Statement of the Federal Trade Commission Concerning
the Proposed Acquisition of Medco Health Solutions by Express Scripts, Inc.

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April 2, 2012

The Federal Trade Commission has closed its investigation of Express Scripts, Inc.'s proposed acquisition of Medco Health Solutions. As a result of the evidence collected during an intensive eight-month investigation, we conclude that the proposed transaction is not likely to substantially lessen competition in violation of Section 7 of the Clayton Act.[1]

This was not an easy decision.[2] At the outset of the investigation, we were concerned that this proposed $29 billion merger between two of the country's three largest pharmacy benefit managers ("PBMs") might represent a three-to-two merger in the market for the provision of PBM services to large private employers and other plan sponsors. We also recognized that the merger could be viewed as presumptively anticompetitive because the PBM industry is concentrated and the market share of the merged entity would be more than 40%, even using the broadest market definition. Another question, raised by retail pharmacies and consumer groups, was whether the combined firm could exercise monopsony power, driving

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[1] Chairman Leibowitz supported limitations on the ability of the merged firm to engage in certain forms of exclusionary conduct that might have hindered the ongoing expansion of a significant competitor, but withdrew a motion to accept such a remedy for public comment after it failed to receive the support of a majority of the Commission. Commissioners Rosch and Ramirez could not support the proposed relief because they lacked reason to believe that an underlying violation of Section 7 of the Clayton Act had or was likely to occur, or that the relief would be competitively meaningful, as it was modest and aimed at a competitor that is well positioned to protect itself.

Commissioner Julie Brill dissented from the Commission's vote to close the investigation and has issued a separate statement expressing her views. While Chairman Leibowitz and Commissioner Ramirez share some of Commissioner Brill's concerns about this transaction, ultimately they did not believe that a challenge to the transaction was supported by the evidence.

[2] Commissioner Rosch disagrees that the decision to close this merger was "not . . . easy," that he had a "concern" about the transaction at the outset or, more specifically, that it might be "presumptively anticompetitive." As with the numerous other in-depth investigations conducted by our agency each year that do not reveal any significant competitive concerns, the decision to close this investigation was straightforward. As for his views at the outset of the investigation, Commissioner Rosch approached this investigation with an open mind and did not consider this merger to be governed solely by the law applicable to sellers. To the contrary, this is not an ordinary merger case governed solely by the law applicable to sellers (including the concept of a presumption of illegality). From his perspective, this was and is a merger case that is governed at least as much by the law applicable to buyers, subject to the principles of monopsony power. Indeed, that is why we heard so much from pharmacists and their advocates and so little from the employers to which the PBMs sell their services.

drug dispensing fees so low that that they would threaten the important services offered by local pharmacies. Specialty pharmacies also expressed concern that the combined firm would engage in exclusionary conduct. The views expressed by market participants are an important consideration in enforcement decisions, and we carefully examined all of the questions raised. Ultimately, however, we determined that the evidence did not bear out these concerns.

The investigation revealed that the high market shares of the parties do not accurately reflect the current competitive environment and are not an accurate indicator of the likely effects of the merger on competition and consumers.[3] For the reasons described below, we do not have reason to believe that the transaction is likely to cause unilateral anticompetitive effects, enhance the likelihood of successful coordination, or facilitate the exercise of monopsony power in any relevant market in which the merging parties participate.

The evidence we examined was the product of a comprehensive investigation. Our staff interviewed over 200 market participants, including customers, other PBMs, retail and specialty pharmacies, pharmacy trade groups, pharmaceutical manufacturers, and healthcare benefit consulting firms. Millions of documents produced by the merging parties and numerous market participants were reviewed. Staff economists performed detailed analyses of historical sales, cost, and bid data obtained from the parties and other industry participants. We also considered numerous advocacy letters and white papers submitted by a variety of consumer organizations. Our investigation was conducted in cooperation with, and the assistance of, a working group of 32 state attorneys general.

I. The Merger Is Unlikely to Result in Anticompetitive Effects for PBM Services to Employers

The Commission analyzed the effects of the Express Scripts/Medco merger in the market for the provision of full-service PBM services to health care benefit plan sponsors, including public and private employers and unions.[4]

The market for the provision of full-service PBM services to health care benefit plan sponsors is moderately concentrated and consists of at least ten significant competitors.[5] Our staff's investigation revealed that competition for accounts is intense, has driven down prices, and has resulted in declining PBM profit margins—particularly in the large customer segment.

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[3] *See United States v. General Dynamics Corp.*, 415 U.S. 486 (1974) (recognizing that current market shares are not the sole indicator of a merger's likely competitive effect).

[4] This market excludes PBM services provided to health plans, which do not require the full array of capabilities and services demanded by large employers, and consequently, have a different (and broader) set of options when selecting a supplier of PBM services.

[5] Commissioner Brill's dissenting statement asserts that the merger of Express Scripts and Medco is a merger-to-duopoly. We respectfully disagree. As detailed in our Statement, the evidence shows that many competitors other than the Big Three compete effectively in this market, and can be expected to continue to do so after the transaction.

The transaction will reduce the number of significant competitors to nine (plus a fringe of several dozen smaller firms) and give the merged company a market share of just over 40%.[6]

Current competitors in this market include the Big Three, a number of PBMs owned by large national health plans, and some smaller stand-alone PBMs. Although Medco has long been the leading PBM in the industry, it has lost approximately one-third of its business in the last year.[7] CVS Caremark was formed in 2007 when CVS Corporation, the nation's second-largest retail pharmacy chain acquired Caremark Rx, the nation's second-largest PBM. Like Medco, CVS Caremark has long focused on serving the nation's largest employers, including many Fortune 100 companies. CVS Caremark has won a number of major accounts over the past two years, mostly at Medco's expense. Express Scri

There are also several standalone PBMs that are substantially smaller than the Big Three but have had recent success winning significant employer business, including large employer accounts. These PBMs usually compete by trying to differentiate themselves from the Big Three and health plan-owned PBMs by emphasizing a transparent pricing model, providing more individualized account management support, and offering customized PBM offerings. Examples of these PBMs include CatalystRx and SXC, both of which are experiencing considerable growth.[9]

A. Unilateral Effects for PBM Services Are Unlikely

One concern with a merger of direct competitors is that the elimination of a close competitor may allow the merged entity to unilaterally impose anticompetitive price increases on consumers. This merger is unlikely to have these effects. Indeed, the vast majority of customers believe that there would be adequate competition post-merger to ensure continued competitive pricing, and many believe that the merger will lead to *lower* prices for PBM services.

Analysis of bidding data produced by the parties and by large, national PBM consultants demonstrates that Medco and Express Scripts are not particularly close competitors, and that other PBMs often compete successfully for employers, including large employers. The evidence suggests relatively low diversion rates between Express Scripts and Medco,[10] which means that the merger's potential for unilateral price effects is likely to be much smaller than market shares would imply. Express Scripts has had the most success targeting middle-market plan sponsors and health plans. Medco, on the other hand, focuses on high volume, large-employers. For that reason, very few customers interviewed by staff considered Express Scripts and Medco to be their first and second choices. These views were confirmed by the parties' documents and a bid data analysis. Indeed, Express Scripts is just as likely to lose an account to a health-plan offering or a smaller PBM as it is to either Caremark or Medco. This bidding data also revealed that the two firms are not particularly close competitors for large employer accounts (meaning one is not frequently the runner-up where the other has won the account). *See* Merger Guidelines § 6.2.

One reason that the diversion rates between the merging parties appear to be lower than might be expected is that competition from CVS Caremark in recent years has been robust. The data indicate that the closest competitor for Express Scripts and Medco is CVS Caremark, not each other. Over the past two selling seasons, CVS Caremark has had significant success expanding its PBM business and has won several high-profile and lucrative accounts away from Medco, including the Blue Cross Blue Shield Federal Employee Health Benefit Plan (FEHBP), and the California Public Employees' Retirement System (CalPERS).

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[9] *See* Tara Lachapelle, *Medco Takeover Seen Making SXC Priciest Target*, Bloomberg, March 26, 2012 (noting that SXC's revenue is expected to climb 60% in 2013 after more than doubling last year, while Catalyst's revenue is expected to increase 30% in the next year).

[10] Diversion ratios measure the degree of substitution between two products relative to others. Mergers between firms offering products with high diversion rates will tend to cause prices to increase, all things being equal. Low diversion rates suggest that the potential for price increases is low.

the overwhelming majority of customers interviewed for this transaction, including most of the Fortune 100, view the transaction as entirely benign or even pro-competitive.

B. Coordinated Effects for PBM Services Are Unlikely

Another concern with horizontal mergers is that the reduction in the number of independent competitors may allow the remaining firms to collude, tacitly or otherwise, to the detriment of consumers. For many of the same reasons that the merger is unlikely to give Express Scripts unilateral anticompetitive power over price, the merger is unlikely to result in any coordinated anticompetitive effects.

participants' ordinary course documents suggest that suppliers are pulling their competitive punches or would do so after the merger.

Fourth, the RFP process promotes aggressive competition for employer business and impedes coordinated interaction. Particularly for large employers, the volume of business at stake is substantial, and the incentives to compete aggressively for it are significant.[12] In addition, employers routinely retain expert consultants to identify potential bidders, develop detailed solicitations, and evaluate the proposals before settling on a winner.[13] Because of their repeated interactions with PBMs, industry consultants are particularly well-suited to identify and counteract any attempted coordination by suppliers. RFPs are almost always extended to at least four firms, including the incumbent, typically at least two of the Big Three, one or more smaller PBMs, a carve-in proposal from the customer's health plan provider, and occasionally others on a carve-out basis.

In short, the PBM industry has not shown itself to be conducive to coordination, and there is little reason to believe that the transaction will change that or eliminate an existing impediment to coordination.[14]

II. The Merger Is Unlikely to Lead to the Exercise of Monopsony Power for the Retail Dispensing of Prescription Drugs

The Commission also considered whether the proposed acquisition would confer monopsony power on the merged company when it negotiates dispensing fees with retail pharmacies. As a general matter, transactions that allow firms to reduce the costs of input products have a high likelihood of benefitting consumers, since lower costs create incentives to lower prices. Only in special circumstances does an increase in power in negotiating input prices adversely impact consumers. *See* Merger Guidelines § 12. The Commission examined this concern closely but found that the proposed transaction was unlikely to create or enhance monopsony power.

Most importantly, the proposed transaction would produce a firm with a smaller share of retail pharmacies' sales—approximately 29%—than ordinarily considered necessary for the

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exercise of monopsony power. In addition, the data reveal that there is little correlation between PBM size and the reimbursement rates paid to retail pharmacies. Thus, there is no reason to believe that the merger, even if it exceeded the theoretical threshold for the exercise of monopsony power, would in fact lead to lower reimbursement rates.

Moreover, even if the transaction enables the merged firm to reduce the reimbursement it offers to network pharmacies, there is no evidence that this would result in reduced output or curtailment of pharmacy services generally.[15] Furthermore, for contractual and competitive reasons, it is likely that a large portion of any of these cost savings obtained by the merged company would be passed through to the PBM's customers.[16] Although retail pharmacies might be concerned about this outcome, a reduction in dispensing fees following the merger could benefit consumers by lowering health care costs.

III. The Merger Is Not Likely to Result in Anticompetitive Effects with Respect to Specialty Drugs

Specialty drugs are drugs that treat complex and sometimes rare conditions. They often are costly, have significant side effects, or require services as part of the treatment. The principal concern raised by opponents of the transaction regarding specialty drugs is that the merged entity will have the power to demand more exclusive distribution arrangements from manufacturers.[17] The evidence shows otherwise.

The specialty pharmacy market is substantially less concentrated than the overall market for PBM services to health care benefit plan sponsors. Several dozen specialty pharmacies currently operate in the United States. At the national level, those include, but are not limited to, Express Scripts, Medco, CVS Caremark, UnitedHealth, Cigna, Humana, Aetna, BioScrip, SXC, Amerisource-Bergen, Diplomat Specialty Pharmacy, and Walgreens. Although it is difficult to determine market shares for specialty pharmacy services (assuming this were a relevant market), the merged firm's share appears to be approximately 30%—somewhat below its share of PBM

[15] The Commission has previously found that the market for the retail dispensing of brand name and generic prescription drugs is not susceptible to monopsony power for several reasons, including the fact that dispensing fees are negotiated individually between each PBM and each pharmacy. *See* Statement of the Federal Trade Commission at 2-3 & n.4, Caremark Rx, Inc./AdvancePCS, FTC File No. 031-0239 (2004).

[16] Driven by competitive pressures, pass-through pricing arrangements have become commonplace in the industry.

[17] The Commission also investigated whether the merger would lead to greater vertical integration by the merged firm, which could lead to fewer sales by independent pharmacies. We concluded that the merger is unlikely to affect the indb868 .sat the mikely tgy lowersuat the mthe likely merger th

services generally. Moreover, there is little evidence of direct competition between Express Scripts' specialty pharmacy, CuraScript, and Medco's specialty pharmacy, Accredo.

According to manufacturers of specialty drugs, *they* are the ones who are seeking limited and exclusive distribution arrangements today. Indeed, the decision to enter into an exclusive relationship is rare and largely a function of the size of the patient population for the particular drug or a drug's special safety requirements. Manufacturers of exclusive distribution drugs stated that with small patient populations or certain safety concerns, they often prefer to consolidate distribution in one specialty pharmacy to achieve uniform quality service, ensure safety, and maximize the efficacy of the course of treatment. Overall, exclusive distribution arrangements represent only a tiny fraction of specialty drugs and account for a small portion of total drug expenditures. Manufacturers of specialty drugs are not concerned that the combined firm would be able to force them to enter into arrangements limiting the number of distributors.

Finally, there is no evidence that the choice of specialty pharmacy or PBM is affected by its portfolio of exclusives. Manufacturers prefer that the exclusive distributor make the products available to patients of other plans, and PBMs typically enter into agreements with each other to ensure their patients have access to exclusively distributed drugs. Furthermore, at least five firms other than the merging parties hold exclusive distribution agreements for one or more specialty drugs.

IV. Conclusion

While this transaction appears to result in a significant increase in industry concentration, nearly every other consideration weighs against an enforcement action to block the transaction. Our investigation revealed a competitive market for PBM services characterized by numerous, vigorous competitors who are expanding and winning business from traditional market leaders. The acquisition of Medco by Express Scripts will likely not change these dynamics: the merging parties are not particularly close competitors, the market today is not conducive to coordinated interaction, and there is little risk of the merged company exercising monopsony power. Under these circumstances, we lack a reason to believe that a violation of Section 7 of the Clayton Act has occurred or is likely to occur by means of Express Scripts' acquisition of Medco.