

**Express Scripts Sued by Anthem and Shareholders
 (Part One of a Two-Part Series)**

The *Pharmacy Benefits Management* (PBM) sector of the healthcare industry may soon experience substantial shifts in market power, propelled in large part by recent lawsuits implicating one of the largest PBM organizations, *Express Scripts, Inc.* (ESI). On March 21, 2016, *Anthem, Inc.* (Anthem) filed suit against ESI, alleging the ESI breached conditions in the *Amended Restated Pharmacy Benefit Management Services Agreement* (Agreement) between the companies related to the negotiation of “*competitive benchmark pricing*” for PBM services and products, which Anthem alleges amount to a \$13 billion difference between current rates and market rates.¹ Upon receiving news of the Anthem-ESI lawsuit, shareholders of ESI filed suit against the PBM giant, claiming that ESI misrepresented its relationship with Anthem and that ESI’s lawsuit with Anthem led to a “*precipitous decline*” in ESI’s stock, causing economic damages to shareholders.² These two lawsuits may have broader effects within the sector, as:

- (1) Anthem, ESI’s largest client in terms of revenue,³ may switch from ESI to another PBM organization;
- (2) Anthem may internalize its PBM functions, calling into question the value of a PBM organization’s negotiating power with pharmaceutical drug manufacturers;⁴ and,
- (3) Calls for transparency in the negotiation process between a PBM entity and drug manufacturers may increase.⁵

This two-part *Health Capital Topics* series will examine the PBM industry, the recent lawsuits filed against ESI, and the ramifications of such lawsuits for both ESI and the PBM industry as a whole. This first installment will discuss the background of the PBM industry and the recent litigation surrounding ESI.

Generally, PBM organizations provide services for the processing and paying of prescription drug claims.⁶ PBM organizations often work on behalf of health insurance companies, and negotiate drug prices with pharmaceutical manufacturers by managing the payor’s *formulary*, i.e., “*a list of drugs to be covered on an individual’s insurance plan.*”⁷ As part of managing the *formulary* of a payor, PBM organizations “*...promise to generate cost ‘savings’ accrued during the PBM’s separate negotiations in which it negotiates rebates from*

drugmakers...”⁸ Other services provided by these organizations include:

- (1) “[*P*]erforming drug utilization reviews”;
- (2) “[*C*]ontracting with a network of pharmacies”;
- (3) “[*O*]perating mail order pharmacies and mail order claims”;
- (4) “[*I*]mplementing therapy or disease management programs.”⁹

Within the PBM industry, a series of mergers and acquisitions worked to consolidate market power within a few companies.¹⁰ In 2012, ESI purchased *Medco Health Solutions, Inc.* (Medco), the then-second-largest PBM company, for \$29 billion.¹¹ Following ESI’s acquisition of Medco, Catalyst Health Solutions merged with SXC Health Solutions Corporation, rebranding the combined entity as Catamaran.¹² In 2015, Rite Aid purchased EnvisionRX for \$2 billion; and, UnitedHealth Group bought Catamaran for approximately \$12 billion.¹³ As of October 2015, the three largest PBM organizations, ESI, CVS Health, and UnitedHealth Group, held over 75 percent market share for the industry.¹⁴ Other, smaller PBM organizations include Prime Therapeutics, Humana Pharmacy Solutions, and MedImpact.¹⁵ This sort of market consolidation leads to greater leverage within the PBM sector of the healthcare industry.¹⁶ A PBM entity’s market share is important, as size is used as leverage in negotiations with manufacturers to obtain lower costs for pharmaceutical drugs.¹⁷

The degree of stimulus for potential shifts in the competitive environment within the PBM industry is likely to hinge, in large part, on the outcome of the lawsuit between Anthem and ESI. Central to the dispute between Anthem and ESI is the amount of ESI’s potential cost savings generated during the negotiation stage between ESI and pharmaceutical drug manufacturers, as Anthem’s complaint alleges that ESI charged Anthem inflated prices for drugs, and subsequently failed to negotiate in good faith to lower the inflated prices.¹⁸ Under the Agreement between ESI and Anthem, ESI was to provide various PBM services over a ten-year period, from 2009 to 2019.¹⁹ Due to the length of the contract term, the Agreement contains a periodic repricing provision to “*ensure that [Anthem] is receiving*

competitive benchmark pricing.”²⁰ Subject to this repricing provision, if Anthem determines that ESI’s pricing does not “reflect prevailing market conditions” through internal market analysis or the use of third-party consultants,²¹ “Anthem shall have the ability to propose renegotiated pricing terms to [ESI] and [Anthem] and [ESI] agrees to negotiate in good faith over the proposed new pricing terms.”²²

Approximately one year prior to the date of the lawsuit filing, Anthem alleged that the company notified ESI of alleged price inflation and sought to negotiate lower prices in order to reach competitive levels.²³ Thereafter, the lawsuit alleges that ESI failed to negotiate in good faith with Anthem by purposely delaying repricing negotiations, even after Anthem offered to pay \$3.4 billion above the competitive benchmark pricing over the ten-year term of the Agreement,²⁴ and by claiming that it held veto power over all negotiations.²⁵ In January 2016, ESI allegedly proposed to reduce its pricing for PBM services to Anthem by \$1 billion, a level equivalent to eight (8) percent of the health insurer’s initial \$13 billion reduction request to lower pricing to competitive benchmark standards.²⁶ Anthem refused the offer, and ultimately filed suit in March 2016. According to Anthem’s complaint, ESI’s charges for pharmaceutical drugs to Anthem “...now exceed[] competitive benchmark pricing by approximately \$13 billion, plus an additional approximately \$1.8 billion through the post-termination transition period” of one year.²⁷ Anthem’s complaint requests the court for either: (1) a reduction of ESI’s pricing to competitive benchmark levels and for monetary damages Anthem incurred due to ESI’s breach;²⁸ or, (2) to declare that Anthem is entitled to termination under its Agreement with ESI.²⁹

As news spread of Anthem’s allegations against ESI, a class of ESI stockholders filed a separate lawsuit against

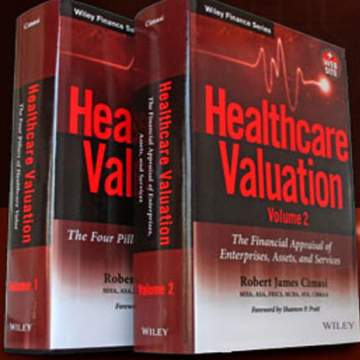
the PBM company, alleging that ESI misled investors by misrepresenting that “its relationship with Anthem remained strong,” as the insurer was claimed to be ESI’s “most important client.”³⁰ In January 2016, investors learned about the contentious relationship between Anthem and ESI when the insurer “publicly threatened to terminate its relationship with [ESI]” due to ESI’s continued refusal to negotiate competitive benchmark pricing with Anthem.³¹ The shareholders alleged that due to ESI’s refusals to negotiate with Anthem to lower inflated prices, as well as ESI’s false assurances regarding its relationship with Anthem, ESI’s market value dropped, causing its investors “significant losses and damages.”³²

The recent lawsuits filed against ESI may alter the competitive landscape in the PBM industry, as market commentators noted that Anthem may either build its own PBM organization or contract with another PBM organization as part of the fallout of its lawsuit with ESI.³³ Should Anthem, which represents 14% of ESI’s annual revenues, shift to a new PBM, ESI may lose significant market share in the PBM industry. Additionally, PBM market commentators suggested that the result of this lawsuit may call into question “the value of a PBM’s negotiating power with pharmaceutical manufacturers”³⁴ if such negotiations would not be reflected in agreements between PBMs and payors. Under this logic, the lawsuits may lead to increased demands for heightened transparency of a PBM entity’s negotiation process with drug manufacturers.³⁵ The final article of this *Health Capital Topics* two-part series will discuss the current status of each lawsuit, and discuss the potential implications of the lawsuits on ESI and the PBM industry in general.

1 “Anthem, Inc. v. Express Scripts, Inc.” Case 1:16-cv-02048-ER (S.D.N.Y., 2016), Complaint, p. 2.
 2 “Melbourne Municipal Firefighters’ Pension Trust Fund v. Express Scripts Holding Company” Case 1:16-cv-03338-UA (S.D.N.Y., 2016), Complaint for Violations of the Federal Securities Law, p. 3-4.
 3 “Anthem Price Dispute Continues To Loom Over Express Scripts” By Lauren Flynn Kelly, AISHealth, March 4, 2016, <https://aishealth.com/archive/ndbn030416-05> (Accessed 8/2/2016).
 4 “If Anthem Splits With Express Scripts, A New PBM May Emerge” By Bruce Japsen, Forbes, March 22, 2016, <http://www.forbes.com/sites/brucejapsen/2016/03/22/if-anthem-splits-with-express-scripts-a-new-pbm-may-emerge/#1da69ce614bf> (Accessed 7/20/2016); “Anthem/Express Dispute Could Shape Evolving PBM Industry” Fitch Ratings, March 22, 2016, <https://www.fitchratings.com/site/pr/1001316> (Accessed 7/20/2016).
 5 “JP Morgan 2016: Why the Anthem, Express Scripts kerfuffle could be massive headache for all PBMs” By Michael Flanagan, FirstWord Pharma, January 16, 2016, <http://www.firstwordpharma.com/node/1350578#axzz4Exokrx9o> (Accessed 7/20/2016).
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 11 *Ibid.*
 12 *Ibid.*
 13 “Walgreens Unlikely To Make Rite Aid’s PBM A Priority” By Bruce Japsen, Forbes, April 6, 2016, <http://www.forbes.com/sites/brucejapsen/2016/04/06/walgreens-unlikely-to-make-rite-aids-pbm-a-priority/#13783d7244a6> (Accessed 8/1/2016); Japsen, March 22, 2016.
 14 Johnson, October 30, 2015.
 15 “PBM Market Share, by Total Equivalent Prescriptions, 2014” Pharmacy Benefit Management Institute, <https://www.pbmi.com/2015/04/2014-pbm-market-share/> (Accessed 7/20/2016).
 16 “The PBM Squeeze: Despite acute margin pressure, retail pharmacies fight to stay in the game” By Julia Talsma, Modern Medicine, April 15, 2013, <http://drugtopics.modernmedicine.com/drug-topics/news/tags/mac/pbm-squeeze> (Accessed 8/10/2016).

- 17 “What is a ‘Pharmacy Benefit Manager?’” By Thomas Gryta, The Wall Street Journal, July 21, 2011, <http://www.wsj.com/articles/SB10001424053111903554904576460322664055328> (Accessed 8/10/2016).
- 18 Anthem, Inc., Complaint, p. 2.
- 19 *Ibid.*
- 20 *Ibid.*, p. 2, 5.
- 21 *Ibid.*, p. 5.
- 22 *Ibid.*, p. 5-6.
- 23 *Ibid.*, p. 8.
- 24 *Ibid.*, p. 14.
- 25 *Ibid.*, p. 9.
- 26 *Ibid.*, p. 13.
- 27 *Ibid.*, p. 2.
- 28 *Ibid.*, p. 40.
- 29 *Ibid.*
- 30 Melbourne Municipal Firefighters’ Pension Trust Fund, Complaint for Violations of the Federal Securities Law, p. 2-3.
- 31 *Ibid.*, p. 3.
- 32 *Ibid.*, p. 4.
- 33 Japsen, “If Anthem Splits With Express Scripts, A New PBM May Emerge,” March 22, 2016; “Bernstein Litowitz Berger & Grossmann LLP Announces Securities Class Action Suit Filed Against Express Scripts Holding Company and Certain of Its Senior Executives” PR Newswire, May 5, 2016, <http://www.prnewswire.com/news-releases/bernstein-litowitz-berger--grossmann-llp-announces-securities-class-action-suit-filed-against-express-scripts-holding-company-and-certain-of-its-senior-executives-300263666.html> (Accessed 7/20/2016).
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