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Health Care

## No Labor of Love at Medco

By [Melissa Davis](#)

Senior Writer

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Just when **Medco** (MHS:NYSE) finally cured a stubborn legal headache, it's starting to feel serious labor pains.

The giant pharmacy-benefit manager announced a long-awaited settlement with the federal government when posting strong first-quarter results on Friday. The PBM also insisted that it continues to operate normally despite a labor dispute that, union officials claim, could threaten a big chunk of the company's business.

"The threat is going to turn into reality," Jack Hammond, an international representative for United Steelworkers, told *TheStreet.com* on Friday. "Let's just put it this way. Union clients represent 25% of Medco's business -- and a lot of those companies are very friendly with us."

United Steelworkers has been fighting against benefit changes for 500 employees who have been locked out of Medco's big facility in Las Vegas and replaced with temporary workers. The union plans to oppose similar changes at two other Medco facilities -- employing more than 1,000 workers total -- when contracts expire there later on this month.

Meanwhile, after years of legal wrangling, Medco has opted to settle a high-profile federal complaint that was headed for a courtroom trial this summer.

The company took a charge of \$163 million to cover its plan to settle allegations that it improperly switched, shorted and canceled prescriptions for federal employees. Under terms of the proposed agreement, the company will admit no wrongdoing, even though it has already changed many of its business practices as a result of the investigation. In addition, the company must operate under a so-called corporate integrity agreement -- meant to prevent future misconduct -- that has yet to be inked.

"I definitely think it's interesting that the company has been in this 'deny, deny, deny' mode," says Derek Brandt, an attorney for SimmonsCooper who assists corporate clients who rely on PBMs. "Then on a Friday morning, a month before the trial, they suddenly announce a settlement."

Still, Medco's strategy seemed to work. At times, some people had predicted that the company could pay as much as \$1 billion to put the sweeping case behind it. But as the years dragged on -- swamping a particularly busy prosecutor's office with work -- some feel that the company simply outlasted its accusers.

Patrick Burns, a spokesman for Taxpayers Against Fraud, suggested as much when discussing the settlement with *TheStreet.com* on Friday.

"The truth of the matter is that Medco threw up every technical roadblock it could in this case," says Burns, whose organization endorses whistleblower lawsuits like those used in the Medco case. "Just the discovery process was exhausting. ... You have to remember that corporations have almost unlimited resources to fight these cases -- especially when they involve a core part of their business."

Yet Burns feels like the government accomplished some major goals in the end.

"When the PBM industry first started receiving a lot of scrutiny -- due almost entirely to whistleblower lawsuits -- it resisted transparency and said it was accountable to no one," Burns recalls. "Now, the industry has increased transparency and a grudging agreement that it is at least accountable to its clients.

"That is a sea transformation. Whether it's enough remains to be seen."

In the meantime, Medco's stock bounced 4.5% to \$53.03 on news of the favorable settlement and solid quarterly results. The stock is now trading near the midpoint of its 52-week range.

### Signs of Change

Medco itself has acknowledged one major change in the industry.

CEO David Snow said on Friday that state governments, in particular, have stepped up their calls for transparency. However, he said that Medco has actually benefited from that shift -- by offering its clients transparent business models -- and pointed to the company's recent string of state contract wins as evidence.

Medco announced a slew of new business when releasing its latest quarterly results. Notably, Medco signed on \$2.4 billion worth of new commercial business -- up from \$700 million during the company's last update -- for 2006. Much of that new business came from existing clients who have expanded through acquisitions. But another \$4.7 billion worth of contract renewals, including a giant Blue Cross deal, came on top of that.

Wachovia analyst Matthew Perry, among others, seemed to marvel at those results.

"Can you talk about the competitive environment?" he asked. "Because it seems like you guys are winning more business than some of the other large PBMs."

Despite reports to the contrary -- with big employers seeking alternatives to traditional PBMs -- Snow himself reported no major changes from a year ago. Even now, he said, the big PBMs continue to land most of the industry's business. However, he added, Medco has "been fortunate" to win more state contracts than most.

But looking ahead, union officials have suggested, Medco's good fortune could run out. On Friday morning, Hammond was preparing for a meeting with the union president designed to push Medco clients into canceling their contracts with the company. After that, Hammond said, the union will begin negotiating on behalf of 500 Medco employees in Tampa Bay on Monday, and another 800 Medco employees in Columbus before the month comes to an end.

All of those employees, he said, will be seeking the same guarantees that have been denied by Medco in Las Vegas.

"We will not waive our rights to bargain" for health care benefits, he insisted. "This could have a major impact (on operations). These are three major facilities for Medco. Let's see if they lock out these other employees, too."

For its part, Medco has painted a prettier picture. For starters, the company claims that only 10% of its "direct contracts" are with unionized organizations. Moreover, it says that it has "reached out (and) talked to all of them."

Thus, the company foresees no major threats ahead.

"Clearly, the union is putting very inaccurate facts out there," Snow said on Friday. But "I'm still fairly optimistic that we will get (everything) resolved."

