From Both Whistleblower cases

MEDCO SEC FILINGS: LONG-STANDING, INTENTIONAL "SERVICE FEE" FRAUD

664. Prior to its 2012 merger with PBM Defendant Express Scripts, Medco Health Solutions was the largest independent PBM operating in the US.

665. As part of a 2004 settlement of a prior Qui Tam case and a related (OIG) Corporate Integrity Agreement, Medco provided unique and instructive financial disclosures in its 2003-2011 SEC 10-K filings regarding the burgeoning "service fee" scheme.

666. For the fiscal years 2003 through 2011, Medco disclosed both overall brand manufacturer rebates, as well as the amount of rebates the PBM "retained". Furthermore, Medco provided disclosures regarding its "service fee" contractual arrangements with drug manufacturers.

667. The 10-K disclosures indicate that Medco quickly and secretly began shifting away from a "manufacturer rebate"-based compensation model towards a primarily "service fee"-based model in the private insurance market upon the 2003 passage of the Medicare Part D legislation. Furthermore, the vast majority of the transition was complete by 2006 when Part D was started.

668. In 2003, Medco "retained" $1.6 billion, or 54% of all brand rebates from manufacturers, which accounted for more than 100% of Medco's gross profits for the year.

669. By 2006, Medco "retained" only $670 million, or 20% of all brand rebates, which accounted for only 28% of surging gross profits for the year.

670. In 2011, Medco's retained a similar magnitude of rebates ($757 million), which represented only 16% of exploding operating profits for the year.

671. For Medco overall, gross profits rose 60% from $1.5 billion in 2003 to $2.4 billion in 2006 and then nearly doubled in the next five years to $4.6 billion in 2011, despite a sharp drop in the contribution from "retained" manufacturer rebates.

672. These financial disclosures bluntly indicate that Medco was completely dependent upon manufacturer rebates for its profits at the time of Part D's legislative passage. In fact, in 2003, with “retained” manufacturer rebates, the remainder of Medco's operation, inclusive of its generic business, was unprofitable in 2003.

673. As the largest PBM in the US in 2003 by a wide margin, these Medco financials infer that manufacturer rebates were the dominant profit driver throughout the PBM industry in 2003.

674. In 2003, as the market leader, Medco had by far greatest generic procurement negotiating leverage and the most efficient mail order operations.

675. If Medco's operations in 2003, excluding “retained” brand rebates, were unprofitable, smaller PBMs were either similarly dependent on manufacture brand rebates for profits or were minimally profitable at best.

676. Medco attributed its remarkable business transformation and profit growth between 2003 and 2011 to gains in its generic business.

677. Medco stated in its 2004 10-K: "the impact on profitability from the increase in generic utilization, particularly in mail order, more than offsets the impact from lower rebate retention on brand name prescriptions."

678. Medco suggested a wider range of profit contributors in its 2006 10-K, stating: “the gross margin effect of overall higher rebate sharing levels is partially mitigated by other elements of pricing including higher claims processing, administrative and other client service fees, higher generic dispensing rates, and increased specialty volumes.”

679. In its final 2011 10-K prior to the Express Scripts merger, Medco reiterated its ongoing dependence on generics for profits: “Our future success will be largely dependent on our

ability to drive mail-order volume and increased generic penetration rates in light of the significant brand-name drug patent expirations expected to occur over the next several years.”

680. Medco never mentioned in its SEC filings a shift in compensation mechanisms for brand drugs from manufacturers towards “service fees” or any impact from Medicare Part D.

681. Based upon its own financial disclosures, Medco's claims regarding accelerating generic profitability between 2003 and 2011 would appear to be mathematically impossible.

682. Excluding “retained” brand drug rebates, Medco reported an astounding increase in its annual gross profits from a -$71 million loss in 2003 to a $3.9 billion profit in 2011.

683. With Medco's generic segment apparently unprofitable in 2003, the implied vast transformation in this business segment would appear unfeasible.

684. In reality, the only viable explanation for this profit transformation is the clandestine shift from a PBM compensation model based on brand manufacturer rebates to one based upon “service fees”, as a direct result of the Medicare Part D financial incentives.

685. With the increased brand “spread” and “rebate” transparency requirements in Part D, “service fees” became the only mechanism for large-scale “hidden” payments between drug manufacturers and PBMs. Medco secretly began the transition in the private insurance sector prior to the 2006 enactment of Part D, without any public disclosure.

686. There can be little doubt that other PBMs followed the lead of the market leader, Medco, in this secretive profit transition.

687. The Medco financial disclosures indicate a well-orchestrated, intentional systemic collusive scheme that has caused unimaginable public harm, now more than 13 years in duration.

688. Medco disclosed that its manufacturer "service fee" contracts with drug manufacturers were calculated as a "percent of revenues", inclusive of price increases.

689. Several of Medco's 10-Ks, including the 2006 document states: “Our contracts with manufacturers provide us with rebates and fees for prescription drugs through our mail-order and retail pharmacy networks, discounts for prescription drugs we purchase and dispense from our mail-order pharmacies, and performance-based fees associated with certain biopharmaceutical drugs. Rebates and fees are generally calculated as a percentage of the aggregate dollar value of a particular drug that we dispensed, based upon the manufacturer’s published wholesale price for that drug”.

690. In closing, the information in this Complaint all points to a singular conclusion. Namely, that the vast “inexplicable” price inflation for the Defendant brand MS drugs, and many others in the US marketplace, has been caused by this intentional, long-standing, secretive and collusive “service fee” scheme. After five-plus years of intensive investigation, we conclude that there is no other viable explanation.