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February 20, 2012

The Honorable Jon Leibowitz
Chairman
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, D.C. 20580

Re: Inadequacy of the Proffered Efficiency Justifications of the Express
Scripts and Medco Merger

Dear Chairman Leibowitz:

The Commission is currently evaluating whether to permit Express Scripts, Inc.'s (ESI) proposed acquisition of Medco Health Solutions (Medco), which will create a dominant pharmaceutical benefit manager with over 150 million covered lives. In an effort to justify a merger with severe competitive concerns, the parties claim the merger will result in remarkable cost savings to consumers of over \$1 billion annually.¹ However, as this letter demonstrates, these claims simply do not pass muster. The claims are neither merger specific nor verifiable. There is no evidence that any savings will be passed on to the consumer. And any efficiencies generated are not "extraordinary" and therefore insufficient to counteract the harm to competition. In fact, the efficiency claims in their Congressional testimony are fatally flawed in the following ways:

- **The Parties have not demonstrated cognizable and verifiable efficiencies** – Rather than provide hard data and concrete plans Express Scripts has proffered platitudes such as "providing leadership," "responding to the national call for a more affordable and accountable healthcare system," and "better back-office efficiencies" in its Senate testimony.² Such platitudes offer little to suggest concrete cost savings, much less cost savings that will benefit consumers.
- **The claimed efficiencies are not merger specific** – When merging parties argue that the merger will allow them to accomplish that which they have both individually accomplished prior to the merger, regulators and policymakers should be very skeptical. The so-called consumer oriented "programs" that ESI and Medco claim they will be able to employ to improve drug utilization already exist. In fact, the combination of the two

¹ In his written testimony before the Senate Judiciary Committee, Express Scripts CEO George Paz claimed the "benefits of this merger [include] generating greater costs savings for patients and plan sponsors." See George Paz, Testimony before the Senate Judiciary Committee, December 6th, 2011 page 8.

² George Paz Testimony before Congress, September 20th, 2011 page 8.

firms would eliminate the market incentive to continue to create and fund these programs. Moreover, the so-called increased buying power they may secure can be secured through internal growth. An otherwise anticompetitive merger cannot survive if its primary value is derived from streamlining organization operations or further exploiting scale economies. All of ESI/Medco's proffered efficiencies fall into these two categories.

- **The increased “buying power” claims are highly suspect** – ESI and Medco both claim that the merged firm will wield its combined buying power to the consumers' benefit – but there is no indication that the merged firm will be able to extract any further savings from either pharmaceutical manufacturers or pharmacies. In fact, when challenged on this notion by Senator Kohl in the Senate Judiciary Committee hearing, the parties backed off from this assertion.
- **There is no proof, or reason to expect, savings will be passed to consumers** – Merging firms must demonstrate that any savings will be passed on to the health care plan and the ultimate consumer. Given the past history of ESI and Medco's skyrocketing profits, there is no reason to believe the combined ESI and Medco – competing only with CVS/Caremark in an industry with extremely high barriers to entry – will pass any significant portion of savings on to the consumer.
- **The parties have not met the burden of showing “extraordinary” efficiencies** – The law requires that a merger leading to a duopoly or heavily concentrated market must produce extraordinary efficiencies to overcome the risk of anticompetitive effects. This is a risk the Commission should not accept. The claimed efficiencies cannot meet this burden, indeed the alleged \$1 billion is only about 1% of the companies' combined costs.
- **The parties are inconsistent with their explanation of efficiencies** – In September, ESI CEO George Paz testified that the primary benefit from the transaction would be increased bargaining leverage. However, in December he backed off from this statement – and even proclaimed that previously, when the deal was announced, he had explained that back-office savings would account for the majority of savings, and not the “supply chain.”

This letter begins by reviewing the role of efficiencies in merger law, including the standards articulated by the Merger Guidelines and recent caselaw. It then outlines the proffered efficiencies of the transaction between ESI and Medco and notes how they are deficient. It closes with a critique of an efficiency study the parties submitted for the Senate Judiciary Hearing.

1. The Role of Efficiencies in Merger Law

The demonstration of efficiencies is a defense that merging parties may raise as rationale for approving their transaction after the government has succeeded in outlining its prima facie case of consumer harm.³ The Merger Guidelines reflect this approach, stating “primary benefit of

³ *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 720 (D.C. 2001).

mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products."⁴

The standards for efficiencies sufficient to offset an otherwise anticompetitive merger are high, and become higher in proportion to the magnitude of anticompetitive effects,⁵ sometimes referred to by courts as "extraordinary efficiencies" in the case of high market concentration.⁶ Indeed, as the D.C. Circuit reasoned when it enjoined the merger of H.J. Heinz and Beech-Nut, efficiencies have never justified an otherwise anticompetitive merger and the parties face a tremendous burden in a merger to duopoly, as is the case here.⁷ The Guidelines support this proposition, stating "when the potential adverse competitive effect of a merger is likely to be particularly substantial, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive."⁸

The efficiencies must be cognizable and they must be merger-specific, meaning the merging parties could not or were unlikely to achieve the benefits without the merger. The Merger Guidelines provide that "efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by a reasonable means" and "cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service."⁹

Efficiencies must also be verifiable through supporting data and analysis, with a strong preference against analysis created in anticipation of merger review. Notably, the merging parties must demonstrate that the savings are likely to be passed on to the consumers.¹⁰ As articulated in *FTC v. Cardinal Health*,¹¹ the savings passed on to consumers must be a considerable portion of the efficiencies generated, and the savings should not be attainable without a merger. Finally, the efficiencies may not be associated with anticompetitive reductions in output or service.

The merger of Express Scripts and Medco will result in a reduction in the number of large scale PBMs from three-to-two. A merger to duopoly is a particularly problematic transaction, as stated by the *Heinz* court: "no court has ever approved a merger to duopoly."¹² Under the Merger Guidelines and case law, any efficiencies posited by Express Scripts and Medco would need to be "extraordinary" because it is a merger to duopoly. Phillip Areeda has provided a threshold for "extraordinary" in merger analysis where the transaction creates a dominant firm.¹³ According to

⁴ MERGER GUIDELINES § 10.

⁵ *Id.* stating "The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market."

⁶ *United States v. H&R Block*, Civil Action No. 11-00948 (D.D.C. 2011) (quoting *Heinz*, supra note 2).

⁷ *Heinz*, supra note 3, at 720-21.

⁸ MERGER GUIDELINES § 10.

⁹ *Id.*

¹⁰ *Federal Trade Commission v. Staples*, 970 F. Supp. 1066, 1090 (D.D.C. 1997).

¹¹ 12 F.Supp.2d 34 (1998).

¹² *Heinz*, supra note 3.

¹³ 4A Phillip E. Areeda, et al, ANTITRUST LAW ¶976.

Areeda, “provable efficiencies must be at least 8 percent across the entire output in the market... further, the defendants must show that the merger is unlikely to result in higher consumer prices.”¹⁴ The \$1 billion of proffered savings does not meet the 8% threshold, but instead represents approximately 1% of the combined company’s costs. These are hardly “extraordinary efficiencies.”

The high standards for demonstrating efficiencies, and the law’s skepticism of efficiency justifications for transactions that would otherwise substantially lessen competition, have been reiterated as recently as this past November. In enjoining a proposed acquisition between H&R Block and TaxACT, the D.C. District Court summarily dismissed the merging parties’ efficiency justifications.¹⁵ The parties posited that the merger would allow the two companies to synergize operations and reduce cost by operating more efficiently, and investing in new technologies. The court concluded that neither of these efficiencies were merger specific or verifiable, and opined “If a company could achieve certain cost savings without any merger at all, then those stand-alone cost savings cannot be credited as merger-specific efficiencies.”¹⁶

The H&R Block court also emphasized the need for proffered efficiencies to be verifiable. In fact, the H&R Block court reflected upon H&R Block’s historical acquisitions and its inability to demonstrate any efficiencies resulting from these acquisitions, noting “this history only underscores the need for any claimed efficiencies to be independently verifiable in order to constitute evidence that can rebut the government’s presumption of anticompetitive effects.”¹⁷ There is paltry evidence, if any, that past PBM mergers have led to significant efficiencies.

2. Express Scripts’ and Medco’s Proposed Efficiencies

Almost all mergers have the potential for efficiencies. Merging firms potentially will be able to consolidate overhead costs, eliminate redundant personnel, and simplify internal infrastructure. In the instances of excess inventory or unused resources, the merging firms can focus on capitalizing on these potential assets.¹⁸ These efficiencies are not specific to the Express Scripts/Medco transaction and are, as described in more detail in the following section, not cognizable efficiencies under the antitrust laws.

When they announced the deal, ESI and Medco released a statement in which they claimed they had “identified estimated synergies of \$1 billion once fully integrated, which represents

¹⁴ *Id.* at ¶ 976d at 93–94.

¹⁵ *United States v. H&R Block, Inc.*, Case 1:11-cv-00948-BAH, Nov. 10, 2011 (D.D.C. 2011).

¹⁶ *Id.* at 82–83.

¹⁷ *Id.* at 85.

¹⁸ Puzzlingly ESI and Medco have not discussed integrating facilities, such as combining the two firms’ mail order and specialty pharmacy facilities. However, these claims are also unlikely to be merger specific. As noted by one analysis, both Medco and ESI had the ability to sell or close their excess mail order facilities, and the “FTC would be able to make a convincing case that most of the savings generated from mail order facility rationalization are not merger-specific.” The analysis also notes that excess capacity in mail order has not been “a significant driver of competition” in the PBM industry. *See* Evren Ergin, Barclays Capital Equity Research, *Risk Arbitrage: Medco-Express Scripts Antitrust: Part II*, Sept. 12, 2011.

approximately 1% of the combined company's costs."¹⁹ However, as scrutiny over the transaction has increased, the companies have provided little proof to substantiate such broad claims. Previously, on September 20, 2011, Express Scripts CEO George Paz had the opportunity to explain to Congress in writing the precise efficiencies that the merger would create before the House Judiciary Committee. He provided some general statements of potential efficiencies including:

- Generating greater cost savings for patients and plan sponsors through increased negotiating power;
- Closing gaps in care and achieving greater adherence through behavioral approaches and clinical strengths;
- Providing leadership and resources required to drive out waste and improve health outcomes;
- Utilizing shared expertise to better manage the cost and care associated with specialty drugs – the biggest driver of costs in the drug supply chain; and
- Responding to the national call for a more affordable and accountable healthcare system.²⁰

These claims can be boiled down to two basic arguments: the merger will increase Express Scripts' buying power, and therefore enable it to better control healthcare costs; and the combined firm will be able to implement a series of programs and procedures to oversee the quality of Americans' health. None of proffered efficiencies is cognizable under the antitrust law, much less sufficient to overcome the considerable anticompetitive effects of the merger from increased consolidation and likely resulting consumer harm.

3. Express Scripts' and Medco's Proffered Efficiencies Do Not Meet the Requirements of the Law and Sound Economics

As referenced above, efficiencies centered on consolidating overhead costs, eliminating redundant personnel, and simplifying internal infrastructure do not constitute efficiencies sufficient to overcome considerable consolidation concerns. Even in the case in which the target firm is extremely out-dated, badly organized, and inefficient, and the acquiring firm is the model of efficiency, the courts have found that these efficiencies do not outweigh competitive concerns.²¹ Instead, antitrust law looks favorably upon efficiencies that can be described as "synergies." Synergies is defined by Joseph Farrell, FTC's Director of Economics, and Carl Shapiro, former Deputy Assistant Attorney General of the Antitrust Division, as efficiencies that result from a combination of rare or unique assets that are hard to trade.²² There is no evidence or suggestion of such operational differences between Express Scripts and Medco – but it is illustrative that even in the starkest of circumstances, these arguments do not hold water.

¹⁹ Medco Press Release, Express Scripts and Medco Health Solutions sign definitive merger agreement; Medco shareholders to receive \$29.1 billion, July 21, 2011 *available at* http://www.medcohealth.com/medco/corporate/home.jsp?ltSess=y&articleID=CorpAlertMedco_ExpressScripts.

²⁰ See George Paz, Testimony before Congress, September 20th, 2011, at 8.

²¹ *Heinz*, supra note 3.

²² Joseph Farrell & Carl Shapiro, *Scale Economies and Synergies in Horizontal Merger Analysis*, 68 ANTITRUST L. J. 685 (2001).

A. A Framework for Reviewing Merger Efficiencies

According to Farrell and Shapiro, regulators should be skeptical of efficiency claims based on scale economies (that is, efficiency claims that result from size rather than innovation or acumen). Efficiencies from scale economies are rarely merger-specific – either or both of the firms could accomplish growth outside of the merger. In the instances in which scale efficiencies are merger-specific, they conclude “there is reason to doubt that they will be both large enough and sufficiently passed through that consumers will benefit.”²³ This creates an inverse relationship – the more likely the merger is to create efficiencies, the less likely the efficiencies will be merger-specific.²⁴ Instead, Farrell and Shapiro explain that regulatory agencies should seek efficiency justifications that qualify as “synergies.”

Synergies are those efficiencies that result from a combination of rare or unique assets, and require the “intimate integration of the parties’ unique, hard-to-trade assets.”²⁵ Hard-to-trade assets are “assets that allow production on a superior production function, as distinct from causing different choices.”²⁶ A combination of assets that would allow an “output/cost configuration that would not have been feasible otherwise” is more likely to qualify as a synergy.²⁷ Examples of hard-to-trade assets that might lend themselves to a synergistic combination include patents, unique facilities, or special skills within one firm that would be extremely hard or even impossible to replicate outside of that firm.

Farrell and Shapiro explain that “it would seem unlikely that there would be scope for large efficiencies unless the parties individually had significant market power prior to the merger,” and “no firm would long operate below minimum efficient scale.”²⁸ They highlight that scale efficiencies are a double-edged sword – the bigger the efficiency the more likely it can be obtained without the merger – and because of this fact, regulators should be particularly skeptical of efficiencies based on scale economies. Farrell and Shapiro then conclude “it would seem hard to make a compelling case for merger-specific simple scale economies.”²⁹

This analysis creates an inherent contradiction in ESI and Medco’s justifications for their transaction – either they already operate with significant market power, thereby undermining arguments that the PBM market is dynamic, or the arguments that the merged firm will have an increased ability to secure lower purchase prices for drugs from pharmacy manufacturers is misstated if the market is, in-fact, competitive.

As outlined below, there is nothing that ESI and Medco are proposing they will be able to accomplish through this merger that they would not be able to accomplish – individually –as two separate firms. Furthermore, the power the merger would generate is evidence of the lack of competition currently in the market – and not benefits for consumers after the merger.

²³ *Id.* at 687.

²⁴ *Id.* at 689-90.

²⁵ *Id.*

²⁶ *Id.* at 693.

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.* at 701.

B. The Alleged Increased Buying Power is Not Cognizable and is Not Merger Specific

The argument that Express Scripts will harness its augmented buying power to the benefit of the consumer is not a cognizable efficiency sufficient to overcome the presumption of anticompetitive effects from the merger. Antitrust law looks unfavorably upon hypothetical efficiencies resulting from an increased ability to secure inputs. These types of efficiencies were referred to as “raw efficiencies” by the FTC’s staff,³⁰ meaning that they shape the firm’s ability to obtain inputs, and are rarely upheld as cognizable. In fact, the FTC staff study reported that the Bureau of Competition accepted raw-material savings as a cognizable efficiency in only 3% of the transactions reviewed.³¹ This is for the precise reason described above – either firm could increase its own buying power unilaterally.

Both Express Scripts and Medco already have massive buying power.³² The combination of the two firms would result in only a marginal increase in bargaining power. Even if the merged firm did secure pharmaceuticals cheaper, there is no reason to believe that this is a merger-specific outcome. Either of these firms controls enough of the market that they could unilaterally seek a better price, or could seek to improve their negotiating position through internal growth rather than merger. Courts have acknowledged this fact. In *FTC v. Staples*³³ the court recognized that the merged firm would have an advantage in buying power, which might even lead to lower consumer prices. However, the court also recognized that both Staples and Office Depot were growing very rapidly – opening as many as 100 or 150 new stores each year – so that increased buying power would have occurred as a result of internal expansion.³⁴ The same trend is true in the PBM industry, where ESI and Medco continue to grow. Any increased purchasing power would be equally as realizable by either firm individually through internal growth.

Moreover, there are reasons to doubt the degree that the combined firm would secure greater buying power. When Express Scripts CEO George Paz testified at the December 6, 2011 Senate Judiciary Committee hearing he admitted “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. Paz replied “as we said to Wall Street, the majority of the synergies in this transaction are not coming from the supply chain, they are coming from efficiencies...savings are two-fold: people staying adherent to

³⁰ Malcolm B. Coate & Andrew J. Heimert, *Merger Efficiencies at the Federal Trade Commission 1997-2007*, Bureau of Economics, Federal Trade Commission, February 2009.

³¹ *Id.* at 35.

³² This discussion focuses on buying power vis-à-vis pharmaceutical manufacturers. ESI may also argue increased buying power in contracting with pharmacies. We believe this is also not merger specific. Furthermore, the Merger Guidelines instruct that an efficiency justification is not cognizable if it results in a reduction in quality of service. *See* MERGER GUIDELINES § 10.

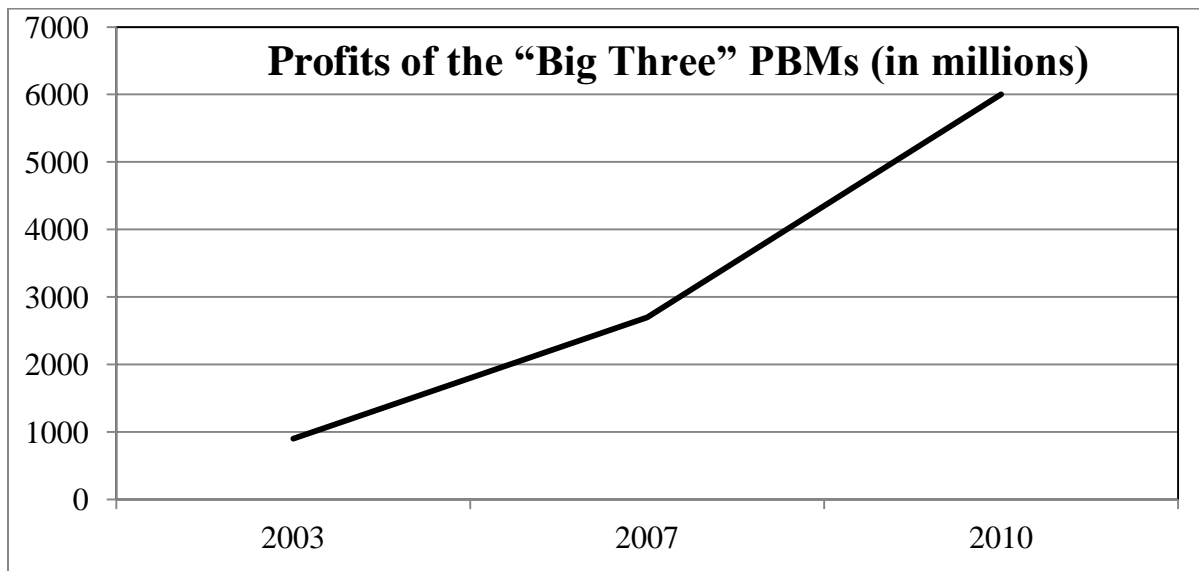
³³ 970 F. Supp. 1066 (D.D.C. 1997).

³⁴ *Id.* at 1090.

regimens, and two, better back-office synergies.”³⁵ As Senator Kohl observed in his letter to the Commission “So it is clear that obtaining greater drug price discounts from manufacturers cannot be an argument to justify this merger.”³⁶

C. Efficiencies are Unlikely to be Passed on to Consumers

Express Scripts’ contentions that it will pass on saving to consumers do not satisfy antitrust concern. Pharmacy benefit managers are among the most profitable companies in America. Profits for these companies skyrocket annually, and the profits of the three largest PBMs have increased by over 600% in the past seven years, to over \$6 billion annually, as the below chart indicates:



The courts have refused to recognize efficiency claims where the merging parties may reap higher profits rather than sharing the savings with consumers. In a recent case involving a merger that reduced the number of competitors from three to two, the court enjoined the merger concluding that “while reducing the costs of doing business provides several advantages for the merged firm, these advantages could show up in higher profits instead of benefitting customers or competition.”³⁷ In this case, having consolidated its power, the combined firm will be more likely to further marginalize the benefits it supposedly passes on to consumers, plan sponsors, and large employers.

The FTC has already addressed the question of whether, and to what extent, the burden of demonstrating an “extraordinary” efficiency is satisfied in a merger to duopoly in which the combined firm proffers to benefit consumers through additional cost savings. In *Federal Trade Commission v. Cardinal Health, Inc.*³⁸ the FTC acknowledged that certain efficiencies would be

³⁵ George Paz, Testimony before the Senate Judiciary Committee, audio, December 6, 2011.

³⁶ *Id.* at 3.

³⁷ *Federal Trade Commission v. CCC Holdings*, 605 F. Supp. 2d 26, 74 (D.D.C. 2009).

³⁸ 12 F.Supp.2d 34 (1998).

generated by two separate mergers of four pharmaceutical wholesales, resulting in two remaining firms. However, the Commission argued “(1) the extent of the claimed efficiencies is inflated, (2) the percentage of savings passed on to consumers may decrease from present levels, and (3) that many of the claimed efficiencies are not specific to the mergers — they could also be achieved through continued competition.”³⁹ The court agreed and enjoined the merger.

The FTC’s arguments from *Cardinal Health* are directly applicable to the ESI/Medco merger. In *Cardinal Health*, the merging parties contended that their improved buying power would result in better prices for purchasers, and ultimately consumers. In fact, the parties suggested they would be able to pass on approximately half of the saving to consumers. Express Scripts contends a similar efficiency, arguing that it will be able to secure better prices, and will share those saving with consumers. In both cases, we are looking at a middleman asserting that its improved purchasing power will lead to lower prices, and consumer benefit. The *Cardinal Health* court recognized that competition is most likely to lower prices: “while it must be conceded that the mergers would likely yield the cost savings more immediately, the history of the industry over the past ten years demonstrates the power of competition to lower cost structures and garner efficiencies as well.”⁴⁰

The FTC’s arguments, as well as the court’s rationale, remain true today. As Chairman Senator Kohl recognized it is unlikely the combined firm will pass on any significant portion of the savings it produces to consumers, stating “substantial doubt exists as to whether any declines in reimbursement rates would in fact be passed on to plan sponsors.”⁴¹ Senator Kohl points to two facts that support this conclusion. First, the elimination of a top tier competitor PBM will only diminish the need and incentive to pass on savings. Second, as noted previously in this letter, PBMs as an industry – and Express Scripts and Medco in particular –have struggled to demonstrate any cost savings for plan sponsors after acquisitions and consolidation.

As history, economics, and an investigation by the Senate Subcommittee on Antitrust, Competition Policy, and Consumer Rights all suggest, the merger of Express Scripts and Medco will not lead to cost savings for plan sponsors or their plan participants. Any financial windfall from this transaction will likely end up where it most often does in the PBM industry – with PBM shareholders.

D. Implementation of Programs and Policies are Nor Merger Specific

The policies and programs designed to increase the quality of consumer care that Express Scripts aims to implement are neither cognizable nor merger-specific. Both merging entities already provide such services. For instance, ESI uses data-driven tools to address non-adherence to prescription regimens; while Medco employs “Therapeutic Resource Centers” to personalize pharmacy care for certain patients. Both companies contend that they offer programs and oversight designed to ensure drug adherence, control waste management, and promote patient personalization. ESI and Medco are not unique in the creation of tools to assist patients – many

³⁹ *Id.* at 62.

⁴⁰ *Id.* at 63.

⁴¹ Letter from Senator Herb Kohl, Chairman, Subcommittee on Antitrust, Competition Policy, and Consumer Rights, to the Honorable Jonathan D. Leibowitz, Chairman, Federal Trade Commission, February 2, 2012, at 5.

PBMs implement similar programs. In many ways, these services have become a basic service for PBMs.

The H&R Block case recently considered the weight of such technological and operational benefits when analyzing the competitive effects of a proposed merger.⁴² The merging parties contended that the merger would enable the combined firm to lower overhead by combining operations in a more cost-conscious location, and consolidate technology platforms. The merging parties also suggested that the merger would allow them to synthesize a series of redacted tax service programs. The court concluded that these efficiencies are not cognizable, as they are neither merger specific nor verifiable. After first explaining that the merging parties failed to carry the burden of showing that the proffered efficiencies “cannot be achieved by either company alone because, if they can, the merger’s asserted benefits can be achieved without the concomitant loss of a competitor,”⁴³ the court concluded that benefits of this nature could be realized by either company independently. The H&R Block court explained that neither party had provided enough evidence to demonstrate why they were unilaterally incapable of implementing similar tools and streamlining operational tasks in a similar manner without the merger.

The court’s analysis is apt to the evaluation of the transaction between ESI and Medco. Much like the merging parties in H&R Block, Mr. Paz failed to ever explain how the proposed efficiencies generated by a merger between ESI and Medco would be merger specific. Furthermore, there is no reason to believe that either of these firms would not be able to implement such programs independently. To the contrary, with the current three-firm top tier PBM structure, competition compels these firms to invest in such programs.

4. The Merging Parties’ Public Report Asserting the Benefits of PBMs is Unconvincing

The day before Express Scripts’ and Medco’s CEOs participated in hearing before the Senate Judiciary Committee to discuss whether the merger would generate “Cost Savings for Consumers, or More Profits for Middlemen,” the companies circulated a report released by their consultants entitled “The Economic Benefits of Pharmacy Benefit Managers.”⁴⁴ Although not explicitly released for this purpose, it is clear that the parties sponsored this report as part of the dialogue in evaluating whether the transaction will lead to consumer benefit.

Unsurprisingly, the report concludes that PBMs benefit consumers in a number of ways. The report “estimates” that ESI and Medco “save plan sponsors and consumers roughly \$51 billion per year,”⁴⁵ although this calculation is derived using a 2002 estimate by the Congressional Budget Office of the amount “by which drug spending would fall relative to unmanaged purchases” for people on Medicare.⁴⁶ In fact, all of the data in this study compares the savings generated by Medco and/or ESI to what a “cash paying customer” would pay. The merging

⁴² United States v. H&R Block, Inc., Case 1:11-cv-00948-BAH, at 83, Nov. 10, 2011 (D.D.C. 2011).

⁴³ *Id.* at 83 (citing *FTC v. H.J. Heinz Co.*, 246 F. 3d 708, 720 (D.C. Cir. 2001)).

⁴⁴ Jonathan Orszag & Kevin Green, *The Economic Benefits of Pharmacy Benefit Managers*, Dec. 5, 2011 [hereinafter Orszag].

⁴⁵ *Id.* at 5.

⁴⁶ Congressional Budget Office, *Issues in Designing a Prescription Drug Benefit for Medicare*, at 40, Table 6, October 2002.

parties do not provide an estimate of savings generated for those covered by health insurance already, or in comparison to those plan sponsors contracting with other PBMs.

The report also sings the praises of the merging firms' efficiencies. ESI and Medco's consultants proclaim "by containing costs and improving patient outcomes, PBMs reduce the cost of providing effective drug management solutions."⁴⁷ Furthermore, the report concludes "for those categories of cost savings that are not subject to such 'automatic' pass-through mechanisms, such efficiencies reduce the PBM's costs, allowing it to compete more aggressively in the marketplace. Economic analysis indicates that such efficiencies also are likely to benefit consumers over time as they increase the incentive and ability of the firm to reduce prices, provide better products, and expand output in other ways." This paper has already addressed why the pass-through argument is insufficient as a matter of law. The economists argue that the long-term effects of PBMs will benefit consumers – but, much like above, they fail to explain why this is related to the merger. In fact, this report demonstrates that the current state of competition provides the correct incentive for PBMs – even the big three – to compete on ancillary programs such as drug adherence, waste management, and patient personalization.

The report is as alarming for what it does not discuss as for what it does. The economic report released the day before the Senate Judiciary Committee's hearing on the proposed merger fails to mention the merger at all. This glaring omission is just one of the many fallacies contained within the report:

- Old Data – the report relies almost exclusively on old data and old government reports, including reports from 2002 and 2003. The entire landscape of the PBM industry has changed dramatically since these reports were released, and their relevance to the current debate is limited at best.
- Unreliable Estimations – the entire report bases its estimates of savings on a 2002 Congressional Budget Office study that itself estimated potential PBMs savings as compared to a consumer paying out of pocket. The report suggests that these savings are comparable to that of the average consumer or plan sponsor, which is not the case.
- Skyrocketing PBM Profits – lost in the rhetoric outlining the savings-generating value of PBMs is the fact that their profits continue to skyrocket. The contention that the savings pass through to the customer rings hollow when one realizes that the PBMs are extracting enormous profits from their market position.
- Failure to Connect Up Rising Health Care Costs – the report begins by painting a picture of increasing health care costs, but fails to address PBMs' role in driving these costs up.
- Mountain of Consumer Protection Cases – Unsurprisingly, the report does not provide any information on the multitude of cases brought against PBMs for fraudulent and deceptive conduct that have secured over \$370 million in penalties and fines to date.

PBMs are not the panacea analysts such as Compass Lexecon claim they are, and the merger of the second and third biggest PBMs is certain to result in harm. Suggestions that the current state of affairs in the PBM industry is healthy and competitive are misplaced, but even more

⁴⁷ Orszag, *supra* note 44, at 43.

misguided is the suggestion that the merger will lead to further consumer benefit rather than harm.

Conclusion

In the end, the efficiencies proffered are neither cognizable nor merger-specific, and they are far from sufficient to overcome the presumption of anticompetitive effects resulting from further consolidation in an already concentrated industry. The Commission should not take the risk of permitting this clearly anticompetitive merger based on these speculative efficiency claims.

Sincerely:

A handwritten signature in cursive script that reads "David A. Balto".

David A. Balto