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September 29, 2011

Mr. Dan E. Gustafson
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Dear Mr. Gustafson,

On behalf of the Committee on the Judiciary's Subcommittee on Intellectual Property, Competition and the Internet, I want to express our sincere appreciation for your participation in the hearing on "The Proposed Merger between Express Scripts and Medco". Your testimony was informative and will assist us in future deliberations on the important issues addressed during the hearing.

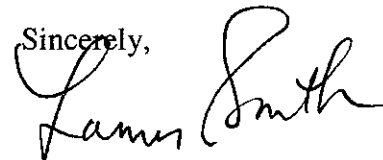
Also, please find a **verbatim** transcript of the hearing enclosed for your review. The Committee's Rule III (e) pertaining to the printing of transcripts is as follows:

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Please return your transcript edits to the Committee on the Judiciary by October 13, 2011. Please send them to the Committee on the Judiciary, Attention: Olivia Lee, B-352 Rayburn House Office Building, Washington, D.C., 20515. If you have any further questions or concerns, please contact Ms. Lee at (202) 225-5741.

Thank you again for your testimony.

Sincerely,



Lamar Smith
Chairman

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812 Mr. GOODLATTE. And now we will hear from Mr. Gustafson.
813 Welcome.

814 TESTIMONY OF DAN E. GUSTAFSON

815 Mr. GUSTAFSON. Chairman Goodlatte, thank you for
816 providing me the opportunity to testify today. My name is
817 Dan Gustafson, and I practice antitrust law at Gustafson
818 Gluek in Minneapolis. I am also working with a group at the
819 American Antitrust Institute to evaluate the proposed merger.

820 Although our work is preliminary, we have identified
821 several potential concerns with regard to this merger, but
822 before I identify these concerns, let me emphasize first that
823 the time for careful evaluation of this merger is now.
824 Although antitrust enforcement can sometimes undo the effects
825 of already concentrated markets or anticompetitive conduct,
826 preventing such conduct before it occurs is far more
827 effective antitrust and public policy. For that reason we
828 applaud the FTC's second request for information as it
829 continues to evaluate this merger proposal.

830 PBMs play an important and ever-expanding role in our
831 health care system. They touch most American lives in their
832 role as managers of prescription drug benefits through their
833 pharmacy claims processing, formulary management and

834 | home-delivery pharmacy services. They also negotiate
835 | discounts and rebates on purchases from pharmaceutical
836 | companies.

837 | The market for national PBM services is already
838 | concentrated. CVS Caremark, Express Scripts and Medco
839 | control more than 50 percent of the market when measured in
840 | terms of prescriptions, and over 80 percent of the market
841 | when measured in terms of large plan-sponsored contracts. A
842 | merged Express Scripts-Medco company will overwhelmingly
843 | dominate the PBM services market, covering nearly 150 million
844 | prescription drug consumers and over 50 percent of the large
845 | plan sponsors. In terms of covered lives, no other PBM would
846 | remotely approach Express Scripts-Medco.

847 | As a result of our evaluation of this merger, we raise
848 | several concerns. First, will the merger reduce competition
849 | for the provision of PBM services to large plan sponsors?
850 | Although there are numerous smaller PBMs, many of these
851 | smaller entities operate only in regions, some serve only a
852 | special niche markets such as government services, and other
853 | offer a limited menu of services in areas such as specialty
854 | drugs, mail order or claims processing. The smaller PBMs
855 | lack the ability to negotiate the same discounts and rebates
856 | from drug manufacturers that large PBMs can obtain. As a
857 | result, regional PBMs may be unable to constrain potential
858 | anticompetitive conduct.

859 Second, will the proposed merger lead to increased
860 prices or reduced services in the distribution of specialty
861 pharmaceuticals? Significant concerns exist in the market
862 for the distribution of specialty drugs where Express Scripts
863 and Medco will own the two largest specialty pharmacy
864 businesses. The proposed merger will result in a company
865 holding more than a 50 percent share of the specialty
866 pharmacy market segment. Specialty pharmacies provide
867 important service and treatments to consumers with complex,
868 chronic and often life-threatening illnesses. They often
869 help administer complex treatments, work with physicians to
870 monitor patient therapy, and play a role in the medication
871 compliance issues. Reduced competition in this market
872 segment could lead to increased costs and reduced services to
873 the consumers who depend on those treatments the most.

874 Third, will the proposed merger increase the exercise of
875 buyer power to reduce the delivery of traditional
876 pharmaceutical services? We are concerned that the major
877 PBMs already possess the ability and incentive to exercise
878 market power over retail independent and chain pharmacies.
879 Reimbursements from the PBMs is a major source of their
880 revenue, and the proposed merger could enable the two
881 remaining large PBMs to push compensation to the retail
882 pharmacies below competitive levels, eliminating jobs and
883 leading to reduced and important services for their

884 consumers.

885 This proposed merger would also create the largest
886 mail-order pharmacy in the United States, accounting for
887 nearly 60 percent of all mail-order scripts, because large
888 PBMs could divert prescriptions to their own mail-order
889 facilities instead of to their retail traditional pharmacies.

890 They could maximize their own gains if they then select
891 drugs on which they receive superior rebates from
892 manufacturers. The opportunity for potentially
893 anticompetitive self-dealing which harms consumers may be
894 enhanced by the creation of a dominant PBM in the mail-order
895 pharmacy market space and elimination of one of its only two
896 competitors.

897 Finally, we need to be careful to examine the claim
898 deficiencies to determine if the savings that are proposed
899 are specific to this merger and cannot otherwise be obtained
900 by means unrelated to the merger. A careful analysis made as
901 to whether and to what degree these claimed efficiencies will
902 actually be passed on to plans, and therefore consumers, is
903 important as well.

904 Past consolidation in this industry provides sufficient
905 data to evaluate the previous efficiency promises that have
906 been made. The recent spike in the profits of the largest
907 PBMs suggest less and not more competition and, as a result,
908 higher prices for plans and for consumers.

909 Thank you for providing me the opportunity to testify
910 today. I am happy to answer any questions that you may have.

911 Mr. GOODLATTE. Thank you, Mr. Gustafson.

912 [The statement of Mr. Gustafson follows:]

913 ***** INSERT 1-5 *****

1439 pharmacist to call up doctors to tell them that they
1440 prescribe the wrong thing.

1441 Mr. LECH. Oh, it happens all the time, practically
1442 daily.

1443 Mr. CONYERS. Oh, really?

1444 Mr. WIESNER. That is a daily occurrence, sir.

1445 Mr. CONYERS. All right, let me recognize my friend over
1446 here.

1447 Mr. GUSTAFSON. Congressman, I wanted to answer the
1448 question about fraud and abuse. I would suggest that the
1449 best thing that will combat the fraud, waste and abuse would
1450 be more vigorous competition. If these companies are forced
1451 to fine tune their operations in order to lower their costs
1452 so they can lower their bids to the customers that they seek
1453 to obtain contracts from, that alone will generate the best
1454 cost savings through saving fraud, waste and abuse.

1455 And I was going to respond to Congressman Watt when he
1456 asked what would be missing if these two companies combined.
1457 What we will be missing is a national bidder in each of these
1458 accounts. When they have national accounts that they put out
1459 to bid every 3 years, what will be missing from the
1460 competitive landscape is a company that is capable of making
1461 a bid on those contracts.

1462 Mr. LECH. In regard to fraud, waste and abuse, if I
1463 could reference the document I mention, Waste Not-Want Not,

1739 | have fewer options and thus not be in a position to demand
1740 | greater transparency?

1741 | Mr. GUSTAFSON. I think that is right, Congresswoman. I
1742 | think one of the things that competition does in this
1743 | marketplace, in any marketplace, is it forces the seller to
1744 | be more transparent because the consumer has more choices, or
1745 | in this case the plan sponsor or whoever the customer is in
1746 | that instance. So I think that concentration in this market
1747 | will allow the participants who remain to be less
1748 | transparent, and I think that is bad for the competition
1749 | levels and it is bad ultimately for the consumers.

1750 | Ms. CHU. Okay. Thank you.

1751 | Mr. GOODLATTE. I thank the gentlewoman. The gentleman
1752 | from New York, Mr. Nadler, is recognized for 5 minutes.

1753 | Mr. NADLER. I thank the chairman.

1754 | Mr. Gustafson, Mr. Watt discussed the issue of product
1755 | markets. What do you see as the relevant product markets for
1756 | antitrust purposes that should be analyzed as part of this
1757 | merger and in which product markets would concentration under
1758 | the merger cause the most concern and could divestitures in
1759 | any of these market alleviate those concerns?

1760 | Mr. GUSTAFSON. Congressman, I think that there
1761 | is--probably the FTC will ultimately decide that there is
1762 | more than one market here. There certainly seems to be
1763 | markets that--at this stage of our investigation that large

1764 plan sponsors is probably a market, the specialty drugs may
1765 very well be a market. So I think that there is--mail order
1766 may be a market. Probably not, but it is possibly a
1767 different marketplace. But ultimately I think there is more
1768 than one market.

1769 The question about whether divestitures would be a
1770 solution to this merger, it is probably too early to tell,
1771 but there are certainly some things that you could consider
1772 in terms of divestiture that would be useful. One is the
1773 speciality drug companies that these two merger partners own.

1774 Another would be the mail order businesses that they own or
1775 part of the mail order businesses, because both of those
1776 instances would lessen their grip on the national accounts.

1777 Mr. NADLER. Thank you.

1778 Mr. Snow, you testified that the merger would give the
1779 new combined company greater power to negotiate prices with
1780 drug companies and therefore would result in lower drug
1781 prices.

1782 Mr. SNOW. Correct.

1783 Mr. NADLER. Would you say the same principle would
1784 apply if we were to say that Medicare could negotiate drug
1785 prices with the pharmaceutical companies and if we let them
1786 negotiate the prices, instead of prohibiting them by law, the
1787 market power of Medicare would cause a great reduction in
1788 drug prices for Medicare?

1914 defined. It defines a marketplace. It is not a county-wide
1915 or region-wide or every independent pharmacy.

1916 Mr. GOODLATTE. Mr. Lech, I hate to interrupt you, but
1917 the gentleman's time has long expired.

1918 Mr. NADLER. I thank the chairman for his indulgence.

1919 Mr. GOODLATTE. The gentleman from Florida, Mr. Deutch,
1920 is recognized for 5 minutes.

1921 Mr. DEUTCH. Thank you, Mr. Chairman.

1922 Mr. Chairman, as I brought up in a letter to the FTC
1923 Chairman, I have heard some real concerns from constituents
1924 in my district that the acquisition could result in
1925 diminished competition, could have a negative impact on
1926 healthcare costs, or could jeopardize the overall quality of
1927 patient care, and I would like to focus on two of those, if I
1928 may. The first is cost.

1929 Mr. Snow, if I understood you correctly, you said that,
1930 or if you could elaborate, there would be \$1 billion passed
1931 back to consumers. I would like to understand that. And
1932 then, Mr. Gustafson, after Mr. Snow explains, if you could
1933 respond, because I think what you said earlier in your
1934 testimony was that past consolidation suggests that there
1935 will be higher prices for consumers.

1936 Mr. Snow, could you speak first?

1937 Mr. SNOW. Absolutely. Thank you. So we have contracts
1938 with clients today that have 100 percent pass-through of our

1939 pricing, of our rebates. So when a merger like this occurs,
1940 you actually combine the best-of-breed contracting that we
1941 currently have as independent companies today. When you just
1942 look at best-of-breed contracts between the two companies
1943 post-merger, it results in \$1 billion of savings that by
1944 definition under our existing contracts with our clients they
1945 get immediate benefit for. It goes right back. And when I
1946 say client, it is our employer customers and our health plan
1947 customers and our State government customers.

1948 Mr. DEUTCH. So Mr. Gustafson, could you help me make
1949 some sense of this, because ultimately I am concerned about
1950 the I am fact it is going to have on consumers.

1951 Mr. GUSTAFSON. What I had testified about was that when
1952 they claim the \$1 billion in efficiencies, we need to make
1953 sure we document it, because we have had a lot of
1954 consolidation in this industry where promises have been made.
1955 We have a data set. We can go back and look. When CVS and
1956 Caremark merged, they made promises about efficiencies, and
1957 when--

1958 Mr. DEUTCH. I am sorry, Mr. Gustafson. What kind of
1959 promises were made and what was the result?

1960 Mr. GUSTAFSON. Well, I am not familiar with the
1961 specifics of the promises as I sit here, but I know the
1962 mergers were defended on the basis that they would provide
1963 cost savings which would be passed on. And the data that I

1964 | have seen suggests that the profits of these companies are
1965 | soaring, which suggests that they are not passing it on,
1966 | which suggests that they are taking whatever savings they get
1967 | and putting them through to their bottom line.

1968 | Mr. DEUTCH. I appreciate that. I would like, Mr. Lech,
1969 | if I could turn to you for a moment. In your testimony you
1970 | talked about the gradual shift of smaller and medium-sized
1971 | PBMs being bought out by larger ones and you mentioned that
1972 | the reduced competition hurts smaller pharmacies like yours.

1973 | Can you speak specifically--can you help us understand
1974 | what that looks like for your customers? Those negotiations
1975 | with PBMs that have changed, what impact has it had on the
1976 | customers, on the consumers?

1977 | Mr. LECH. Well, the reason it will have a negative
1978 | effect is basically because it is a take it or leave it
1979 | contract. The statement was made earlier that, you know, we
1980 | are very business-minded, savvy people, and if we get a
1981 | contract that doesn't look good, we are going to say no.
1982 | Well, that is hard to do. It is not hard to do
1983 | business-wise, but hard to do in a humane kind of way, to say
1984 | "Congressman, I can't fill your prescriptions anymore." So
1985 | access to the pharmacy of their choice and I believe also
1986 | ultimately the price and the cost.

1987 | What we have seen in all these claims of we are going to
1988 | reduce costs, we are doing to reduce costs, the prescription

2069 standards and underneath, you know, our client contracts, he
2070 is an important component of our offering.

2071 Mr. GOODLATTE. Mr. Lech?

2072 Mr. LECH. What Mr. Paz fails to tell you is that the
2073 Department of Defense is a special entity, because through
2074 the mail they are given larger discounts. Those discounts
2075 have not passed on as much to me as an independent pharmacy.
2076 So the economies of scale are different with the Department
2077 of Defense because their contracting ability is greater than
2078 your average corporate purchaser.

2079 Mr. PAZ. The savings, though, is discussed--

2080 Mr. GOODLATTE. I can't go back and forth too many
2081 times.

2082 Mr. Gustafson, you testified that the Express
2083 Scripts-Medco merger reduces the number of viable providers
2084 of PBM services to large plan sponsors from three to two.
2085 Why aren't Catalyst, Optum Rx and Prime Therapeutics, which
2086 already handled plans for Fortune 50 companies, viable
2087 providers of PBM services to large plan sponsors? Catalyst
2088 has won contracts for such large employers as Ford Motor
2089 Company, Nike, Sprint, Waste Management and Southwest
2090 Airlines.

2091 Mr. GUSTAFSON. They are not as big, and when these two
2092 combine, they are going to be bigger yet. And when they take
2093 that combination, they are going to be able to extract more

2094 | discounts on the side of the pharmaceutical companies, they
2095 | are going to be able to direct more to the mail order, they
2096 | are going to have a bigger control of the specialty pharmacy
2097 | products. All of that is going to make them more powerful
2098 | vis--vis the other PBMs.

2099 | Optum Rx is a good example because they suffer from
2100 | another potential problem. UnitedHealth Care, their
2101 | underlying parent, I guess it is, is a competitor of other
2102 | plan sponsors. And so there has been a fair amount written
2103 | about the reluctance of Cigna or Aetna or someone like that
2104 | to use a PBM like Optum Rx because of the potential issues
2105 | with respect to data access, things like that.

2106 | But I think the question that we ought to address in
2107 | this is how big is big enough? I mean, if we were talking
2108 | about a merger of--

2109 | Mr. GOODLATTE. Under the antitrust law that is not the
2110 | issue that we address. The issue that you address is do they
2111 | have market power that would preclude others from being able
2112 | to enter the marketplace and offer competitive plans that
2113 | would maintain the competition that is, in the view of--
2114 | certainly in my view--in view of the law as it is written, is
2115 | a desirable thing to have?

2116 | Mr. GUSTAFSON. Sure. I agree with that. What I was
2117 | suggesting was how big is big enough with respect to the
2118 | efficiencies they claim they can garner by getting together

2119 | and being bigger? At some point, you know, there are no more
2120 | efficiencies that can be gained by getting bigger. They only
2121 | become able to extract the power that they have--

2122 | Mr. GOODLATTE. Well, that is the underlying issue, not
2123 | how large they have to be and still maintain their
2124 | efficiency.

2125 | But let me yield to the gentleman from North Carolina
2126 | Mr. Watt and see if he has any additional questions.

2127 | Mr. WATT. Well, I have got all kinds of questions. I
2128 | am not sure what they have to do with the merger, but I am
2129 | just trying to be a little bit clearer on how this industry
2130 | fits together.

2131 | Somebody help me if I am leaving out somebody. You have
2132 | got pharmaceutical companies, you have got plans. Those are
2133 | the insurers, right, or self-employed--self-insured
2134 | employers, right?

2135 | Mr. LECH. Payers.

2136 | Mr. WATT. Payers. You have got independent pharmacies.
2137 | That is Mr. Lech. You have got chain pharmacies. That is
2138 | Mr. Wiesner and CVS and Rite Aid and--

2139 | Mr. SNOW. Walgreens.

2140 | Mr. WATT. Walgreens. You have got PBMs, and you have
2141 | got customers.

2142 | Mr. SNOW. You also have big box pharmacies. Walmart,
2143 | Target, Costco.

2269 guideline, not only merger guidelines, but a remedies
2270 guideline, along with the Department of Justice, and so they
2271 can look at some divestiture issues in an appropriate
2272 context. But it is very detailed about when they can look
2273 and what the implications of divestiture might be for the
2274 merged entity, yes.

2275 Mr. WATT. Mr. Gustafson, what is your take on the
2276 divestiture question I raised before? And then I am going
2277 stop and yield back.

2278 Mr. GUSTAFSON. I think it is certainly something that
2279 the FTC should look at. I mean, what makes this potential
2280 combination a concern is the fact that they do have the
2281 mail-order operations and the specialty pharmaceuticals,
2282 because it increases the leverage they have in the
2283 marketplace. And so I think it is certainly an option that
2284 the FTC ought to explore. But I think that you heard that
2285 they are not interested in this merger if they have to be
2286 divested of those services.

2287 Mr. WATT. Can they explore it, Ms. Kanwit?

2288 Ms. KANWIT. I have a response to that. Specialty is
2289 really critical, as you just heard Mr. Paz and Mr. Snow
2290 comment. I mean Teva just came out with a multiple sclerosis
2291 drug which would cost upwards of 42-, \$45,000 a year. We are
2292 talking very, very expensive drugs. One of things PBMs do
2293 that the FTC has found is drive down costs by negotiating