Senator Mike Lee
Questions for the Record
David A. Balto, Consumers Union, et. al.

1. At the hearing, you stated that you do not believe the PBM market is currently competitive and that it would become even less competitive should the merger be approved. Mr. Snow of Medco stated that his company lost important contracts and significant business to a number of different competitors during 2010.

    a. Does Medco's loss of significant business to a number of different competitors in 2010 suggest a competitive market for PBMs, and why or why not?

    It is true that Medco lost business during 2010. It is not true that these contract losses do anything to dispel the notion that this is a highly concentrated industry, with only three viable players.

    Medco's most significant lost contracts were the Federal Employees Health Benefits Program and the California Public Employees' Retirement System. These funds both opted for CVS/Caremark instead of Medco. Medco also lost MemberHealth LLC to CVS/Caremark. UnitedHealth Group Inc. is an outlier in this analysis. This large insurance company covers over 18 million lives and is the largest American insurer by market value, and was uniquely positioned to bring its PBM function in-house, especially after its purchase of PacifiCare Health Systems in 2005.

    It would be inapposite to conclude that Medco's loss of business is evidence of vibrant competition. Instead, most of the covered lives are shifting from one member of the big three to another, with others in a unique position to take matters into their own hands. In fact, UnitedHeatlh's decision should be seen as evidence that the market lacked competition – the insurer was so unhappy with its PBM options that it chose to absorb the cost internally.

2. At the hearing, you asserted that this merger will result in higher costs for consumers. The Congressional Budget Office estimated that PBMs reduce drug costs by roughly 30 percent per year. Similarly, a 2003 General Accounting Office study found the average price of prescriptions through mail order was 27 percent below the average cash price consumers would pay at a retail pharmacy for brand name drugs, and 53 percent below the retail cash price for generic drugs.

    a. Do you dispute these findings?

    I dispute the GAO findings to the extent that they are taken out of context to suggest a level of savings garnered by mail-order as compared to similarly situated PBM customers without mail-order. The analysis provided by the 2003 GAO report, and often cited by PBM loyalists, actually compares the level of savings that mail-order provides to

"*cash-paying customers without third-party coverage*."[1] The difference offered by mail-order is much less stark when compared to PBM retail prices. This report also concedes that the difference between PBM and cash-paying customers "may overstate PBMs' negotiating success because, absent a PBM, plans would likely manage their own drug benefits and also attempt to negotiate discounts with retail pharmacies." This quotation is often utilized to insinuate that PBMs, or mail-order through PBMs, offers up to 27% savings on brand name drugs and 53% on generic drugs from what the normal consumer would pay. This is a misrepresentation of the finding, and I dispute the use of this data point to suggest such a conclusion.

Furthermore, this is an old report. The GAO released the report, and the newest data contained therein is from 2002 – nearly a decade old. The PBM market is not the emerging industry that it was in 2002. It has grown in scope, and become extremely consolidated, with only three firms controlling the majority of the market. This report is simply not a reliable source for assessing the modern impact of PBMs.

Much like the GAO report, the Congressional Budget Office's report relied upon by PBM loyalists is outdated and unreliable. Furthermore, to state that the CBO report simply states that PBMs provide 30% savings to consumers is misstating the report. In this report, the CBO was estimating the likely effects of competing bills on drug price for Medicare patients only. The report is rife with suggestive and predictive language, and in no ways portrays itself to be a comprehensive study or final analysis of the savings generated by PBMs. In fact, the table from which this 30% estimate was taken is entitled "CBO's Assumptions for Four Prescription Drug Proposals." This report is too old and too imprecise to be relied upon as support for the conclusion that competition is healthy in the PBM market, much less to suggest that the merger would not substantially lessen competition.

b. If you agree that PBMs save customers money on prescription drugs, do you view the merged entity as being different from current PBMs in that it will not result in savings for consumers, and why or why not?

There are three conditions necessary for a thriving PBM industry to work. First, there must be real, active competition between PBMs so that they each serve as legitimate price constraints on the rest. Nominal competition is not sufficient. There is already a dearth of competition in the PBM market, especially in the market for large PBMs capable of servicing a large plan sponsor. 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." CVS/Caremark is the only firm in the market capable of serving as a price constraint on Express Scripts and Medco. If the merger is allowed to proceed, the result will be a duopoly in which the remaining firms have no incentive to pass through anything but the bare minimum of savings to the consumer.

[1]United States General Accounting Office, *Effects of Using Pharmacy Benefit Managers on Health Plans, Enrollees, and Pharmacies*, at 9, available at http://www.gao.gov/new.items/d03196.pdf.

Second, there must be minimal conflict of interest between the PBMs' responsibilities as an agent on behalf of it plan sponsor customers, and its drive to increase profits. To be clear – profits are not bad, nor is profit seeking. However, when an intermediary is tasked with negotiating the lowest price possible, but also financially compensated for preferring one distribution channel over another, the conflict of interest is too great to overcome. Such is the case with the big three PBMs who own and operate their own mail-order facility and specialty pharmacies. The Health & Human Services Office of Inspector General report "Concerns with Rebates in the Medicare Part D Program" illustrates this conflict, concluding "sponsors received rebates when they encouraged beneficiaries to use certain drugs." PBMs are willing to drive the ultimate consumer – the patient – to drugs not prescribed by the physician in order to maximize their profits. This very conflict of interest spurred the Federal Trade Commission to twice intervene in the merger of two PBMs. In 1995 the FTC investigated Eli Lilly's acquisition of PCS, and entered into a consent agreement which required the merging firm to improve transparency, maintain an open formulary, and implement an internal firewall to prevent communications between Eli Lilly and PCS regarding bids, proposals, prices, and other information.[2] Then, in 1999 the Commission investigated and entered into a virtually identical consent decree with Merck-Medco following the merger of these two firms.[3] The takeaway from these cases is clear: conflicts of interest have haunted the PBM market since its earliest days, and the government has proven its willingness to be proactive to respond to competitive harm in the industry.

Third, the PBM market must be transparent. In his testimony ESI CEO George Paz contended that his company was very transparent, and asserted that plan sponsors call the shots, with the PBMs merely accommodating these requests. However, the Health & Human Services Office of Inspector General report referenced above paints a different picture. This report finds that sponsors often have "complex contractual relationships"[4] that lack transparency, thereby suggesting that there is no accounting or verification mechanism for filings claiming to offer such high pass through rates. This lack of transparency 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

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[2] *In the Matter of Eli Lilly and Company*, FTC File No. 012 3214, available at http://www.ftc.gov/os/caselist/0123214/0123214.shtm.

[3] *In the Matter of Merck &Co. Inc. and Merck-Medco Managed Care, LLC*, FTC File No. 951 0097, available at http://www.ftc.gov/os/caselist/c3853.shtm.

[4] Department of Health and Human Services, Office of Inspector General, "Concerns with Rebates in the Medicare Part D Program" at ii.

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 harm that will result from this merger is not the existence of PBMs, but rather the change in the competitive landscape that will result from the merger. And this harm will come without any cognizable efficiencies or increased bargaining leverage. 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. Unfortunately, none of the Committee members asked Mr. Paz to explain precisely why ESI and Medco need to merge to create these beneficial programs. He listed several such programs in this and his past testimony in September, such as Medco's Therapeutic Resource Centers, illustrating that the two companies are able and incentivized to implement these programs now. The fact remains that we do not need the merger to incentivize the PBMs to create these programs.

The resulting mega-PBM will be much different than those that were the foundation of the GAO's 2003 study. The combined ESI/Medco will wield monopoly power while simultaneously expanding its reach into vertical profit centers such as mail-order and specialty, thereby worsening an already alarming conflict of interest. The resulting duopoly will be disincentivized from innovating for the benefit of consumers. Instead, they will be able to completely focus their attention on driving profits to the harm of the ultimate consumer, the patient.