

*The New York Times***DealB%k**

Edited by Andrew Ross Sorkin

JULY 22, 2011, 4:35 PM

Confronting Antitrust Issues in a Giant MergerBy *STEVEN M. DAVIDOFF*

Express Scripts's \$29.1 billion planned acquisition of Medco Health Solutions is a good illustration of how parties negotiate when there is significant antitrust risk.

There are three giants in the prescription drug sector: Express Scripts, CVS Caremark and Medco. A combined Medco-Express Scripts would control at least 30 percent or more of the drug benefit administration market. The next largest competitor would be CVS Caremark, with 17.8 percent of that market, according to data cited by The St. Louis Post-Dispatch. The big three's dominance is particularly acute in the large plan market for prescription drug services, where they reportedly control up to 80 percent of the market.

The key to this deal's completion will be how the Federal Trade Commission reacts when it reviews the transaction for compliance with federal antitrust laws.

The Medco and Express Scripts strategy in dealing with the F.T.C. regulator can be gleaned from the pairs' acquisition agreement filed on Friday.

In every acquisition agreement, the parties address how they will deal with regulatory authorities. When there are particular antitrust problems, the parties will then set out more specifically what the buyer needs to do to obtain antitrust clearance.

A common provision addressing these issues is a "hell or high water clause." This is a provision that obligates a buyer to take all steps to satisfy regulatory authorities, including making divestitures.

But a pure hell or high water, which requires any amount of divestitures (even the whole company), is rare. Instead, the buyer is typically required to take some measure of

5.8(e) of the merger agreement):

- 1) The divestiture of one mail-order dispensing facility anywhere except St. Louis, where Express Scripts is based.
- 2) The divestiture of specialty pharmacy dispensing or infusion facilities having a net book value no more than \$30 million outside of Indianapolis.
- 3) The divestiture of contracts that generated collectively earnings before interest, taxes, depreciation and amortization, or Ebitda, not in excess of \$115 million during the last 12 months.

The agreement also states that in no event shall Express Scripts be required to divest more than 35 million individual prescription drug claims.

The big give here is the third one. The term “contracts” is really a reference to contracts for national prescription plans, a big area of concern given the 80 percent concentration rate of the big three. The disposition of contracts generating \$115 million in Ebitda could be significant and constitute assets worth more than than \$1 billion.

The question is whether this will be enough. There is no termination fee on the deal for failure to obtain antitrust clearance. In other words, if the parties fail to obtain antitrust clearance, they each owe the other nothing. The provisions above, however, serve as their own hook with which Medco can push Express Scripts to complete this transaction.

To obtain such clearance, Express Scripts and Medco are likely to argue to the F.T.C. that there is a fourth big competitor in the market: UnitedHealthcare. This means that the prescriptions benefit business is really shrinking from four to three providers, not three to two. And the issue of national prescription plans can be dealt with by dispositions according to the acquisition agreement.

In addition, Express Scripts and Medco will focus their arguments to the public framed by the debate over rising health care costs. The two will argue that the combined company could lower government health care costs, and health care costs generally, by using its size to push down drug prices, particularly for generic drugs. Given the peculiarities of the health care industry and the real need for cost savings, the parties' argument may be a good one.

No doubt Express Scripts and Medco think this deal could take a while to close. The transaction has a drop-dead date, which can be extended to Oct. 22, 2012, and I would not be surprised if this transaction takes up to a year to clear, if it does so. A drop-dead date is a date in the merger agreement after which either party can terminate the transaction.

Finally, a few other points of interest about the transaction.

The merger agreement has a termination fee of \$950 million if a competing bidder comes along. This is unlikely because CVS Caremark is the only other real possible bidder, and CVS's acquisition of Caremark is now generally viewed as a failure. CVS almost certainly would not want to get even bigger and double-down on its bad acquisition. In fact, the Express Scripts-Medco deal can be seen as a real loss for CVS because it now means that CVS cannot auction Caremark off to Express Scripts or Medco. The attempt to forestall this auction is another driver of this deal.

Also, Express Scripts and Medco are required to have their shareholders approve the transaction. If shareholders of one company reject the deal, it will have to reimburse the other company for its expenses up to \$225 million.

Express Scripts has obtained a commitment letter for \$14 billion in financing for the transaction. This is a significant number and shows that the credit markets remain robust. Further illustrating the strength of the credit markets, Express Scripts did not negotiate a provision in the acquisition agreement to terminate the deal if its financing fails. This is despite a yearlong wait for completion of the transaction. Or maybe it is the financing banks here — Credit Suisse Group and Citigroup — who are the optimistic ones this time around, since they also bear the financing risk for that long a period.

The transaction is also good news for Jim Woolery, JPMorgan Chase's new co-head of North American mergers and acquisitions, who came over from Cravath, Swaine & Moore back in January. He is working on this transaction as well as AT&T's planned acquisition of T-Mobile, the two largest deals of the year.

Steven M. Davidoff, writing as The Deal Professor, is a commentator for DealBook on the world of mergers and acquisitions.