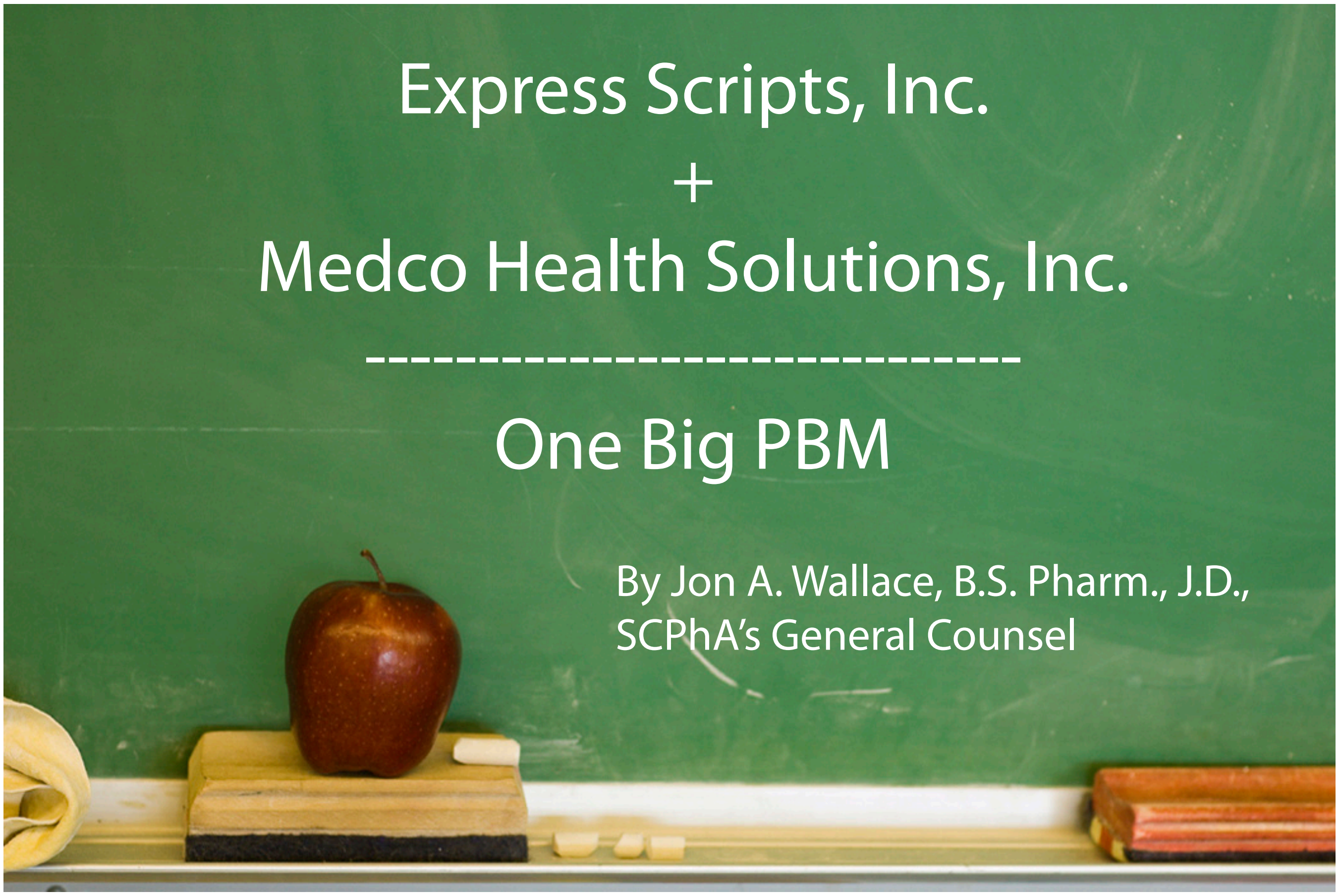


Express Scripts, Inc.
+
Medco Health Solutions, Inc.

One Big PBM

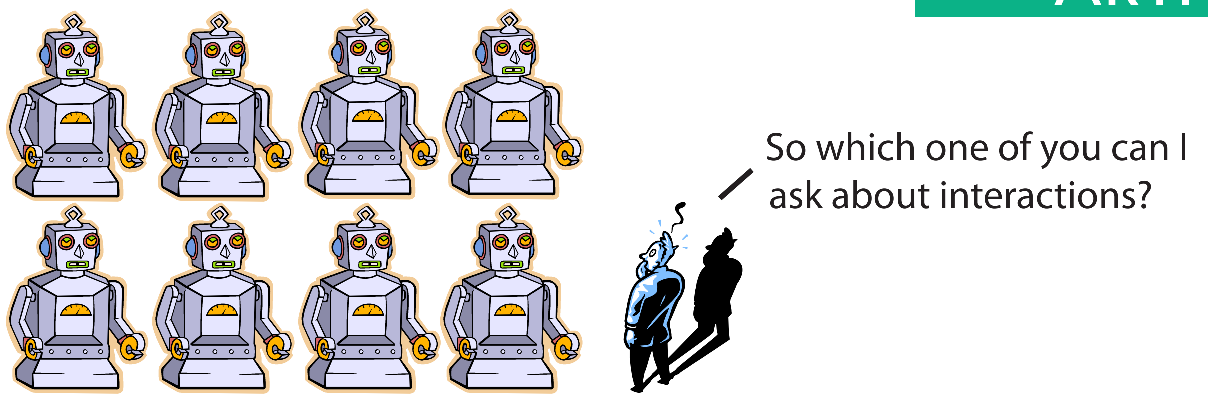
By Jon A. Wallace, B.S. Pharm., J.D.,
SCPhA's General Counsel

What if someone told you "there's a fiction that a pharmacist comes out and dialogues with you. In reality, a high school student hands you a script from the shelf." This person continues to say that "robots are twenty-three times more accurate than human pharmacists, in terms of errors in dispensing prescriptions." These statements would be rather offensive, but you might not care what one person thinks, right? However, if this quote is from David Snow, Chief Executive Officer of Medco Health Solutions, Inc., it might be a bit more alarming, especially considering that Express Scripts and Medco are potentially combining to create a "mega" Pharmacy Benefit Manager ("PBM") that would control upwards of 80% of the prescriptions in the private sector, 60% of mail order, and 30% of all prescriptions processed. As it stands now, Medco, Express Scripts, and CVS Caremark control 80% of the large plan sponsor market and cover 240 million lives. Whether you are a community pharmacist, employer, or patient, this is a concerning development.

Over the years, the pharmacy benefit manager ("PBM") has taken a more prominent role in healthcare. Evolving from claims processing, these companies now directly control one of the largest cost segments of healthcare dollars. They set formularies, co-pay levels, reimbursement rates, and control networks. As an intermediary between patients, employers, insurers, pharmaceutical manufacturers, and pharmacies, the three largest PBMs reported a profit of roughly $6 billion last year. Incidentally, David Snow, the aforementioned CEO of Medco, received over $16 million of compensation in 2010.

Express Scripts announced on July 21, 2011 that it intended to acquire Medco for $29 billion ("acquisition"). Since that time, twenty-five state attorney generals have formed a coalition expressing concern about its impact. Furthermore, the House Ways and Means Committee's Health Subcommittee and the House Antitrust Committee's Subcommittee on Intellectual Property, Competition and the Internet have held hearings on the matter. The Senate Judiciary Committee's Antitrust Subcommittee is expected to hold a hearing next month.

Ultimately, however, the viability of this acquisition rests with the Federal Trade Commission ("FTC"). The FTC is a regulatory agency that is charged with



the duty to prevent unfair methods of competition, police against unfair and deceptive trade practices, and administer a wide variety of consumer protection laws. Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, mergers and acquisitions of this nature are subject to premerger antitrust review by the Antitrust Division of the Department of Justice and the FTC. As an aside, Congress does not have direct control of the FTC, but can apply limited pressure to the agency through a myriad of mechanisms. The FTC is currently investigating the merger and has issued a second request to ESI and Medco, which means that the FTC is asking for additional documents and information relevant to the Medco acquisition. From a timing standpoint, this documentation can be rather large, which makes both production and review rather onerous.[1] Obviously, the FTC's actions suggest that it believes the acquisition may have potential anticompetitive consequences.

Through opaque spreads and rebates, and limiting network participation to affiliated mail order or pharmacies, PBMs have wrecked havoc on community pharmacies. Most pharmacy owners with which I have spoken do not necessarily mind competition; rather, what they do mind is unfair competition, which manifests itself in many ways, but most profoundly in forced mail order and limited access. I recently heard a good analogy from a pharmacist: If a big retail store moves into a small town and starts selling shovels for less than the local hardware store, this represents an unfavorable business development for the local hardware store owner, but competition sometimes "is what it is." However, if the large retailer moves in selling shovels for less and has the power to forcefully prevent all people in the town from going to the local hardware store . . . well, that's another thing. Pharmacies, especially independent pharmacies, merely ask for the opportunity to fairly compete.

Although the FTC is certainly interested in understanding the impact and unfair competitive advantage directed toward community pharmacies and how this might be magnified by a PBM as large as ESI and Medco, the more compelling story is the impact on patients and employer plans. There are many examples and data that show the positive impact community pharmacists have on patients and health outcomes, especially in rural areas so prevalent in South Carolina. Patient choice and access to caring pharmacists have been the traditional bedrock of healthcare for many reasons. Ultimately, though, the FTC's decision will be based on the question of whether the combination of these companies will substantially lessen competition. Since not all competition is bad, the question will be whether the merger is "competitively harmful" or "competitively beneficial." ESI and Medco will have a compelling tag line that generally resonates well on the surface. They will say that the acquisition allows for them to operate synergistically, which reduces costs, presumptively being passed on to the consumer. Further, I would imagine they would say that the more covered patient lives of the combined entity will allow them attain a stronger negotiating position with drug manufacturers, which would achieve further savings. The Achilles heel of this argument is that most PBMs, like ESI and Medco, do not operate in a transparent fashion—meaning, the profits generated by the aforementioned spreads and rebates are not known. Ultimately, it is rather doubtful that savings, if any are actually achieved, will be passed on to consumers, but will instead add to their bottom line.

Another important component of the FTC's analysis will focus on whether PBMs other than an ESI and Medco or CVS Caremark can effectively enter and compete in the marketplace. As we know, the barriers to entry in the PBM market are significant, especially competition for the large plan sponsors.

[1]*Many experts believe that the FTC will make a decision on the acquisition as early as February 2012.*

Since the needs of the large plan sponsors generally exceed the capacity of the smaller PBMs, it would be exceedingly difficult for any regional PBM to effectively compete for the contract. Thus, when one of the large PBMs is competing for business, it is only competing against the other. Barriers to new PBMs effectively entering and competing in the marketplace should serve as further fuel for the FTC disallowing the competition to be reduced from only a few to just two. Without competition, ESI and Medco would be in a position to control the large plan sponsor market without viable alternatives other than CVS Caremark.

To say that Pharmacists have many issues with PBMs—and some PBMs more than others—would be a gross understatement. In many ways, as pharmacists, we are driven by the fear that we will ultimately be put out of business by a combination of low reimbursement and closed networks. For most pharmacists, the real fear of this acquisition is what the impact might be on their patients. With less accessible community pharmacies, many patients, especially those in rural communities, will be hurt. Who will be there for the patient that can't pay? Who will be there for the patient that needs his medicine in the middle of the night? Who will provide the acute medicines? Who will be there to help the elderly sort through their fifteen medicines that they take per day? Who will be there for the patient who is put on multiple doses of the same medicine by different specialists? If not the community pharmacist, then who . . . PBMs and mail order?

In the end, the hopeful expectation is that the FTC recognizes the complexity and dire ramifications of this acquisition. I think it is fair to say that true competition leads to lower prices, better service and, most importantly, transparency, which should in fact be the evolution of the PBM industry instead of further mergers and acquisitions.

Jon Wallace received his pharmacy degree from the University of North Carolina and his law degree from the University of South Carolina. Mr. Wallace serves as General Counsel for the South Carolina Pharmacy Association and is a Clinical Associate Professor in the Department of Clinical Pharmacy and Outcome Sciences at the South Carolina College of Pharmacy. He is in private practice with Green Ford & Wallace, LLC in Charleston, South Carolina engaged in pharmacy and health law issues.