Deal Dynamics Under Antitrust Fire: Contrasting AT&T/T-Mobile and Express Scripts/Medco

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Topics

• Antitrust and politics of Express Scripts/Medco

• Contrasting AT&T/T-Mobile

• Guidance for managing regulatory risk on your next deal
Express Scripts/Medco: PBM Industry

- Medco based in Franklin Lakes, NJ
- $29 billion combination of 2 of the 3 largest U.S. pharmacy benefit managers ("PBMs")
- PBMs negotiate discounts with pharmacies and pharmaceutical manufacturers on behalf of employers
Express Scripts/Medco: Investigation

- 2nd largest announced deal of 2011 after AT&T/T-Mobile
- Investigated for 8 months by FTC and more than 30 State AGs
- Over 80 members of Congress publicly expressed concerns to the FTC; two congressional hearings
- Last-minute private lawsuit attempting to block deal
Express Scripts/Medco: Outcome

- Largest deal to close thus far in 2012
- Unconditional clearance: no remedies or divestitures, all regulators provided clearance
- Private lawsuit fails
- Deal closes on schedule
Antitrust Risk Assessment

• What is the likelihood the deal will be cleared unconditionally?

• Will divestitures be needed?

• What types of divestitures?
Antitrust Timing Considerations

- Will there be a second request?
- How long will the process take?
- What can be done to control the timing and minimize delay?
Allocating Risk: Balancing Deal Value and Deal Certainty

• Covenants (divestiture and other remedies)

• Conditions (pending litigation or investigations)

• Termination provisions (timing; reverse breakup fees)

“Medco’s proposed sale to Express Scripts comes at a high 28% premium. However, given the antitrust risk, . . . the deal agreement is marked by an interesting omission: there’s no reverse breakup fee.”
FTC Scrutiny

For Release: February 11, 2004

FTC Closes Its Investigation Into Caremark Rx’s Proposed Acquisition of Advance PCS

Transaction Involves Two U.S. Providers of Prescription Benefit Management Services

The Federal Trade Commission today announced that it has closed its antitrust investigation into Caremark Rx, Inc.’s proposed acquisition of Advance PCS, and that it has notified the companies of this decision. The transaction involves two providers of prescription benefit management (PBM) services in the United States. PBMs administer prescription benefits for most U.S. consumers under contracts with health plans or directly with employers.

As part of the FTC’s continuing effort to provide transparency in its decision-making process and to provide guidance about the application of the antitrust laws to mergers in this market, the Commission has issued a statement outlining its reasons for closing the investigation. The statement is available as a link to this press release on the FTC’s Web site.

The vote to close the investigation and issue the Commission statement was 5-0.

Copies of the Commission’s statement are available from the FTC’s Web site at www.ftc.gov. The FTC’s Bureau of Competition seeks to prevent business practices that restrain competition. The Bureau carries out its mission by investigating alleged law violations and, when appropriate, recommending that the Commission take formal enforcement action. To notify the Bureau concerning particular business practices, call or write the Office of Policy and Evaluation, Room 394, Bureau of Competition, Federal Trade Commission, 600 Pennsylvania Ave, N.W., Washington, D.C. 20580, Electronic Mail: antitrust@ftc.gov; Telephone (202) 326-3300. For more information on the laws that the Bureau enforces, the Commission has published “Promoting Competition: Protecting Consumers: A Plain English Guide to Antitrust Laws,” which can be accessed at http://www.ftc.gov/ops/emp/index.htm.
State AGs

- Over 30 State AGs joined the FTC in investigating the merger
- State AGs tend to be budget-constrained and do not have economic staff
- Impact on timing
Political Opposition

- Merger announcement spawned opposition websites, newspaper ads, radio ads, and intense lobbying
Political Opposition

Join the Fight Against the ESI Medco Merger

PBM WATCH

Stop the ESI Medco merger!

The Merger is Problematic
Advocacy Against the Merger

THE EXPRESS SCRIPTS MEDCO MERGER
Political Opposition

- Senate and House Antitrust Subcommittees held hearings

- Medco “Air Cover” strategy allowed FTC do its job
Political Opposition
Air Cover Strategy

- Meetings with key Senators, Representatives, and Congressional staff important to the FTC
- Draw on facts, not favor banks
- Focus on benefits rather than support
- Distinguish customer views from competitor views
- Ruthless message consistency – internal documents, external lobbying, and FTC/State AG advocacy
2010 Horizontal Merger Guidelines

- Test case under new guidelines
- Guidelines deemphasize market shares
- Greater focus on competitive effects
  - Head-to-head competition between merging companies
- FTC leadership: Express Scripts/Medco “highlighted areas of analysis that get greater billing in the revised guidelines”
Market Shares May Not Be Determinative

- According to the FTC:

  "An initial market share analysis indicated high concentration and suggested that this might be a very problematic transaction."

  **But...**

  "[T]he high market shares of the parties do not accurately reflect the current competitive environment."
• Medco and Express Scripts were “not particularly close competitors”
  – Express Scripts' strength was “middle-market plan sponsors and health plans”
  – Medco’s strength was “high volume, large employers”

• “The data indicate that the closest competitor for Express Scripts and Medco is CVS Caremark, not each other”

• “Very few customers interviewed by staff considered Express Scripts and Medco to be their first and second choices”
Yesterday vs. Tomorrow

- Significant changes in industry’s competitive dynamics
- UnitedHealth moving business from Medco to in-house PBM
- Smaller players investing heavily
- Healthcare reform’s effects on PBM industry
Slogans vs. Commercial Realities

**OPPOSITION**

Stop the ESI Medco merger!

“The merger will reduce the number of large PBMs from 3 to 2.”

“For large employers and unions, the big three are the only three real alternatives.”

“The market . . . consists of at least ten significant competitors.”

“The fact that many large employers currently use a PBM other than one of the Big Three.”
Costs, Benefits and Your Drug Plan

The F.T.C. approves a major merger, but competition appears to be alive and well

It seems counterintuitive, but the Federal Trade Commission has just decided that a $29 billion merger of two of the three largest companies that manage pharmaceutical benefits for employers and health plans — Express Scripts and Medco Health Solutions — would not substantially lessen competition. That judgment deserves credence because of the thoroughness of the F.T.C.’s eight-month inquiry and the willingness of the agency to oppose other mergers when the evidence warrants.

The best news to come out of the investigation is that there are a growing number of challengers to the giant pharmacy benefit managers, known as P.B.M.s, including big insurance plans that have decided to enter the business and smaller stand-alone companies that are increasingly winning business by offering customized services, such as making their pricing models more transparent.

The big players should take note.

The P.B.M.’s purchase drugs from manufacturers or wholesalers and dispense them, by mail order or through pharmacies, to enrollees in a health plan. A majority of the F.T.C. commissioners found that the market for P.B.M. services contains numerous, vigorous competitors.

Medco and Express Scripts together had $116 billion in revenue last year, and CVS Caremark had $107 billion in revenue. UnitedHealth Group and other insurers have set up P.B.M.s, and, with the smaller but growing challengers, the F.T.C. concluded that there should be as many as nine significant competitors after the merger.

The F.T.C. majority also concluded that Medco, which serves mostly large employers and health plans, and Express Scripts, which serves mostly medium-size plans, had not been close competitors. The investigation also found that the overwhelming majority of customers who buy P.B.M. services, including most of the biggest employers, thought the merger would have no effect on competition or prices or might even enhance competition.

The strongest opposition to the merger came from community pharmacies and chain drugstores that fear the merged company would have too much power to force them to accept lower prices for dispensing drugs. The F.T.C. mostly discounted these fears but added that any reduction in dispensing fees at pharmacies could benefit consumers by lowering their costs.

The pharmacy groups have filed suit seeking to block the merger. We are persuaded that the commissioners made the right choice.
AT&T/T-Mobile: Transaction

• AT&T announced plan to acquire T-Mobile for $39 billion in 2011
• Combined 2 of the nation’s 4 largest wireless providers
• AT&T promoted transaction as job-creating
• Promised to extend 4G coverage to 97% of population
• Investigated by DOJ, FCC, and State AGs
AT&T/T-Mobile: Outcome

• DOJ sued to block merger

• 7 State AGs joined DOJ suit

• Parties abandoned transaction
Political Strategy

• AT&T’s “Lobby to Success” strategy

“[W]e appreciate that 11 state attorneys general and hundreds of other local, state and federal officials are publicly supportive of our merger.”

– AT&T Statement

• Huge D.C. ad campaign promoting the merger
Political Strategy

- AT&T’s “Lobby to Success” strategy

AT&T vows to bring back 5,000 U.S. jobs if merger approved

(Reuters) - Telecommunications giant AT&T Inc, whose proposed buy of T-Mobile USA is under scrutiny by U.S. regulators, promised to bring 5,000 wireless call-center jobs back to the United States if the deal wins approval.

AT&T Is Buying Off Everyone From Gay Groups To Teachers To Support Its T-Mobile Merger

Several liberal advocacy groups with no clear stake in the proposed merger between AT&T and T-Mobile have come out in favor of the deal after receiving tens of thousands of dollars of donations from the companies in recent years.

Eliza Kleinman at Politico reports that the NAACP, the Gay and Lesbian Alliance Against Defamation (GLAAD), and the National Education Association have all announced support for the
Stubborn Facts

- Bad internal company documents
- Company data unhelpful
- T-Mobile a “maverick” competitor
- Efficiencies claims contradicted
Bad Internal Company Documents

T-Mobile USA Strategic Plan

Our heritage and future is as a challenger brand. TMUS will attack incumbents and find innovative ways to overcome scale disadvantages. TMUS will champion the customer and break down industry barriers with innovations.

Image created based on quotes in DOJ complaint.
Bad Internal Company Documents

AT&T Competitive Overview

The more immediate threat to AT&T is T-Mobile

The one-two punch of an advanced network and the backhaul required to support the additional data should be taken seriously

* Image created based on quotes in DOJ complaint.
“[A] significant portion of customers who ‘churn’ from AT&T switch to T-Mobile, and vice versa. This shows a significant degree of head-to-head competition between the two companies.”

- DOJ Complaint
T-Mobile a “Maverick” Competitor

“T-Mobile . . . places important competitive pressure on its three larger rivals, particularly in terms of pricing, a critically important aspect of competition.”

- DOJ Complaint
Efficiencies Claims Contradicted

• AT&T claimed the only way to expand its 4G coverage to 97% of U.S. population was via the $39 billion acquisition

• But AT&T’s internal documents suggested the same expansion could be completed without the merger at a cost of only $3.8 billion

FCC Questioning AT&T-Mobile Merger. Only 3.8 Billion Needed, Not Acquisition

The recent acquisition of T-Mobile by AT&T may already be complete on paper, but it’s not finalized until the FCC says so. Today, the FCC began to dig deeper into AT&T’s interest in T-Mobile, starting with evidence. The FCC requested a justification on their $39 billion buyout of T-Mobile when only $3.8 billion is needed to complete their...
Antitrust Risk-Shifting: Reverse Break Fee

- Selling companies face the potential losses of key employees and customers

- Thus, deals can be won or lost in the agreement’s risk-shifting provisions

- AT&T paid $4 billion reverse breakup fee
# A Tale of Two Transactions

<table>
<thead>
<tr>
<th>Merger Involves Leading Firms</th>
<th>Express Scripts / Medco: #2 and #3</th>
<th>AT&amp;T / T-Mobile: #2 and #4</th>
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<tbody>
<tr>
<td>Public Opinion</td>
<td>Vocal congressional opposition. Outspoken opposition from industry advocacy groups.</td>
<td>Mixed reviews from Congress and advocacy groups. Public support from groups that received AT&amp;T largesse.</td>
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<tr>
<td>Risk Assessment</td>
<td>Front-loaded, data driven evaluation showed difference in competitive focus and changing competitive landscape.</td>
<td>Track record of successfully concluding acquisitions based on local market analysis and acceptable level of divestitures.</td>
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<tr>
<td>Strategy</td>
<td>Cooperate with FTC and states. Coordinate PR and legal strategies to enable FTC to make decision based on facts and law.</td>
<td>Aggressive PR and lobbying strategy. Adversarial posture with FCC. Apparent failure to communicate with DOJ.</td>
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<td>Result</td>
<td>FTC and state AG clearance without conditions.</td>
<td>DOJ and states sued to block transaction. FCC opposed transaction. Parties abandoned deal.</td>
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Managing Regulatory Risk on Your Next Deal

- Strategic deals can get done
- Don’t be scared by market shares
- Changes in industry dynamics can create new opportunities
- Self-critical, up-front risk assessment is essential
- Timing and risk-shifting provisions in merger agreements are crucial
Dealing with Regulators

• Marketplace realities trump slogans and rhetoric

• Arm agencies with factual evidence to help them refute political opposition
  – Likely a more effective strategy than attempting to lobby your way to success

• Get control of your data and tell your data-grounded story