

## Outlook for the Pharmacy Benefit Management Industry (Part Two of a Two-Part Series)

Recent legal actions against *Express Scripts, Inc.* (ESI) have triggered momentum for potential shifts in the competitive landscape for the *Pharmacy Benefit Management* (PBM) industry in the United States. Most notably, Anthem's March 2016 lawsuit against ESI alleging non-competitive pricing for PBM services has increased calls for heightened price transparency among PBMs, as well as a movement toward in-house PBMs among health insurers.<sup>1</sup> Despite these trends, the future of independently operated PBMs might not be entirely inauspicious. Since PBMs have the ability to privately negotiate prices with pharmaceutical manufacturers, PBMs can bargain for cheaper, sometimes exclusive, deals that smaller health insurance providers do not have the competitive position to leverage.<sup>2</sup> This second installment of the two-part *Health Capital Topics* series on the PBM industry will discuss the current state of the litigation regarding ESI, and the potential impact that such litigation may have on ESI and the PBM industry as a whole.

In March 2016, Anthem sued ESI for not providing “competitive benchmark pricing” for its services and products.<sup>3</sup> Anthem alleges that the difference between the current rates charged by ESI and the actual market rate totals \$13 billion in losses.<sup>4</sup> ESI responded with a countersuit in April 2016, which denied Anthem's allegation of not providing “competitive benchmark pricing” and claimed that Anthem “failed to negotiate in good faith” with ESI.<sup>5</sup> Anthem rebutted by filing a motion to dismiss several of ESI's counterclaims in July 2016.<sup>6</sup> The court has not delivered a ruling on such claims and motions, and litigation for the case is ongoing.

Despite the counterclaims, the lawsuit has caused dissatisfaction to percolate among various ESI stakeholders, subsequently spawning new lawsuits involving the company. As mentioned in Part One of this series, certain ESI shareholders filed a class-action suit against the PBM giant in May 2016, alleging that ESI misrepresented its relationship with Anthem, causing financial losses for the shareholders when news of the litigation caused a “precipitous decline” in ESI stocks.<sup>7</sup> Additionally, in June 2016, several participants in health plans that utilize Anthem and ESI to provide health and pharmaceutical benefits, respectively, brought a class-action lawsuit against both companies.<sup>8</sup> The lawsuit

alleged that ESI charged “above competitive pricing levels” and that Anthem failed “to adequately monitor [ESI's] activities to the detriment of [its clients],” both in violation of their fiduciary duties under the *Employee Retirement Income Security Act* (ERISA).<sup>9</sup>

Further, five pharmacies filed a separate class-action suit against ESI in August 2016, claiming that ESI illegally utilized the pharmacies' “customer information and prescription data” in order to siphon customers from the private pharmacies toward using ESI's mail-order pharmacy.<sup>10</sup> The suit alleges that if pharmacies contracting with ESI do not provide ESI with certain customer information, such as the patient's address and prescription drug order, the PBM will not reimburse the pharmacy for filling prescriptions.<sup>11</sup> Although the lawsuit states that this information is provided to ESI in order for the company to “perform the functions it has agreed to perform,”<sup>12</sup> the lawsuit alleges that ESI utilizes this information to switch customers who are using high profit medications to ESI's mail-order service without their knowledge.<sup>13</sup> The suit alleges such actions reduce pharmacy profits, as well as violates the *Health Insurance Portability and Accountability Act* (HIPAA) by using protected health information beyond the scope of its PBM functioning.<sup>14</sup> Further, the pharmacies allege that the practice of mailing prescriptions is potentially dangerous for the health of patients who consume these products.<sup>15</sup> Many medications must be stored at specific temperatures and humidity levels in order to maintain their clinical effectiveness,<sup>16</sup> which the pharmacies allege cannot often be assured through the postal service.<sup>17</sup> Exposure to non-regulated environments can render a medication ineffective, meaning that the medication would not have its intended impact on a patient's health.<sup>18</sup> Litigation in all cases is currently ongoing.

The pending lawsuits could result in several negative repercussions for ESI. First, if Anthem wins the case against ESI and is able to void their contract before its natural termination in 2019,<sup>19</sup> the PBM industry may undergo significant shifts in market share. Most notably, ESI would potentially lose approximately 14 percent of its revenue if Anthem successfully voided its PBM contract with ESI.<sup>20</sup> Second, Anthem's successful implementation of its plan to develop an in-house PBM may add a new competitor to the PBM market,

potentially fragmenting this industry.<sup>21</sup> Third, ESI's mail-order pharmacy business could face financial consequences should the court rule in favor of the pharmacies claiming that ESI illegally used client information and is in violation of HIPAA.<sup>22</sup> Considering that mail-order prescription revenue for ESI rose from \$8 billion in 2009 to \$37.6 billion in 2013,<sup>23</sup> scaling back its mail-order service could result in significant revenue losses for ESI.

The outcome of ESI's case with Anthem could foreshadow a broader trend of insurance providers moving toward in-house PBMs. Currently, UnitedHealth Group utilizes a wholly owned subsidiary, OptumRx, to provide PBM services.<sup>24</sup> Likewise, Cigna and Humana also operate their own PBMs: Cigna Pharmacy Benefit Management<sup>25</sup> and Humana Pharmacy Solutions,<sup>26</sup> respectively. If the proposed Aetna-Humana and Anthem-Cigna mergers are successful, this would create both: (1) the second and third largest health insurance providers by market share, respectively; and, (2) greater patient pools from which to operate their in-house PBMs.<sup>27</sup> Despite this trend toward consolidation, the strategy of developing in-house PBMs may be limited. First, this strategy might only be available to larger health insurance providers who can leverage their market power to negotiate lower prices from pharmaceutical manufacturers.<sup>28</sup> In this context, PBM organizations may still be needed to serve as intermediaries between smaller insurance companies and pharmaceutical manufacturers. Second, due to antitrust concerns, the *U.S. Department of Justice* (DOJ) and state attorneys general have filed lawsuits blocking the mergers,<sup>29</sup> with litigation in both cases currently ongoing. Should the lawsuits block the mergers, it is unclear whether Aetna and Anthem would possess the requisite number of covered beneficiaries to move forward with establishing their own in-house PBMs.

One reason that health insurance companies may establish in-house PBMs is to better control prescription costs.<sup>30</sup> The lack of price transparency in the PBM industry can prevent health insurance providers from deciphering if they are paying a *fair market price* for prescriptions.<sup>31</sup> Currently, the process PBMs use to set prices is largely opaque. Since a PBM often contracts with multiple pharmaceutical manufacturers and insurance companies, it can negotiate different prices with each business.<sup>32</sup> This means that clients might receive different rates for the same service(s) or product(s), potentially generating animosity between the PBM and its clients.<sup>33</sup> Although health insurers expect to be charged a higher price for a medication than the *wholesale price* the PBM negotiates with manufacturers,<sup>34</sup> that price markup varies across medications and PBMs.<sup>35</sup> Therefore, the PBM has some discretion when negotiating the price of a drug.<sup>36</sup> When faced with such arguments, PBMs have asserted that disclosing their negotiation practices would reduce a PBM's effectiveness in brokering discounts for health plans, ultimately increasing consumer costs.<sup>37</sup>

The current lawsuits against ESI suggest that changes could be on the horizon for the PBM industry. Issues with price transparency are already increasing the push for in-house PBMs. While this option may not be available to every insurance provider, it could indicate a shift in how PBMs operate if their largest clients become their competitors. This shift may increase competition among the currently operating PBMs, and may even impact how pricing and services are offered across the PBM industry in the future. Healthcare providers treating patients covered by health insurers utilizing PBMs may find it prudent to monitor continued developments in this market to determine the potential impact on provider reimbursement and patient access to affordable pharmaceutical benefits.

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