A majority of the Commission has voted to close the investigation of ESI’s acquisition of Medco. I cannot support this action. In my view, the Commission had reason to believe that the acquisition violated Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act. In reaching this conclusion, my guiding principle is the Congressional intent underpinning the Clayton Act Section 7. As the D.C. Circuit reminded us in *Heinz*,¹ Section 7 “does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the merger create an appreciable danger of [such consequences] in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for.”²

This $29 billion merger – between two of the largest three pharmacy benefit management providers – is a game changer. I have reason to believe that this merger is, in fact, a merger to duopoly with few efficiencies in a market with high entry barriers – something no court has ever approved. I therefore respectfully submit that the Commission should have filed a complaint in Federal district court seeking to enjoin the transaction pending a full trial on the merits here at the Commission.

In reaching this decision, I have reviewed and weighed the extensive evidence and econometric analysis generated by the parties as well as by the FTC staff in the course of their investigation of the proposed merger. I fully acknowledge that the evidence doesn’t all point towards the same outcome. And that is especially understandable in a case like this, concerning a market that is so involved.


² *Id.* at 719.
Pharmacy benefit management providers (PBMs) administer pharmaceutical benefits for most U.S. consumers under contracts with large health plans or directly with employers. The three largest PBM providers in the United States today are ESI, CVS Caremark, and Medco. There is a reason why ESI, CVS Caremark, and Medco refer to themselves as the Big Three. ESI is currently the nation’s leading PBM provider with 90 million covered lives, followed by CVS Caremark with 85 million, and Medco with 65 million covered lives. After the merger of ESI and Medco, the merged entity will be over five times larger than the third largest firm.

Under any definition of the market, this merger will create a highly concentrated market that should be presumed to be likely to enhance market power. In the large commercial employer market, the Big Three PBMs have a dominant market share of between 80 and 90 per cent. This acquisition would therefore increase Herfindahl-Hirschman Index (HHI) concentration levels in this market from 2,760 to 4,063, an increase of over 1,300. This market definition is consistent with the approach taken in other FTC PBM merger investigations. In 2004, the Commission found in its review of the Caremark/AdvancePCS merger that it is appropriate to “analyze the impact of the present transaction on large employers that require broad PBM service offerings on a national scope.” The Commission also found that, following that merger, there were only three “remaining independent, full-service PBMs with national scope – Medco, ESI, and the merged Caremark/AdvancePCS.”

Even if large employers are not a relevant market, the structural analysis of this merger does not change significantly. Whether the relevant market is limited to the top 100 or the top 300 commercial employers, or even in an all employer market, the combined firm would have a 45 per cent market share and the Big Three PBMs would have a combined 73 per cent market

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3 David Balto Written Testimony to the Senate Subcommittee on Antitrust, Competition Policy, and Consumer Rights, at 5 (12.6.2011).

4 *U.S. Department of Justice and Federal Trade Commission, 2010 Horizontal Merger Guidelines* §5.3.


7 *Id.*
share. The pre-merger HHI would increase from 1,939 to 2,927 post-merger, with an increase of 988. And even in an all employer market, the Big Three’s nearest competitor, Aetna, would have a market share well below 10 per cent. I also note that Aetna depends on a strategic relationship with CVS Caremark, under which the latter provides several key management and administrative PBM services to Aetna. ⁸ I sincerely wish I could agree with the majority that the PBM market will consist of at least nine significant competitors post-merger, plus a fringe. However, I am at a loss to see how any of these purportedly significant competitors can be seen as anything other than a fringe when compared to the Big Three. The numbers literally and figuratively simply don’t add up.

Unlike the majority, I cannot entirely exclude that unilateral effects are possible in light of this market structure. The diversion ratios implied by the market shares in an all employer market suggest that a not insignificant number of customers view ESI and Medco as each other’s closest competitors. Sophisticated diversion analysis done by FTC economists confirms this to be the case. In other words, it is insufficient to say, as the majority does, that unilateral effects are unlikely to result from the merger merely because the data indicate that the closest competitor for each of Express Scripts and Medco is not the other, but rather CVS Caremark. As the H& ⁺ R Block court recently found, the fact that a firm other than the merging firms may be their closest competitor “does not necessarily prevent a finding of unilateral effects.” ⁹

So I retain some discomfort about unilateral effects from this merger.

It is in the area of coordination where I believe this merger creates an appreciable danger of anticompetitive effects. The concentration levels resulting from this merger establish a prima facie case of coordinated effects under existing case law. In light of this prima facie case, the case law further teaches us that the burden falls on ESI and Medco to “produce evidence of ‘structural market barriers to collusion’ specific to this industry that would defeat the ‘ordinary

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presumption of collusion’ that attaches to a merger in such a highly concentrated market.” The majority is correct that the most plausible theory of collusion or coordinated interaction in this case is customer allocation; however, I cannot agree with the majority that the theory fails when I am confronted with real world evidence that, even today, the PBM market may be susceptible to coordination.

I find this evidence in statements made both internally and to analysts by ESI and Medco’s CEOs. The ESI CEO has made statements to his senior executive team demonstrating an effort to control competitive forces in response to an aggressive bid from another Big Three PBM. Public statements made by Medco’s senior leadership to analysts mirror the internal statements of ESI’s CEO. As recently as last year, the Medco CEO told his investors that pricing in the marketplace is “disciplined and rational for the most part” and that he would “expect that to continue in the future.” My fellow Commissioners believe that the CEO statements are ambiguous, and I recognize that reasonable minds may differ on this issue. However, looking at them in context, I believe these statements demonstrate that the market is susceptible to coordination.

These CEO statements are more troubling still in light of evidence suggesting that, absent the acquisition, Medco is positioned to play a maverick role in the marketplace. After a recent short string of high-profile lost contracts, Medco has considerable excess capacity to fill. Industry precedent shows that when large PBMs have lost a significant number of customers, they are incented to respond aggressively in the marketplace. After CVS Caremark lost several large customers during its 2009 selling season, the company rebuilt its business, albeit with a “significant decline in gross margin” – in other words, lower, more competitive, prices to employers. If past is prologue – and I believe that it is – Medco now is poised and incented to follow CVS Caremark’s example and become a maverick in this market. Just last year, the

10 H&R Block, 2011 U.S. at 106, citing Heinz, 246 F.3d, at 725.

11 Pursuant to Section 6(f) FTC Act, 15 U.S.C. §46(f), I am unable to discuss the specific contents of these internal company documents.

12 Bloomberg Transcript, Oppenheimer & Co. Healthcare Conference, at 5 (11.03.10).

13 CVS Caremark Q4 2010 Earnings Call Transcript, at 12 (2.3.2011).
Medco CEO told his investors that the company felt “great about the 2010 performance” and, going forward, he felt “very bullish about ’11, and particularly bullish about ’12. So, the story is the same for Medco, very strong growth.”\textsuperscript{14} At a minimum, it is unclear to me how the majority has become confident that Medco is not positioned to be a maverick, absent this merger.

The majority points out that customers have not expressed strong concerns about the antitrust implications of the merger. This is the fact that gives me the most pause for thought. I believe, however, that this fact may be explained by the specific dynamics of the threat to competition in this industry. In a merger likely to result in coordinated effects, customers may not always be well placed to provide evidence regarding what is in essence opaque activity – customer allocation among competitors, or at the least refraining from bidding for each other’s customers.\textsuperscript{15} Here, I believe that the likelihood of coordinated effects are sufficiently evidenced in the parties’ own statements. In a market in which the ESI CEO has already told his investors that the company “can continue to grow [its] profits in the marketplace by just competing on the clients that make sense,”\textsuperscript{16} to this Commissioner at least, it is not difficult to conceive how the post-merger duopoly could pull its competitive punches when it comes to bidding for one another’s customers.\textsuperscript{17}

I also part company with my fellow Commissioners regarding their analysis of likely, timely and sufficient entry in the PBM market. It is well understood by the Commission that

\begin{itemize}
  \item \textsuperscript{14} Bloomberg Transcript, Goldman Sachs Healthcare CEO Unscripted Conference Transcript, at 1 (01.06.2011).
  \item \textsuperscript{15} I also note the statement of Senator Kohl regarding the merger in which he remarked that “it is notable that no large employer who privately expressed concerns to us wished to testify at today’s hearing, often telling us that they feared retaliation from the large PBMs with whom they must do business.” Statement of U.S. Senator Herb Kohl on the ExpressScripts/Medco merger (12.6.2011).
  \item \textsuperscript{16} ESI Q3 2010 Earnings Call Transcript, at 5 (10.28.2010).
  \item \textsuperscript{17} I find further support for my conclusion regarding customer allocation in recent remarks given by Commission Rosch at George Mason University, in which he commented: “While we are on the subject of coordinated effects, I should say that I have always felt that some economists take too cramped a view of the anticompetitive coordinated effects that may result from a merger. An argument I often hear from economists is that as long as pricing is opaque, there is little or no danger of coordinated effects from a merger. That, however, ignores other types of coordinated effects, such as tacit customer or territorial allocation agreements output restrictions, and non-price forms of competition. Indeed, the CCC/Mitchell case involved a concern regarding customer allocation.” Remarks of J. Thomas Rosch, Comm’r, Fed. Trade Comm’n 16-17 (Feb. 9, 2011), \textit{available at} http://www.ftc.gov/speeches/rosch/110209georgemasoncartelsmergers.pdf.
\end{itemize}
large-scale entry into the PBM market is difficult. As the Commission concluded as long ago as 1998 “[t]here are substantial entry barriers” in this market, and “[e]ven if new entry were to occur, it would take a long time, during which time substantial harm to competition could occur.” The years since 1998 have not changed this conclusion. Indeed, the fact that this market has remained so concentrated since then is proof of that conclusion.

Under the Merger Guidelines, to be sufficient, entry or expansion must replicate at least the scale and strength of one of the merging parties, and entry by one or more firms operating at a smaller scale is only sufficient if such firms are not at a significant competitive disadvantage. The majority is comfortable that smaller PBM rivals have through investments reduced, if not eliminated, their historical cost disadvantage vis-à-vis the Big Three PBMs. Yet, the real world evidence suggests to me that smaller PBMs are at a significant competitive disadvantage compared to the Big Three PBMs. Significantly, the Big Three PBMs enjoy a 90 per cent customer retention rate, creating few opportunities for smaller rivals to displace their installed base. And as smaller PBM rival Catalyst told investors in its recent 10K Report “[t]he PBM industry is highly consolidated and dominated by a few large, profitable, well-established companies with significant financial and marketing resources, purchasing power and other competitive advantages that we do not have.”

The Merger Guidelines also instruct us in analyzing entry to “consider the actual history of entry into the relevant market and give substantial weight to this evidence.” The PBM industry is replete with examples of failed entry. Each of the five largest U.S. health insurance companies has attempted to develop a PBM. Two of these insurance companies – WellPoint and Aetna – have sold or outsourced their PBMs to the Big Three, and thus are no longer truly

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20 See e.g. the statement from Medco CEO Mr. Snow: “we had $20 billion of renewals last year, and we renewed virtually all of it, with 99-plus retention rate.” Bloomberg Transcript, Goldman Sachs Healthcare CEO Unscripted Conference, at 5 (01.06.2011).
21 CatalystRX 2010 Form 10-K, at 20 (emphasis added).
22 Horizontal Merger Guidelines §9 (emphasis added).
independent competitors. Once again, because past is prologue, this evidence cannot be ignored. While I admire UnitedHealth’s optimism in re-entering the PBM market, I find myself agreeing with Judge Collyer in *CCC/Mitchell* when she observed that “[t]he mere fact that new entrants and fringe firms have an intent to compete does not necessarily mean that they are significant competitors capable of replacing lost competition.”23 The fact of the matter is that with an infinitesimal PBM market share today, I fear that UnitedHealth is— to quote Judge Collyer— “an ant to an elephant”24 compared to the soon-to-be Big Two PBMs.

Along with Chairman Leibowitz, I supported a consent order placing some limitations on the ability of the merged firm to engage in certain forms of exclusionary conduct, which would have at least helped provide some counterbalance to the barriers that create a strong presumption against timely and sufficient entry and repositioning. Unfortunately, even this limited relief was not palatable to some of my fellow Commissioners, and so did not materialize.

In sum, the legal presumption against this merger is overwhelming and is not, in my view, sufficiently rebutted by evidence regarding competitive effects or entry. As the D.C. Circuit observed in *Heinz*, “[a]s far as we can determine, no court has ever approved a merger to duopoly under similar circumstances.”25 The parties seek to overcome the *Heinz* presumption by proffering efficiencies, but these efficiencies are for the most part not cognizable and, in any event, are insufficient to rebut the presumption. As the *Heinz* court explained, in a highly concentrated market characterized by high barriers to entry, the parties opposing a preliminary injunction must provide “proof of extraordinary efficiencies” in order to rebut the presumption of anticompetitive effects.26 I find no such proof here.

The majority of the Commission believes this merger-to-duopoly will not have anticompetitive effects. I call on the Commission to demonstrate that the majority’s hypothesis


24 *CCC Holdings*, at 87.

25 *Heinz*, at 717.

26 *Id.*, at 720.
is true: three years from now, the Commission should conduct a thorough analysis of this industry to determine if prices to employers in fact have gone down. While I sincerely hope that I am wrong about the effects of this merger, I believe – with deep sadness and concern – that will not prove to be the case.

After examining the totality of the evidence – the market structure, the data, the statements of executives of the merged parties and other testimony, the fact that Medco would be poised to play a maverick in this market, the lack of entry capable of replicating the scale of competition lost through this merger, and the lack of efficiencies to overcome the presumption of anticompetitive effects – I respectfully dissent from the Commission’s decision to close this investigation.