Medco claims it was acting at the direction of a client, but this seems unlikely. And even when Medco acquiesced and included the generic, it still refused to do so for its mail-order services. Therefore, we must have a contradiction. Either the plan sponsor who requested brand Lipitor for all prescriptions, or the plan sponsors who complained and asked for generics to be used instead of the more expensive brand, are being denied their request. Such is the nature of the big three's relationships with plan sponsors. Like all harm stemming from this transaction, the merger will exacerbate the problem and make a bad situation worse.

5. In previous testimony before Congress, you've advocated for increased transparency in the PBM marketplace. Specifically, you've contended that PBMs do not adequately disclose reimbursement rates to pharmacies and payments from drug companies. You have also said that transparency can improve competition in the PBM markets.

Yet, Express Scripts has asserted to us that their practices, including pharmaceutical rebate contracts, are transparent and regularly audited by their clients.

Do you agree with Express Scripts, that they operate transparently with their clients? And, in your view, would this proposed merger improve or hamper PBM transparency?

I disagree with Express Scripts' claim that they operate transparently with their clients. While it may be true that Express Scripts does have certain plan designs that offer their clients a certain level of transparency, they artificially raise the cost of these designs to a level that makes them entirely undesirable to most plan sponsors. It is undeniable that, as one court has observed, "a layer of fog"[2] exists over the PBM industry that prevents most plan sponsors from knowing how much of the savings PBMs actually pass along to the payors.

This merger would hamper PBM transparency. By reducing the number of full-service, national PBMs from three to two, the merger would significantly diminish PBM market rivalry. Robust competition not only constrains prices, but also promotes quality and diversity in services. Accordingly, the remaining two PBMs would be less inclined to offer transparent plan designs.

6. Should the FTC decide to approve the merger, would you recommend the FTC require any conditions to preserve competition?

First off, I must reinforce the fact that the FTC should block the proposed merger. It is Express Scripts' 155 million covered lives--70 million more than the next largest PBM-- that are going to irreparably damage competition in this market and harm American consumers. A divesture of a portion of their specialty pharmacy or mail-order capabilities will insufficiently address the competitive concerns raised by the merger as Express Scripts will maintain the same ability to drive down reimbursement to pharmacies below competitive levels and drive consumers away from their pharmacy of choice and into their captive services.

If the FTC should decide to approve the merger, I would recommend that the FTC require the companies to divest *all* affiliated specialty pharmacy and mail-order pharmacy capabilities. Additionally, the FTC should protect consumer choice and competition in the delivery of pharmacy service by prohibiting Express Scripts from restricting pharmacy network access and engaging in exclusive distribution arrangements.

[2] *Pharm. Care Mgmt. Ass'n v. Rowe*, 2005 U.S. Dist. LEXIS 2339.