

# Express-Scripts: The FTC Decision

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## Introduction

In April 2012, the Federal Trade Commission (“FTC”) announced that it had closed its eight-month investigation of the \$29 billion acquisition by Express Scripts, Inc. (“Express Scripts”) of Medco Health Solutions (“Medco”) without imposing any limitations on the parties.<sup>1</sup> This merger combined two of the three largest domestic Pharmacy Benefit Managers (“PBM”). PBMs manage prescription drug plans for employers and insurers and serve as the middlemen between the drug companies and the payors. The merger was heavily politicized, with many groups opining on the benefits and costs of the acquisition. Provided below is an analysis and discussion of the FTC’s decision to not challenge the merger.

## Market Share

The FTC stated that the merged firm would account for more than 40% of the broadest market, defined as the market for the provision of full-service PBM services to health care benefit plan sponsors, although the parties contended that the combined market share was significantly lower. The FTC found that this market was moderately concentrated with at least ten significant competitors and that the competition for accounts within this market was intense and had driven prices down.

Careful consideration of the market dynamics showed that although Medco was the leader in the PBM industry; it lost approximately one-third of its business within the last year, with many of these accounts going to CVS Caremark, the nation’s second largest PBM. In addition to competition from smaller PBMs, the FTC found that the identity of market players was changing. Health insurers had made substantial investments and were expanding their PBM offerings. Many of these health plan owned PBMs were becoming viable competitors to the top three PBMs. The FTC noted that these health plans and smaller, standalone PBMs have won significant business in the PBM market.

## Unilateral Effects

The FTC concluded that the merger was unlikely to have unilateral effects because Medco and Express Scripts were not close competitors. The bidding data produced by the parties and large, national PBM consultants suggested relatively low diversion rates between Medco and Express Scripts. The FTC concluded that Express Scripts primarily served middle-market plan sponsors and health plans, while Medco focused on high volume, large employers. Very few customers considered the parties to be their first and second choice. Because the evidence suggested relatively low diversion rates, the FTC found the merger’s potential for unilateral price effects was much smaller than implied by the combined firm’s market share.

Industry dynamics further supported the view that the transaction was unlikely to produce unilateral anticompetitive effects. The evidence examined by the FTC demonstrated that health plan owned and standalone PBMs have become serious contenders for business. In the bid process, many employers included health plan owned and standalone PBMs to leverage better prices from Medco, Express Scripts, and CVS Caremark. These smaller PBMs were also winning business. Finally, the FTC found that Medco, Express Scripts, and CVS Caremark did not enjoy substantial cost savings over smaller competitors. Notably, the FTC stated that the majority of the customers interviewed regarding the merger believed that the transaction would be competitively neutral or pro-competitive.

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<sup>1</sup> *Statement of the Federal Trade Commission Concerning the Proposed Acquisition of Medco Health Solutions by Express Scripts, Inc.*, FTC File No. 111-0210 (April 2, 2012).

## Coordinated Effects

The FTC found that the merger was also unlikely to result in coordinated effects. Although the analysis for coordinated effects is more qualitative than the analysis for unilateral effects, the FTC found that many of the same reasons the merger was unlikely to give Express Scripts unilateral power over price applied to the analysis of coordinated anticompetitive effects.

The FTC observed that price coordination was unlikely because price competition in the PBM market was multifaceted and opaque. Each PBM contract included numerous, different pricing components, which were difficult to compare. The PBMs only learned of their competition for contracts after bids had been accepted, complicating any potential attempt to coordinate since competitors would be unknown.

Although the FTC stated that the allocation of customers was a more plausible theory than price coordination, it found customer allocation highly unlikely. It determined customer allocation was unlikely because CVS Caremark's recent successes suggested that it would find competing vigorously to be more profitable and smaller standalone PBMs and emerging health plan owned PBMs did not have an incentive to join a customer allocation arrangement because they recently made substantial investments in additional capacity. Ultimately, the FTC found that significant competition was present in the relevant markets with no indication that this dynamic would change after the merger.

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## Monopsony Power/Specialty Drug Market

The Commission noted that the merger was not likely to confer monopsony power upon the combined firm to enable it to pay lower reimbursement rates to pharmacies in a way that would injure competition. Most critically, the FTC noted that the transaction would produce a combined firm with a smaller share of retail pharmacy sales, approximately 29%, than is generally necessary for monopsony power. The FTC also found that the data demonstrated little correlation between PBM size and the reimbursement rates paid to retail pharmacies.

In the specialty pharmacy market, the FTC found that the combined firm would likely not have the power to demand more exclusive distribution arrangements from manufacturers. The specialty pharmacy market is less concentrated than the overall market for PBM services. The FTC further noted that the manufacturers are the entities seeking exclusive arrangements and exclusive arrangements are for only a small percentage of specialty drugs.

## Commissioner Julie Brill's Dissent

Commissioner Julie Brill dissented and issued a separate statement.<sup>2</sup> Commissioner Brill viewed the transaction as a merger to duopoly and concluded that the remaining participants were fringe—not significant—players. She asserted the market was susceptible to coordinated effects in the form of customer allocation. She also argued that Medco was positioned to play a maverick role in the marketplace, despite its position as the largest firm in the market for PBM services, because Medco recently lost a number of high profile contracts.

## Conclusion

The Express Scripts-Medco merger illustrates that market share analysis may not be the decisive element of merger review in every case and may comprise only a portion of the overall analysis of the competitive impact of a prospective merger. The FTC demonstrated here that it will examine the actual role of all participants in the market and the dynamic between manufacturers, middlemen, and retailers through a thorough review of economic data, interviews, and general understanding. Particularly, the FTC demonstrated an openness to examining the potential change in market participants in the health care industry. The Express Scripts-Medco merger may serve as

<sup>2</sup> *Statement of Commissioner Julie Brill Concerning the Proposed Acquisition of Medco Health Solutions (MEDCO) by Express Scripts, Inc. (ESI)*, FTC File No. 111-0210 (April 2, 2012).

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an example of the Commission's move away from a focus on market definition and concentration in accord with the 2010 Horizontal Merger Guidelines.<sup>3</sup>

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<sup>3</sup> *Horizontal Merger Guidelines*, U.S. Department of Justice and the Federal Trade Commission (August 19, 2010).

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