

Of Note: Cardinal Health is a supplier of CVS/Caremark.

# FORTUNE

## New troubles for CVS Caremark

By Mina Kimes, writer  
March 23, 2010: 10:01 AM ET

(Fortune) -- When two of America's biggest health-care companies -- CVS and Caremark -- merged in 2007, regulators barely noticed. Now lawmakers, customers, and pharmacists are accusing it of using its combined clout to pressure consumers to use CVS. Besides an FTC probe, Fortune has learned, several states are investigating the \$99 billion company, which some people hope will be broken up. "I think there's potential for an actual divestiture," says David Balto, a former FTC policy director who now works with the National Community Pharmacists Association (NCPA). CVS Caremark says it is not aware of the states' investigation, but the Florida attorney general's office confirmed the inquiry.

At the heart of the controversy is CVS Caremark's unique business model. Both a drugstore chain and a pharmacy benefits manager, the company sells medicine through its own stores while simultaneously reimbursing rival chains through its PBM. Critics say that arrangement poses a conflict of interest, because PBMs are supposed to be drugstore agnostic -- and Caremark, they say, can't help but favor CVS.

"It gives them an unfair, distinct advantage," says one Michigan-based independent pharmacist who declined to be named for fear that Caremark, which regularly audits pharmacies, would subject his business to harsher checks. "They're forcing business there, which is something they said they wouldn't do," he alleges.

When CVS CEO Tom Ryan proposed the merger in 2006, he promised that the resulting business would be "agnostic to where the consumer fills their prescription." But several independent pharmacists -- members of the NCPA -- told Fortune that Caremark redirects its members into CVS stores by offering lower co-payments there, automatically filling prescriptions at CVS, and, in some cases, telling them outright to go to CVS.

### **Pushed to fill prescriptions at CVS**

Caremark patients have also complained about diminished choice. Sylvia Everett, a retired teacher in Aransas, Texas, says she was upset when her 99-year-old mother wasn't allowed to fill a Nexium prescription at the local pharmacy she has used for decades after being discharged from the hospital last fall. "I called Caremark. They told me, you can get it at CVS," she says. "But there's not one in my town."

Most of the prescriptions reportedly redirected to CVS are part of an initiative called Maintenance Choice. When health plans sign up for that program, their members can -- or must -- procure batches of certain drugs with cheaper co-payments through Caremark's mail-order service or CVS pharmacies. "We've added another layer of options," says CVS Caremark's Castel. She says there are also cases in which specialty drugs can be filled only at CVS.

Some rival pharmacists say Caremark exploits its access to their patients' information by sharing it with CVS pharmacists, who then call those patients at home, instructing them to pick up drugs at CVS. "They tell them: 'For your safety, you should only be using one pharmacy,'" says one California-based community pharmacist.

Castel says there is a medical imperative behind the calls. "There are advantages for the patient in having all of their prescriptions in one pharmacy," she says.

The spokeswoman points out that Caremark works with some 64,000 pharmacies, only 7,000 of which are CVS stores. "We have nothing to hide, and we're cooperating fully with the commission's inquiries," she wrote in an email.

### **Could Caremark be forced to divest?**

The FTC's inquiry, which began in August, is likely to heat up after Julie Brill, a former Vermont assistant attorney general, was confirmed as an FTC commissioner. Brill helped lead a multi-state coalition that brought lawsuits against drug companies and major PBMs, including Caremark, in the mid-2000s. The suits -- which accused the PBMs of practices like pocketing rebates -- won hundreds of millions of dollars in damages.

If the FTC finds CVS Caremark's behavior to be anticompetitive, it may order the company to institute a firewall. There is recent precedent: The Commission announced in February that it would require such a wall between PepsiCo ([PEP](#), [Fortune 500](#)) and Pepsi Bottling Group and PepsiAmericas, which bottle and distribute drinks sold by Pepsi's competitors. Or it could be forced to sell CVS altogether.

CVS Caremark ([CVS](#), [Fortune 500](#)) also faces legislative challenges. Ohio is considering a bill that would ban PBMs with relationships with retailers -- like CVS Caremark -- from exploiting those ties, and a Mass. representative recently introduced a bill in Congress that would prohibit the Federal Employees Health Benefits Program (FEHBP), currently one of CVS Caremark's biggest customers, from doing business with a PBM owned by a retailer.

The loss of the FEHBP as a client would weigh heavily on Caremark, which has not been performing as well as investors would like. When CEO Tom Ryan announced in November that Caremark had lost \$4.8 billion in 2010 contracts, CVS' stock dropped 20% that day.

### **Next steps for health care**

Therein lies the irony of CVS's regulatory troubles: The merger hasn't been a success. Ryan insisted in November that the losses had nothing to do with the integrated business model, citing one-off events and marketing missteps. Helene Wolk, a Sanford Bernstein analyst, thinks Caremark's woes are separate from the integrated business model. "If you look at its performance versus Medco (MHS, [Fortune 500](#)), Caremark has been a laggard for three years," she says. "There was an issue here, which I think was about management execution or lack thereof."

Ryan seems bent on fixing that. Caremark's former president, Howard McLure, retired and was replaced in December by Per Lofberg, the former chairman of Merck-Medco, a drugmaker-PBM hybrid that was formed in the early '90s. CVS recently announced plans to invest more money in its PBM. Most analysts seem to have faith in a turnaround, or at least view the stock as undervalued: CVS Caremark currently has 18 buy ratings and zero sells.

But at least one analyst, BMO Capital Markets' Dave Shove, thinks CVS Caremark's problems can't be fixed so easily. Shove says Caremark's salespeople have been too focused on touting their relationship with CVS -- making them an easy target for competitors. "I could easily imagine selling against this," he says.

While numerous companies in other industries have tried to buy PBMs over the years, says Shove, none have succeeded. For example, Merck-Medco broke itself up in 2003, a few years after the FTC told it to change its business practices. Shove expects CVS Caremark to take a similar route. "PBMs are the unruly foster children of health care. They have been adopted by many different kinds of organizations -- drug companies, managed care, hospitals," he says. "Much like unruly foster kids, they get sent back out."