Senator Mike Lee
Questions for the Record
David B. Snow, Medco

1. **I have heard concerns expressed by pharmacies that they do not have sufficient bargaining power in their negotiations with PBMs such as your company. Some point to Walgreens' failed negotiations with Express Scripts as an example of insufficient bargaining power on the part of pharmacies.**

    a. **How would the merger affect your interactions with pharmacies and what you are able to offer consumers?**

    Retail pharmacies have been – and will continue to be – an indispensible component of the services we deliver to our plan sponsors and their members, regardless of the merger. It is important to understand that PBMs such as Medco respond to the demands of clients, and that clients demand that their PBMs provide both a retail and mail network for their members. Retail pharmacies are an integral part of health care in America, and Medco recognizes its obligation to provide a comprehensive, convenient and cost-competitive retail option as part of its core suite of services.

    Even if this were not Medco's desire, it is a market requirement. Retail dispensing of prescriptions remains the dominant method by which members receive their pharmaceuticals, and our clients demand that we provide robust retail networks. Mail order services represent only about 15 percent of prescriptions dispensed today in the United States; the other 85 percent are dispensed through retail channels. Moreover, there are vast numbers of prescriptions that are not suitable for mail order, such as acute antibiotics and 30-day prescriptions. Medco's client contracts, as well as regulations, require Medco to provide certain access levels to retail pharmacies for our members.[1] Client demand and these regulatory requirements ensure that we work collaboratively with retail pharmacies to ensure they remain in our networks.

    Moreover, the perception that independent pharmacies have been losing prescriptions to mail order pharmacies is simply unsupported by the relevant data; however, independents have been losing significant prescription volume to chain pharmacies and big-box retailers, including supermarkets and mass merchants. Data recently released from the National Association of Chain Drug Stores (NACDS) shows that even though all pharmacy segments are filling more prescriptions year over year, the relative share of mail order pharmacy has remained flat, while the share of chain and big-box retail pharmacies, such as CVS and Walgreens or Walmart and Sam's Club, has increased at the expense of the community-based independent pharmacies.[2] The

[1] It is important to note that Medco, as a Medicare Part D Prescription Drug Plan, is required by law to ensure that beneficiaries have "convenient access to network pharmacies" – meaning they live within a certain distance of a pharmacy. In addition, under the terms of its client agreements, Medco is contractually obligated to ensure that its retail pharmacy network meets exacting proximity requirements so all plan members can readily access a retail pharmacy, e.g., generally speaking, members in urban areas must live within one mile of a pharmacy, suburban members must live within three miles and those living in rural areas must live within five miles of a retail pharmacy.
[2] NACDS Chain Pharmacy Industry Profile 2011-2012.

growth for chain and big-box retailers has been fueled, in part, by 90-day maintenance prescriptions that are increasingly filled at retail stores and not at mail order. In other words, mail and retail pharmacies are now direct competitors for those 90-day prescriptions, blurring the line between the two pharmacy channels. As the Federal Trade Commission (FTC) noted last year in a letter commenting on a bill that was pending before the Mississippi legislature:

> *Plan sponsors sometimes encourage patients with chronic conditions who require repeated refills to seek the discounts that 90-day prescriptions and high-volume mail-order pharmacies can offer. Mail-order pharmacies, including those owned by PBMs, compete directly with retail pharmacies.*[3]

We have attached a chart in Appendix A that illustrates this pattern.

In fact, Medco data shows that on average, an independent pharmacy loses 64 prescriptions to a chain pharmacy for every single prescription lost to a mail order pharmacy. Nearly half (47 percent) of members who fill prescriptions in an independent pharmacy use more than one pharmacy, including chain and big-box retail pharmacies. If independent pharmacies consolidated these prescriptions they would increase their share by 44 percent.

Although as the acquired company we are not in a position to comment specifically on operations post-merger, we believe our merger will help retail pharmacies compete more effectively and stem these losses to chain pharmacies.

Highlighting the importance that Medco places on the continued viability of independent retail pharmacies, Medco has partnered with independent pharmacies in Illinois and New Mexico as part of pilot programs to provide additional reimbursement to independent pharmacies. This reimbursement is for providing clinical counseling to members and closing gaps in care that members may have related to the appropriate use of medication.

Interestingly, based on data presented by their own trade association, traditional community-based independent pharmacies continue to grow in number and increase their top-line revenue and bottom-line profits. Between 2009 and 2010, the number of independent pharmacies grew by almost 400 to more than 23,000, representing a $93 billion industry. Average independent pharmacy sales increased by 3.7 percent in 2009, from $3.88 million to $4.03 million.[4] Pharmacy profits have doubled since 1999, with average profits per pharmacy of almost $1 million.[5] In the context of one of the most difficult economic environments in generations, that is an enviable position for any industry.

[3] FTC letter to The Hon. Mark Formby, Mississippi House of Representatives, March 22, 2011, regarding MS SB 2245, p. 4; accessible at http://www.ftc.gov/os/2011/03/110322mississippipbm.pdf.
[4] National Community Pharmacists Association, 2010 NCPA Digest, October 2010.
[5] Drug Channels, "Owning a Pharmacy: Still Pretty Profitable", January 25, 2011 (Analysis of 2010 NCPA Digest Data).

b. Do you feel that you need more bargaining power in your interactions with pharmacies?

Our mission is to lower drug costs and improve health outcomes for our plans' sponsors and the members we mutually serve. Although as the acquired company we are not in a position to comment specifically on operations post-merger, we believe the Express Scripts-Medco combination would make us more effective at representing their interests as we negotiate with large drug manufacturers and chain/big-box drugstores for the lowest possible prescription drug costs.

2. It is my understanding that only a few PBMs serve most of the Fortune 50 companies.

a. How much of your overall business comes from this segment of the market?

In 2011, only 6.8 percent of Medco's business came from Fortune 50 companies.

b. Do you view this segment of the market as competitive, and if so who are the other PBMs that you see as competing with you for these large contracts?

We believe there is strong empirical evidence demonstrating that competition in the PBM business – overall, and specifically for large employers – is robust, dynamic and increasing at a rapid pace as the lines blur across traditional competitors, including retail pharmacies, health plans and PBMs. Among the large employers, we do not view Express Scripts and Medco as head-to-head competitors; Medco has not lost a large employer client to Express Scripts in more than three years. Additionally, based on the current dynamics across the pharmacy industry, the historical concept of what some refer to as the "Big Three PBMs" is outdated and has lost whatever relevance it once had. We also note that the implementation of the new health care reform law has already begun to change the competitive landscape for PBMs, and this pace of change will further accelerate as different aspects of the law become effective and continue to be implemented.

Large employers already use more than just CVS Caremark, Medco and Express Scripts. Looking at the Fortune 50, according to a July 2011 Morgan Stanley report, nine PBMs serve Fortune 50 companies: Aetna, Catalyst Rx, CVS Caremark, Express Scripts, Medco, Prime Therapeutics, Restat, SXC Health Solutions and OptumRx (owned by UnitedHealth Group). Additionally, two Fortune 50 companies, Costco and Kroger, have their own PBMs.[6] Some of these PBMs are among the nation's fastest-growing organizations, developing scale and capabilities at a rapid pace. In 2011, only 6.8 percent of Medco's business came from Fortune 50 companies.

[6] Morgan Stanley, "Healthcare Services & Distribution: Large Employer Market Key to Deal Approval", July 28, 2011.

Medco directly experiences this fierce competition for large employer accounts. Although Medco has enjoyed considerable success since its 2003 spin-off, for our 2012 plan year alone, Medco has lost $10 billion in business – losing 40 clients, large and small – to more than 15 different PBMs. The PBM competitors that recently won these accounts from Medco include: Aetna, CVS Caremark, Catalyst Rx, Cigna, Envision Pharmaceutical Services, Express Scripts, HealthPlus of Michigan, HealthSpring, SXC Health Solutions, MedImpact Healthcare Systems, OptumRx, Prime Therapeutics and ProAct.

This current dynamic, coupled with the changing landscape triggered by health care reform, refutes the historical idea of a "Big Three" construct in the marketplace. In fact, UnitedHealth, the largest health insurer in the country, has contracts with clients for PBM services that, when consolidated at its PBM, will instantly make it the third largest PBM in the country. UnitedHealth owns its PBM, branded in the marketplace as OptumRx. UnitedHealth today provides PBM services to its many clients by using both OptumRx, largely for its government clients, and Medco, largely for its commercial clients. UnitedHealth has announced that it will be moving to OptumRx all the PBM services that Medco currently provides, taking in-house the 14 million lives currently served by Medco. On the pharmacy side, UnitedHealth already provides coverage to a number of Fortune 100 clients, including Delta, Hewlett-Packard, Oracle, Apple, Proctor & Gamble, and state plans such as the State of New York.

UnitedHealth has stated publicly that it anticipates that it will continue to grow its PBM. Today, UnitedHealth alone provides medical insurance coverage for 45 percent of the lives associated with the employers in the Fortune 100. This provision of medical benefits creates a natural feeder to support the continuing growth of OptumRx, which is soon expected to exceed $30 billion in annual revenue as a UnitedHealth subsidiary. In the most recent rankings, UnitedHealth was listed No. 22 in the Fortune 500, with revenues exceeding $94 billion. As part of its publicly announced growth plans, the company in 2012 expects to invest more than $115 million in OptumRx, and has already committed to adding more than 600 jobs to its Kansas City mail order facility, which is capable of dispensing more than 100,000 prescriptions a day. OptumRx also has an additional mail order facility in California.

Today, more than 40 PBMs aggressively compete to provide differentiated value propositions for public and private payors of all sizes. Seven PBMs each process more than 150 million prescriptions annually, 12 PBMs serve more than five million members each, and at least 17 PBMs serve large state accounts. Additionally, nine Fortune 500 companies operate PBMs directly for their employees. Thus, regardless of the past dynamics in the market for large employers, today's marketplace is changing rapidly and will continue to evolve.

3. **Can you please clarify your views of independent community pharmacies and discuss how the merged entity would ensure that consumers are receiving the services they need from community pharmacies?**

Our clients demand that we provide members with broad and convenient access to a comprehensive network of pharmacies. As we elaborated in the response to Question 1, above, retail pharmacies provide a critically important service across the health care continuum, and we consider independent community pharmacies indispensible to the success and viability of the overall pharmacy network.

As the acquired party in this transaction, we are not in a position to comment on specific operational matters post merger. However, there is nothing that we believe would alter the fact that independent pharmacies remain critical to the success of the enterprise.

4. **I have heard concerns expressed that the merged entity could design prescription drug plans that economically force patients to use mail order or unfamiliar pharmacies for certain medications, thus diminishing and fragmenting patient care.**

    a. **Do PBMs currently pressure customers to use mail-order services or other pharmacies that may be unfamiliar to the consumer?**

No, they do not. Medco, as a PBM, does not have the power or the ability to direct members to use mail service. The decision to use mail order delivery is made solely by plan sponsors. PBMs offer plan sponsors different benefit design options, and the plan sponsor chooses and implements the benefit design that best meets its objectives. It is the plan sponsors that select whether, or to what extent, they provide financial incentives to encourage members to use of mail order pharmacies.

Members always have the option of filling prescriptions at any pharmacy they select. However, their plan determines the level of reimbursement provided based on the conditions outlined in the plan's benefit design. This is why, to encourage members to use a lower cost and more efficient delivery channel, many plan sponsors offer a lower co-payment for mail order – just as they may choose to lower co-payments for generics, compared to brands. This reduces costs and ensures plan sponsors can continue to provide access to affordable benefits. In some cases, using a retail pharmacy for a prescription that falls under a mandatory mail-order plan design could require the patient to pay the full, albeit discounted, retail cost of that prescription.

Also, there are certain types of prescriptions that are not appropriate for mail order pharmacies to dispense, such as acute antibiotics and short-term pain medications. A merger would not alter those circumstances.

Medicines shipped via mail order are largely "maintenance" medications. These are taken by members with chronic or complex conditions to manage their care on a long-term basis. Currently, 70 percent of all maintenance prescriptions (90-day supply) are dispensed at retail pharmacies; only 30 percent are dispensed through mail order pharmacies.[7]

We would also emphasize that our mail order pharmacies provide comprehensive patient counseling by trained pharmacists. Medco employs more than 3,000 pharmacists who assure our clinical quality standards remain the industry standard. They are available around the clock, every day of the year to answer member questions and address concerns – even if those members are using a retail pharmacy. We also offer our members the opportunity to speak with pharmacists who are specifically trained in specialized areas related to chronic and complex conditions – ranging from heart health and cancer care to asthma and diabetes – a capability that is unrivaled in the mainstream retail environment.

b. Would the merger in any way affect the manner in which your company structures its contracts with plan sponsors with respect to mail-order services?

Medco's current contracts with its plan sponsors and any new contracts entered into prior to the merger closing date will remain in effect after the merger, and cannot be changed without the consent of the plan sponsor. Although as the acquired company we are not in a position to comment specifically on operations post-merger, nothing will alter the fact that the decision to use mail order delivery is made solely by plan sponsors.

5. At the hearing, Susan Sutter expressed concern that a low percentage of clients were exercising their contractual audit rights. Ms. Sutter expressed concern that the low rate of audits was due to contractual terms that require clients use auditors agreed to by the PBM.

a. How often do clients perform audits of your company?

We operate with complete transparency in the context of our relationships with our plan-sponsor clients. Plan sponsors perform audits at their discretion – as frequently as they choose in accord with the terms they have negotiated as part of their agreement with Medco. As Mr. Streator testified at the hearing, his organization takes an aggressive position on audits and takes full advantage of these privileges. Last year, there were more than 600 audits of our contractual relationships with our clients.

[7] NACDS Chain Pharmacy Industry Profile 2010-2011.

b. Do your contracts contain clauses requiring that audits be performed only by auditors agreed to by your company?

Every contract is unique, containing terms and conditions that are agreeable to both parties. As a general policy, Medco allows any entity selected by the client to conduct claims audits on the client's behalf. For rebates, the FTC and other government agencies have specifically noted that making the rebate information public would raise health care costs. Thus, for rebate audits, Medco is agreeable to all of the Top 100 stand-alone auditing firms, as well as others by mutual agreement.

We would emphasize that Medco's level of transparency with clients has been publicly described by state attorneys general as setting the "gold standard" in the PBM industry.[8]

c. Will the merger affect the number of audits performed or the contractual clauses with your clients regarding audits?

Given that audits are initiated by plan-sponsor request, the number of audits that may be conducted in the future is a metric that is determined by the plans themselves; therefore, we are unable to offer an accurate prediction. However, we have seen a trend of increasing audits by clients, and we see nothing that would alter that trend.

6. I have heard concerns expressed about the effect of the merger on consumer access to specialty drugs.

a. How do you define the market for specialty drugs and what share of that market would the merged entity have?

Generally, the overall majority of specialty drug distribution is broad, not narrow. When assessing the specialty drug space, it is important to remember that a large amount of drug spend for specialty drug is not adjudicated by PBMs; specialty drugs are also dispensed under the medical benefit by providers such as doctors, hospitals and clinics, as well as pharmacies. Additionally, pharmaceutical manufacturers, not PBMs, control whether their drugs are dispensed on an exclusive or semi-exclusive basis, and manufacturers retain the ability to revoke the arrangements at their discretion. Moreover, the competition in the specialty drug space is robust and growing.

Given this broad and fractured speciality market, depending on the situation, specialty drugs may be paid for under members' medical benefit or under their pharmacy benefit. Medco, as a PBM, only manages the pharmacy benefit. As a result, when

[8] Boston Globe, April 27, 2004; Pink Sheet, May 2, 2004.

considering "share" in specialty, it would be incomplete and misleading to include only the number of pharmacies that dispense specialty products, or a PBM's network. The fact that specialty drugs can be covered on either benefit and are dispensed in a variety of practice settings other than a pharmacy means that the market for specialty medicines is much broader and much more competitive, which works to the benefit of payors and patients alike.

Moreover, there are hundreds of specialty drugs (Accredo, the specialty pharmacy owned by Medco counts about 250 specialty drugs) and thousands of pharmacies dispensing the majority of those drugs. Clients have the ability to decide the number of "specialty pharmacies" that are in their network. On the pharmacy benefit side, for most drugs that are considered specialty, pharmaceutical manufacturers do not limit the number of pharmacies that dispense the drugs; any retail pharmacy can dispense specialty drugs to Medco members, and many do. As a result, there are literally hundreds of retail pharmacies in Medco's networks filling prescriptions for specialty products, including self-administered injectables. There are also pharmacies that dispense only specialty products (along with, perhaps, ancillary drugs). Pharmacies focusing primarily or exclusively on specialty drugs have been growing in size and number.

As you may know, a recent report issued by Adam Fein of Pembroke Consulting has estimated that in 2010 the specialty pharmacies operated by Express Scripts and Medco handled 31 percent of specialty drugs dispensed by specialty pharmacies in the U.S. Because this figure does not take into account specialty drugs dispensed by physician offices, clinics, hospitals and the like, it necessarily overstates the role played by Medco and Express Scripts in the overall dispensing of specialty drugs.

As to the market size after the merger, although as the acquired company we are not in a position to comment specifically on operations post-merger, we believe the merger will create operational efficiencies and purchasing scale that will help to further reduce the cost of providing specialty pharmacy care for our clients and their members.

b. In what ways do you view the merger as allowing you to provide better prices and care to the consumer with respect to specialty drugs?

By integrating specialty pharmacies with core PBM functions, both Medco and Express Scripts have separately realized high rates of patient adherence, increased ability to close gaps in care and better coordination of care for patients with co-morbidities.[9] We believe this level of care will only be enhanced post merger.

The merger of Medco and Express Scripts will result in immediate savings to our clients and, ultimately, to consumers. Under the terms of our existing contracts alone, we project that at least $1 billion in savings from the merger will be passed back to

[9] Jonathan Orszag, Kevin Green, "The Economic Benefits of Pharmacy Benefit Managers," December 2011.

our clients annually starting immediately. These savings are part of our contractual requirements, certifiable by us and independently auditable by our clients, and include savings related to specialty pharmacy.

7. A few witnesses at the hearing asserted that there is no evidence that PBMs pass cost savings through to their clients.

a. What evidence is there that your company passes through cost savings to its clients?

It is important to realize that clients determine the nature of their contract with Medco. Bluntly stated, if PBMs did not deliver value to clients, they would cease to exist.

We have a large number of sophisticated clients, and those clients liberally exercise their discretion to define the form and content of their contract with Medco. Often during the RFP process, Medco supplies different pricing options to the potential plan sponsor, and the plan sponsor chooses the pricing option it believes returns the greatest value aligned to their plan objectives. Thus, a large percentage of our drug spend is with clients that have negotiated "pass through" pricing of retail pharmacy reimbursement rates, and have chosen to keep all the manufacturer rebates connected to the prescription drug use of their members. Medco's public filings state that across its book of business, close to 90 percent of all rebates are passed through to clients – up from about 50 percent just a few years ago, reflecting the trends in client rebate-retention preferences and Medco's contracting flexibility.

In addition to this direct evidence of value delivered to clients, the savings benefits of PBMs generally have been thoroughly documented in studies by economists; government agencies such as the Congressional Budget Office (CBO), Government Accountability Office (GAO), and the FTC; health industry analysts; and clinical researchers. Recently, a report issued by Jonathan Orszag of Compass Lexecon extrapolated from a CBO estimate that PBMs deliver savings of as much as 30 percent compared to unmanaged drug spending levels. Orszag wrote:

> *Simply taking this estimate of cost savings derived by two PBMs – Medco and Express Scripts – the savings to health plan sponsors and consumers are roughly $51 billion per year. But Medco and Express Scripts estimate that they currently derive greater savings through larger discounts from drug manufacturers and retail network partners and benefit plans and consumers in other ways that would not be fully captured in the CBO estimates, such as their more extensive clinical offerings. Including these benefits, these two firms alone save consumers up to roughly $87 billion per year*.[10]

[10] Jonathan Orszag, Kevin Green, "The Economic Benefits of Pharmacy Benefit Managers," December 2011.

b. How can consumers be assured that cost savings or other efficiencies from this merger will ultimately benefit them?

The merger of Medco and Express Scripts will result in immediate savings to our clients and, ultimately, to consumers. As but one example, today, each of our companies has a separately negotiated agreement with each pharmaceutical manufacturer. We know that one or the other company has the better purchasing terms, providing the lowest overall price. As a merged corporation, we would use the terms of the best contracts that currently exist in making these purchases, which are in the tens of billions of dollars. We project that at least $1 billion in savings from the merger will be passed back to our clients annually – starting immediately. Sharing these savings with our clients is part of our contractual requirements, certifiable by us and independently auditable by our clients. Consumers, who are members of our clients, will receive the benefit of the efficiencies through their employers or health plans.

8. I have heard concerns expressed about the transparency of PBMs.

a. Do plan sponsors have full access to the terms of the rebate deals that your company has with drug manufacturers, and if not, why not?

An FTC study, as well as FTC letters and other studies, have highlighted that making the specific contractual rebate terms between PBMs and drug manufacturers publicly available would lessen competition and ultimately increase the costs of drugs for plan sponsors and consumers. For this reason, the terms of the rebate agreements are not made public. In fact public disclosure of rebate agreements is unnecessary because every client has the ability to audit its contract with Medco. These audits ensure that plan sponsors have complete visibility into every element of their contract. This allows them to ensure they receive all the rebates to which they are entitled, consistent with our agreements with drug manufacturers and the plan's agreement with Medco. Depending upon the client, plan sponsors may or may not have direct access to the agreements themselves. This is, again, because of the need for confidentiality. Many of our clients, including health plans, are also our competitors. These clients on occasion decide to negotiate their own rebate agreements directly with drug manufacturers. If they had direct access to our contracts it would decrease competition and increase health care costs.

Conversely, government clients often have the right to review the rebate agreements directly. For example, for the Federal Employee Health Benefit Program plans, the Office of Personnel Management's Office of the Inspector General has – on more than one occasion – received direct access to the rebate agreements in order to audit the contracts at Medco directly. Similarly, the Centers for Medicare & Medicaid Services (CMS) and the Health and Human Services' OIG received direct access to the agreements for audit purposes.

b. Do plan sponsors have full access to the terms of other aspects of your revenue stream such as the details of the spread in your pricing, and if not, why not?

Plan sponsors, as part of their contract with Medco, can determine the level to which they want to audit Medco – it is part of the negotiation process. In fact, a number of plans have contracted to allow auditors to audit Medco's revenue stream. Again, it is worth noting that Medco's level of transparency with clients has been publicly described by state attorneys general as setting the "gold standard" in the PBM industry.[11]

c. Insofar as your concerns regarding sharing rebate information (and other information relative to your revenue stream) is related to confidentiality, would you be willing to disclose this information with the protection of a confidentiality agreement, and if not, why not?

The terms of our rebate agreements are often made available directly to plan sponsors as a matter of contract between Medco and that plan. But the terms are always made available to auditors as part of reviews conducted by the plan sponsors. For example, if a pharmaceutical manufacturer were also a plan sponsor, Medco would not make the terms of competing manufacturers' rebate contracts available; to do so would decrease competition. Similarly, many of our clients, including health plans, are also our competitors. Those clients on occasion decide to negotiate their own rebate agreements directly with drug manufacturers. If they had direct access to our contracts it would decrease competition and increase health care costs. Moreover, it is important to remember as part of the contracting process, clients choose the percentage of rebates they would like to receive, and the level, if any, that they would allow Medco to retain. Thus, the client, from the contracting phase onward, is aware of rebates that it is receiving and the audit rights it has.

In instances where rebate information requests are received from plan sponsors that are not in a position to decrease competition, such as government plans, the terms of the rebate agreements can be viewed directly by the plan. For example, for Medicare Part D, the aggregate rebate dollars are disclosed to the government, and the government is allowed to directly access and audit the rebate agreements.

9. I have heard concerns expressed about the generic utilization rates of the drug plans administered by PBMs. Some data suggests that generic utilization is lower in mail-order than it is in the retail pharmacy setting.

[11] Boston Globe, April 27, 2004; Pink Sheet, May 2, 2004.

a. Do you dispute the data suggesting that generic utilization rates are higher in the retail pharmacy setting than they are in mail-order?

b. If not, how do you account for the lower generic utilization rates associated with mail-order? Do such rates suggest higher costs for consumers?

We believe that data that shows that generic utilization rates are higher in the retail setting can be explained by adjusting for the mix of drugs dispensed. When comparing "apples to apples," the rates are similar. Medco's "generics first" strategy recognizes that in every aspect of our business, when therapeutically appropriate, generics provide the greatest clinical and financial benefit for payors, members and for our company – and incentives are aligned to encourage the optimum use of generics. This is reflected in our rapidly increasing generic dispensing rates across our business.

Medco administers benefit programs for our clients that are accessible to members at retail pharmacies, mail order pharmacies and in certain instances, long-term care facilities. As part of our quarterly performance updates, we publicly report the generic dispensing rates for both our mail order pharmacies and prescriptions filled through retail pharmacies. In the most recent quarter for which data is available (August-October 2011), the retail dispensing rate was 75.4 percent and Medco's mail order generic dispensing rate was 64.8 percent (a year-over-year increase of approximately 2 percentage points in both the retail and mail channels).

As the FTC has cautioned, however, these generic rates must be adjusted to account for the "mix" of drugs. In a 2005 report, the FTC determined that the generic dispensing rate is an "unreliable" measure if it does not take into account the different mix of drugs dispensed through the retail and mail pharmacies, as well as benefit design features and formulary decisions that affect the member's pharmacy selection.[12] Ninety-day prescriptions – generally prescriptions dispensed via mail – are largely applicable to chronic therapies such as cardiovascular and diabetes medicines. Many widely prescribed medicines in these chronic-care categories are relatively new, branded products and, therefore, are not currently available as generics. Proportionally, retail pharmacies tend to dispense a greater share of acute therapies, such as antibiotic and short-term pain medicines, which are largely generic products.

Thus, in light of the FTC's caution about examining the rates after adjusting for this drug mix, it is more accurate and informative to compare generic dispensing rates between retail and mail in those instances when the medication is available in generic form and there is an actual opportunity to dispense a generic. A Government Accountability Office (GAO) report determined, "For drugs where a generic version was available, the retail and mail-order pharmacies dispensed generic drugs at more

[12] Federal Trade Commission Report: "Pharmacy Benefit Managers: Ownership of Mail Order Pharmacies," August 2005.

similar rates – on average 89 percent of the time for retail pharmacies and 87 percent of the time for mail service pharmacies."[13]

The FTC also found that retail and PBM-owned mail pharmacies substitute generics at similar rates and that the generic substitution rates (GSR) observed "show that (PBM-owned) mail order pharmacies were generally more, rather than less, aggressive in dispensing generic drugs than were other pharmacies…."[14]

In addition to overall generic dispensing rates, it is also helpful to examine the efficiency of mail order and retail in quickly moving patients to the generic once the patent for a branded medicine expires. This is important because the faster this substitution occurs, the faster payors and patients derive the financial benefits. For instance, a Medco study revealed that within the first week of generic availability for Ambien (zolpidem), generic substitution rates at Medco's mail order pharmacy reached nearly 97 percent, compared with just 76.6 percent at retail for the same time period. In fact, even after six months the retail generic substitution rate did not catch up to the Medco pharmacy's achieved week-one rates.[15] For Zyprexa, used for treating schizophrenia and bipolar disorder, a generic (olanzapine) became available at the end of October 2011. In the first month, the mail generic dispensing rate was 81.3 percent compared to the retail rate of just 52.8 percent. Finally, for Nasacort AQ, a prescription nasal spray licensed to treat sneezing, runny or stuffy nose, and nasal itching due to allergies, a generic (triamcinolone acetonide) became available in June 2011. After three months, the mail generic dispensing rate was 93.5 percent and the retail rate was 81.6 percent.

10. At the hearing, there was some disagreement about the degree to which PBMs such as your company are regulated by the federal government and the states.

a. Please provide brief details on the manner in which the federal government regulates your company.

b. Please provide brief details on the manner in which state governments regulate your company.

As both a pharmacy and a PBM, to operate in good standing, Medco maintains more than 2,500 licenses and registrations at the federal and state levels combined. Thus, we are extensively regulated at both the federal and state levels.

The following entities have direct oversight over Medco:

- The Centers for Medicare and Medicaid Services (CMS)

[13] GAO Report: "Federal Employees' Health Benefits: Effects of Using Pharmacy Benefit Managers on Health Plans, Enrollees, and Pharmacies," January 2003.
[14] Federal Trade Commission Report: "Pharmacy Benefit Managers: Ownership of Mail Order Pharmacies," August 2005.
[15] Medco 2008 Drug Trend Report.

- The Drug Enforcement Agency (DEA)
- The National Association of the Boards of Pharmacy
- State Departments of Insurance
- State Boards of Pharmacy

The following entities have indirect oversight over Medco through our clients:

- The Office of Personnel Management (OPM)
- CMS
- State Medicaid agencies
- State Departments of Insurance
- State auditors

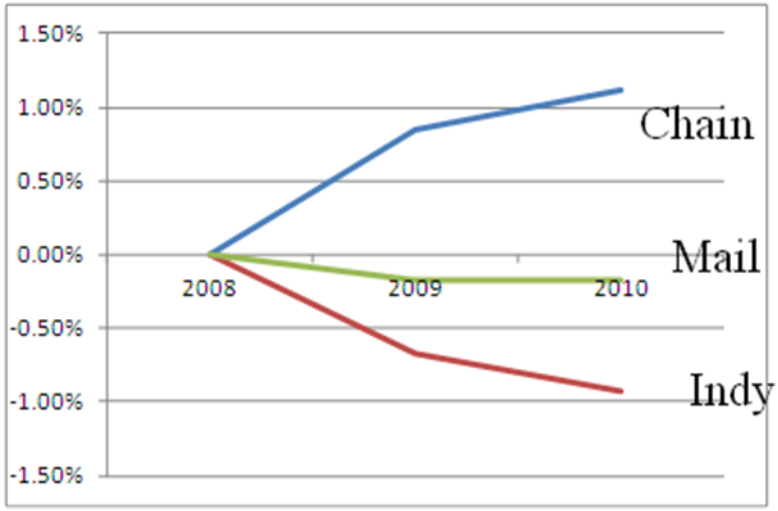
Appendix A

Independent Pharmacies are Losing Share to Chains, Not to Mail

According to NACDS data:[16]

- For several years mail share in the industry has been relatively flat
- While chain share has been growing at the expense of the independent pharmacy

Change in Share



Share calculated by % of total Rx volume

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Mail	5.1%	5.4%	5.5%	5.9%	6.5%	6.8%	6.8%	7.3%	7.4%	7.2%	7.2%
Indy	24.4%	23.6%	22.9%	23.0%	22.7%	21.9%	21.6%	21.3%	20.8%	20.1%	19.8%
Chain	70.6%	71.0%	71.5%	71.1%	70.7%	71.3%	71.6%	71.4%	71.9%	72.7%	73.0%

[16] NACDS 2011-2012 Chain Pharmacy Industry Profile: Calculated from table 37 "Pharmacy Prescriptions by Type of Store."