

# ANTITRUST IN HEALTHCARE CONFERENCE

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ANALYSIS OF MERGERS INVOLVING  
HEALTH PLANS, PBMS AND DRUG  
WHOLESALERS

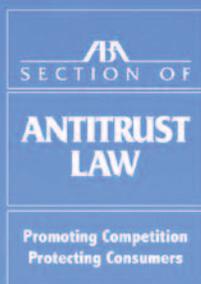
## ANTITRUST ANALYSIS OF HEALTH PLAN, PBM, AND DRUG WHOLESALER MERGERS: KEY PRECEDENT

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MAY 4, 2012**

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# INTRODUCTION

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Over the past several years, the Department of Justice, Federal Trade Commission, state attorneys general, and others have investigated or filed lawsuits seeking to block healthcare transactions. The following summaries represent key precedent relating specifically to healthcare mergers involving health plans, pharmacy benefit managers (“PBMs”), and drug wholesalers. These summaries highlight key considerations and possible remedies for transactions in these industries.

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# HEALTH PLAN MERGERS

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**DEPARTMENT OF JUSTICE, 1999**

The Department of Justice (“DOJ”) and the State of Texas filed suit in federal court in Texas alleging that Aetna Inc.’s \$1 billion acquisition of Prudential Health Care would reduce competition in the sale of health maintenance organization (“HMO”) plans and HMO point of service (“POS”) plans in the Houston and Dallas metropolitan statistical areas. According to the complaint, employers and employees did not view HMO and preferred provider organization (“PPO”) plans as the same product, as evidenced by the fact that “enrollees who leave an HMO disproportionately select another HMO, rather than a PPO, for their next plan.” The entry barriers for HMO and HMO-POS providers in these geographic markets in terms of time, money, and building national scope and a national brand were alleged to be substantially higher than the barriers for PPO or indemnity plans. The combined firm would allegedly have had a 63% share of HMO and HMO-POS enrollees in Houston and a 42% share in Dallas, with DOJ claiming that the firms were “among each other’s principal competitors.” Consequently, DOJ also alleged that this consolidation of purchasing power over physician services would “depress physicians’ reimbursement rates in Houston and Dallas, likely leading to a reduction in quantity or degradation in quality of physicians’ services.”

As part of a settlement, Aetna agreed to divest its interest in the previously-acquired commercial HMO and HMO-POS businesses of NYLCare Health Plans of the Gulf Coast, Inc. in Houston and NYLCare Health Plans of the Southwest, Inc. in Dallas. Aetna agreed not to consummate its acquisition of Prudential Health Care until DOJ, in its sole discretion, determined that these two divested businesses could “function as effective competitors.”

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**DEPARTMENT OF JUSTICE, 2004**

DOJ issued a closing statement following its investigation and clearance of Anthem, Inc.'s \$16.4 billion acquisition of WellPoint Health Networks, Inc. First, in the sale of health insurance products, DOJ determined that Anthem and WellPoint did not compete in any geographic areas under the Blues trademarks, but did compete head-to-head in nine states where WellPoint's non-Blues subsidiaries, UniCare and HealthLink, operated. In these nine states, WellPoint's market share was "very small" and employers and other market participants did not view WellPoint's subsidiaries as close competitors with Anthem. Second, DOJ determined that due to WellPoint's low shares and the lack of complaints by hospitals and physicians in these nine states, the combined firm would not have monopsony power over health care providers. Third, in regards to contracting with hospitals, physicians, and other healthcare providers in Blues plans, DOJ did not find any evidence that the merged firm would be "more likely to impose contractual clauses that might raise competitive concerns, such as 'most favored nation' clauses." Finally, DOJ investigated whether the merger would reduce competition for the acquisition of Blues plans, thereby lowering acquisition prices and "reducing charitable funds available for uninsured and indigent" patients. However, DOJ stated it was unable to identify any "non-profit Blues plans that might convert to for-profit and be sold in the foreseeable future."

**DEPARTMENT OF JUSTICE, 2008**

DOJ required UnitedHealth Group Inc. to divest its Medicare Advantage business in Las Vegas to Humana Inc. in order to complete its \$2.6 billion acquisition of Sierra Health Services Inc. DOJ alleged that the originally proposed acquisition would have combined the top two sellers of Medicare Advantage plans in the Las Vegas area, giving the combined firm a 94% share and likely resulting in higher prices, fewer choices, and reduced quality of Medicare Advantage plans available to Las Vegas's senior citizens.

The Nevada Attorney General's office reached a separate agreement with United. Effective through October 7, 2013, United was required, among other things, to make a \$15 million charitable contribution to various Nevada organizations, to participate in health care studies conducted by Nevada agencies, and to avoid using "most favored nation" or "all products" terms in its contracts with health care providers.

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**DEPARTMENT OF JUSTICE, 2008**

UnitedHealth Group, Inc. agreed to a consent decree with DOJ to resolve competitive concerns arising from its \$8.1 billion acquisition of PacifiCare Health Systems, Inc. DOJ alleged that in Tucson, Arizona, United and PacifiCare were two of the three largest sellers of commercial health insurance to small-group employers with between two and fifty employees. Thus, United agreed to divest all of PacifiCare's small-group business in Tucson.

According to DOJ's complaint, the proposed acquisition would have enabled United to lower physicians' reimbursement rates in Tucson as well as Boulder, Colorado, leading to a reduction in quantity or quality of physician services in these areas. Accordingly, United agreed to divest PacifiCare's commercial HMO contract with the Regents of the University of Colorado, covering approximately 6,000 members.

As an additional matter, United had been renting the provider network of CareTrust Networks, a subsidiary of Blue Shield of California, which was one of PacifiCare's "principal competitors in California." Under the rental agreement, United could access certain Blue Shield information and could confer with Blue Shield on product development issues. Thus, under the consent decree, United agreed to cease exchanging competitively-sensitive information with Blue Shield and to terminate the rental agreement within one year.

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**DEPARTMENT OF JUSTICE, 2010**

DOJ conducted an investigation of Blue Cross Blue Shield of Michigan's proposed acquisition of Physicians Health Plan of Mid-Michigan (PHP). DOJ believed that the combined firm would have a 90% share of the sales of commercial group health insurance and the purchase of physician services in Lansing, Michigan. Additionally, DOJ believed that the firms were each other's "most significant rivals," which had led both of them to "offer lower prices, better service, and more innovative products." Upon learning of DOJ's intent to challenge the merger, the companies abandoned the transaction.

**CITY OF NEW YORK, 2011**

The City of New York filed suit in the United States District Court for the Southern District of New York seeking to block the proposed merger of Defendants Group Health Incorporated ("GHI") and Health Insurance Plan of Greater New York ("HIP"). GHI and HIP were by far the most popular, least expensive of 15 different health plans offered to the City's employees and non-Medicare retirees. Only a small number of the City's employees chose the third most popular plan, which carried much higher out-of-pocket costs.

The City alleged a market of "low-cost municipal health benefits," including "only those insurance plans that are inexpensive and that the City selects for inclusion in the Health Benefits Program." The district court granted summary judgment to the Defendants, finding that the City's market definition was "legally insufficient because it was defined by the preferences of a single purchaser: the City" rather than reasonable interchangeability and cross-elasticity of demand. On appeal, the Second Circuit affirmed the district court's ruling, finding that the City failed to show any factors preventing "insurance companies

other than those [the City] selects for the Health Benefits Program from proposing competitive products should the merged firm raise its premiums to supracompetitive prices.” The Second Circuit also agreed with the district court that a single purchaser’s preferences could not serve as the basis for market definition.

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# PHARMACY BENEFIT MANAGER ("PBM") MERGERS

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*Lilly*



*medco*<sup>®</sup>

CAREMARK<sup>®</sup>



CAREMARK<sup>®</sup>

**CVS**  
pharmacy

CAREMARK<sup>®</sup>



*medco*<sup>®</sup>

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**FEDERAL TRADE COMMISSION, 1995**

The FTC conditionally approved Eli Lilly and Company’s \$4 billion acquisition of McKesson Corporation’s PBM, PCS Health Systems, Inc. The acquisition vertically integrated Eli Lilly’s pharmaceutical manufacturing business with PCS’s PBM business.

To prevent a Lilly-owned PCS from giving “unwarranted preference” to Lilly’s pharmaceuticals over those of its competitors, PCS was required to create an independent Pharmacy and Therapeutics (“P&T”) Committee to design an “open formulary.” The P&T Committee members could not be affiliated with Lilly or PCS and were required to “apply objective criteria in evaluating drugs for inclusion in the open formulary.” On this formulary, Lilly was required to accept discounts and rebates offered by competing drug makers to ensure that formulary decisions accurately reflected these discounts. Additionally, Lilly erected a firewall to prevent PCS from providing Lilly with competitive information on Lilly’s pharmaceutical competitors. In a press release announcing the consent agreement, the FTC warned that the vertical integration of pharmaceutical manufacturers with PBMs “could lead to anticompetitive consequences that require additional relief.” The FTC therefore stated that it would continue to monitor vertical arrangements by Lilly and others in the industry.



**FEDERAL TRADE COMMISSION, 1998**

Merck and Co., Inc. acquired Medco Containment Services, Inc. in 1993 for \$6.6 billion to become the first pharmaceutical manufacturer to integrate with a pharmacy benefit manager. Soon after the FTC’s announcement in 1995 as part of the Lilly-PCS investigation that it would continue to monitor vertical arrangements in these markets, the FTC investigated the Merck-Medco merger

and alleged that the merger may have lessened competition in the manufacture and sale of pharmaceuticals and the provision of PBM services. According to the FTC's complaint, Medco gave favorable treatment to Merck's drugs on its formularies, thereby denying patients greater access to the drugs of competing manufacturers. Additionally, the merger allegedly made it possible for Medco to share competitors' pricing information with Merck, potentially fostering coordination among drug manufacturers.

In 1998, Merck reached a consent agreement with the FTC that was similar to that in the Lilly-PCS merger. Under the consent, Merck-Medco was required to offer an "open formulary" that included drugs chosen by an independent Pharmacy and Therapeutics ("P&T") Committee comprised of neutral physicians and pharmacologists. Moreover, Medco was required to accept discount and rebate offers from competing pharmaceutical manufacturers and accurately reflect such discounts when ranking the drugs on the open formulary. Finally, Medco implemented a firewall to prevent Medco from sharing with Merck competitively-sensitive information on competing manufacturers.



**FEDERAL TRADE COMMISSION, 2004**

The FTC cleared Caremark Rx, Inc.'s \$6 billion acquisition of AdvancePCS Inc. without conditions and issued a closing statement. Prior to this horizontal merger, Caremark and AdvancePCS were two of the largest PBMs in the United States.

In analyzing the transaction, the FTC defined the relevant market as "the provision of PBM services by national full-service PBM firms" – the same market definition used in the Merck-Medco and Lilly-PCS mergers. Finding that national PBMs faced ample competition for small employers from regionally-oriented PBMs, the FTC focused its investigation on "large employers that are more likely to desire the broader service offerings of national, full-service PBMs." The FTC concluded that there would be sufficient "[c]ompetition from the remaining independent, full-service PBMs with national scope – Medco, Express Scripts, and the merged Caremark/AdvancePCS – and significant additional competition from several health plans and several retail pharmacy chains offering PBM services."

Additionally, the FTC investigated whether the merged firm would obtain monopsony or oligopsony power over retail pharmacies. The FTC explained that “it was important not to equate market concentration on the buyer side” with monopsony power, and that shifting purchases from existing purchasers to “lower-cost, more efficient sources” did not constitute such power. The FTC recognized that increased bargaining power that allows large buyers to lower input prices without decreasing overall input purchases could reduce costs and benefit consumers. Due to the characteristics of the market, the FTC concluded that neither monopsony nor oligopsony power were likely to result from the acquisition. The combined firm’s share of purchases of “prescription dispensing services” was too low. Moreover, contracts were individually negotiated by the PBM with each retail pharmacy and sales did not take place at a single price. Thus, the FTC believed that although the transaction would most likely increase the bargaining power of the merged firm and its share of the gains relative to retail pharmacies, the reduction in dispensing fees paid to retail pharmacies would likely be passed through by contract to PBM clients and would therefore reduce overall healthcare costs.



**FEDERAL TRADE COMMISSION, 2007**

In 2006, Express Scripts, Inc. and CVS Corp. engaged in a bidding war to acquire Caremark Rx, Inc., the second-largest PBM in the United States at the time. The FTC issued a second request to Express Scripts, which was the third largest PBM in the United States at the time. CVS publicly argued that Express Scripts’ offer carried significant antitrust risk that would prevent the deal from closing or delay it substantially. CVS stated that Express Scripts’ acquisition “would reduce the major competitors in the PBM industry from 3 to 2.” In light of these antitrust concerns, Caremark rebuffed Express Scripts’ bid and CVS successfully acquired the company for \$26.5 billion without a second request.

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**FEDERAL TRADE COMMISSION, 2007 AND 2012**

In 2007, CVS Corp. acquired Caremark Rx, Inc. for \$26.5 billion. The acquisition vertically integrated CVS's retail pharmacy business with Caremark's PBM business. Unlike the proposed Express Scripts-Caremark merger, the FTC cleared CVS's acquisition of Caremark without a second request.

In 2009, following a number of complaints lodged by pharmacy associations, consumer advocacy groups, and members of Congress, the FTC launched an investigation into the dealings between CVS Caremark's pharmacy unit and its PBM business. Specifically, these groups complained that CVS Caremark's PBM unit "steered" business to CVS pharmacies at the expense of competing pharmacies and that the two units improperly shared competitively-sensitive information about competitors. After an investigation lasting more than two years, the FTC closed its investigation without alleging that CVS Caremark violated any antitrust laws or engaged in any anti-competitive behavior as a result of the vertical merger.

**FEDERAL TRADE COMMISSION, 2012**

Express Scripts, Inc. acquired Medco Health Solutions, Inc. for \$29 billion in 2012. The FTC unconditionally approved the merger following an eight-month investigation and issued a closing statement. The merger combined two of the country's three largest PBMs. The FTC, working with the assistance of 32 state attorneys general, "interviewed over 200 market participants, including customers, other PBMs, retail and specialty pharmacies, pharmacy trade groups, pharmaceutical manufacturers, and healthcare benefit consulting firms."

According to the FTC, the investigation revealed that the combined firm's high market share of more than 40% did "not accurately reflect the current competitive environment and [was] not an accurate indicator of the likely effects

of the merger on competition and consumers.” Focusing on PBM competition for large employers, the FTC found that there would be at least nine remaining competitors after the merger, including CVS Caremark, health plan-owned PBMs, and other standalone PBMs. The FTC described these firms as “vigorous competitors who [were] expanding and winning business from traditional market leaders.” Additionally, the FTC determined that Express Scripts and Medco were not particularly close competitors given that they focused on customers of different sizes. Moreover, coordination was unlikely given the large number of diverse competitors with different business models, the abundance of pricing dimensions, and the involvement of sophisticated consultants in the bid process.

In response to complaints by pharmacy groups and members of Congress, the FTC also examined whether the merged firm would obtain monopsony power and lower reimbursement rates to retail pharmacies below the competitive level. The FTC found that the combined firm’s 29% share of retail pharmacy sales was lower than the share ordinarily needed to create such power. In addition, data showed “little correlation between PBM size and the reimbursement rates paid to retail pharmacies.” Citing to the Caremark/AdvancePCS closing statement, the FTC also noted that individually-negotiated contracts made the market less susceptible to monopsony power. In fact, the FTC believed that even if the merged firm obtained greater bargaining power, the cost savings generated from such power would be passed through to clients by contract and there was no evidence that pharmacy output or services would be reduced.

Finally, the FTC evaluated the competitive effects in the market for specialty drug services. The FTC found that the combined firm would have a share of only about 30% in a market with at least 10 national competitors. Moreover, the FTC discredited concerns that the merged firm would be able to obtain more exclusive distribution agreements from pharmaceutical manufacturers. Pharmaceutical manufacturers told the FTC that they, not the PBMs, were the ones seeking limited or exclusive arrangements based on the “size of the patient population for the particular drug or a drug’s special safety requirements.” Thus, the FTC determined the merger would not change this dynamic.

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# DRUG WHOLESALER MERGERS

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### FEDERAL TRADE COMMISSION, 1998

Less than a month after Cardinal Health, Inc. announced its intent to acquire Bergen Brunswig Corp. for \$3.5 billion, McKesson Corp. announced that it planned to acquire AmeriSource Health Corp. for \$2.5 billion. The FTC obtained a preliminary injunction in federal court to block these proposed mergers of the four largest drug wholesalers. Both transactions were later abandoned.

The district court determined that the relevant market included only the sale of prescription drugs through the wholesale channel, and did not include prescription drugs sold directly by manufacturers, drugs self-warehoused by retail chains, or drugs shipped via mail order. The court reasoned that only a small number of large retail pharmacy chains were capable of self-warehousing and that independent pharmacies and hospitals did not have this capability. Additionally, numerous wholesaler customers testified they would not purchase directly from manufacturers in response to an anticompetitive price increase by the wholesalers. The court ruled that the relevant geographic market included both a national market and certain regional markets in the western half of the United States “where regional wholesalers [were] small in both size and number.”

The court found that the two combined firms would control more than 80% of all wholesale prescription drug sales nationwide, with the next largest competitor (Bindley Western) having only a 4.35% share. The Herfindahl-Hirschman Index would rise from 1648 to 3079 after the mergers. Thus, the court found that the mergers were presumptively anticompetitive.

In evaluating the merging parties’ rebuttal evidence, the court ruled that although new entry or expansion could be timely, it would not be likely or sufficient. Additionally, although large retail chains and group purchasing organizations may have had enough leverage to prevent anticompetitive price increases, independent pharmacies and smaller hospitals did not. Finally, the court found that the efficiencies claimed by the parties, while valid, were not merger specific.

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**FEDERAL TRADE COMMISSION, 2001**

Just three years after the FTC successfully blocked the dual mergers involving the four largest drug wholesalers in the United States, AmeriSource Health Corp. proposed a \$2.3 billion acquisition of Bergen Brunswig Corp. The FTC approved the merger without condition and issued a closing statement.

According to the FTC, the merger combined the third- and fourth-largest drug wholesalers “into a presumably stronger number three,” whereas only the top two firms would have survived the proposed transactions in 1998. The FTC found no evidence that the merging firms “contributed significantly” to decreasing prices in the industry. Importantly, unlike in 1998, the FTC credited the parties’ efficiencies arguments, finding that the transaction “likely [would] give the merged firm sufficient scale so that it can become cost-competitive with the two leading firms and can invest in value-added services desired by customers.” The FTC believed that the combined firm would be able to achieve these efficiencies “more rapidly than either could do individually, and that this timing advantage [would] be significant enough to constitute a cognizable merger-specific efficiency.”

**FEDERAL TRADE COMMISSION, 2010**

Cardinal Health, Inc. announced its plans to acquire Kinray, Inc. in 2010 for \$1.3 billion. At the time, Cardinal Health was the second-largest drug wholesaler in the country. Kinray, meanwhile, was the largest drug wholesaler to independent pharmacies in the New York metropolitan area and surrounding areas but had limited business from larger retail drugstores. The transaction increased Cardinal Health’s independent pharmacy customer base by 40%. The FTC investigated the acquisition but did not issue a second request.

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