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NO. 50348-4-II

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**COURT OF APPEALS, DIVISION II  
OF THE STATE OF WASHINGTON**

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EXPRESS SCRIPTS, INC.,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

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**DEPARTMENT OF REVENUE'S ANSWER TO AMICUS CURIAE  
BRIEF OF OPTUMRX, INC.**

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## I. INTRODUCTION

Amicus curiae OptumRx, Inc. (OptumRx) argues that taxpayers may exclude from the state's gross receipts tax amounts "received [by the taxpayer] to satisfy a client's obligation to a third party." Amicus Br. at 1. That is not a correct statement of the law. There is no general exclusion or deduction for amounts "received to satisfy a client's obligation." Rather, the business and occupation (B&O) tax applies broadly to all gross income of a business, without deduction for expenses and labor costs. Although it is possible in some limited circumstances for a taxpayer to exclude from the tax amounts received from its customers or clients, the taxpayer must satisfy well-established requirements. Among other requirements, a taxpayer must prove that it is acting *solely* as an agent with respect to funds received from the client and paid over to a third party.

Express Scripts concedes that it does not meet the requirements for excluding amounts received while acting solely in the capacity as an agent, and the undisputed evidence in the record confirms its concession. OptumRx offers no legally supportable alternative reason for excluding amounts received by Express Scripts from the B&O tax. Consequently, its claim that Express Scripts is entitled to exclude a large portion of its gross income should be rejected.

## II. ARGUMENT

### A. Express Scripts Is Not Entitled to Exclude From Gross Income the “Ingredient Costs” It Receives From Its Clients.

One of the issues Express Scripts raises in this case concerns a core feature of the B&O tax, namely that the tax is imposed on a taxpayer’s “gross income of the business” without deduction for business expenses. RCW 82.04.220(1). The Legislature made this clear by defining “gross income of the business” as “the value proceeding or accruing by reason of the transaction of the business . . . *without any deduction on account of the cost of tangible property sold, the cost of materials used, . . . or any other expense whatsoever paid or accrued . . .*” RCW 82.04.080 (emphasis added).

The term “value proceeding or accruing” is defined broadly as the consideration “actually received or accrued.” RCW 82.04.090. As our Supreme Court explained over fifty years ago, “[b]roader language could hardly be devised to convey the idea implicit in [these] definitions that the tax applies to everything that is earned, received, paid over to or acquired by the seller.” *Engine Rebuilders, Inc. v. State*, 66 Wn.2d 147, 150, 401 P.2d 628 (1965). Under this broad definition, amounts a business actually receives constitute gross income even if the payment is characterized as a

“reimbursement” for costs incurred by the business. *Pullman Co. v. State*, 65 Wn.2d 860, 867, 400 P.2d 91 (1965).

OptumRx, in its friend of the court brief, provides only a perfunctory (and largely incorrect) analysis of this key issue. *See* Amicus Br. at 10-15. When correctly analyzed, the “ingredient costs” Express Scripts seeks to exclude from its gross income clearly fit within the plain meaning of these key statutorily-defined terms.

**1. Amounts Express Scripts refers to as “ingredient costs” are properly included as gross income of the business.**

The amounts Express Scripts refers to as “ingredient costs” represent consideration it actually received for performing services under the terms of its contracts with its PBM clients. Pursuant to its PBM contracts, Express Scripts agrees to perform a variety of services pertaining to a client’s prescription drug benefit program. For instance, under its contract with King County, Express Scripts agrees to establish and maintain a “network of Participating Pharmacies to serve [plan] Members” as well as processing claims for “Covered Drugs dispensed by a Pharmacy.” CP 1242-43. Express Scripts summarizes the services it typically provides in Exhibit D to its contract with King County:

[Express Scripts] offers its clients, either directly or through its subsidiary companies, a variety of services related to the management of prescription drug benefits. The specific services provided to each client . . . typically include claims

processing and adjudication, pharmacy network contracting and management, formulary development and management, rebate management and administration, trend management, and clinical program development and fulfillment.

CP 1269.<sup>1</sup>

Express Scripts' contracts with plan sponsors are independent from those it negotiates with retail pharmacies providing prescription drugs to plan members. CP 1026; CP 1269. In its dealings with pharmacies, Express Scripts acts as a principal, not as an agent for its PBM clients. Express Scripts remains "solely responsible" for managing the client's drug benefit program, and it "assume[s] the credit risk of [its] clients' ability to pay for drugs dispensed by [the] network pharmacies." CP 1297. In short, the business Express Scripts engages in includes all aspects of managing its clients' drug benefit programs, including the obligation to contract with and pay pharmacies for drugs dispensed to plan members.

A large part of the consideration Express Scripts receives from plan sponsors under the terms of its agreements is roughly equivalent to

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<sup>1</sup> A more legible copy of Exhibit D to the Express Scripts contract with King County is attached as Appendix A. The document, among other things, answers OptumRx's claim that the Department "fails to address how the reimbursements for payments made to pharmacies constitute consideration for activities performed by" Express Scripts. Amicus Br. at 12. As explained in Exhibit D, the "activities performed by" Express Scripts encompass much more than merely processing claims. Those activities also include managing the agreements it enters into with retail pharmacies to dispense prescription drugs to plan members, from which Express Scripts receives gross income equal to the amount it bills and receives from the pharmacies.

the amount it has independently contracted to pay to retail pharmacies for the cost of drugs dispensed to plan members. *See* CP 756 (diagram showing \$45 “Ingredient costs” charged and received from plan sponsor and \$44 “Ingredient costs” paid to retail pharmacy). This is by design. An essential aspect of Express Scripts’ business model is to deal directly with retail pharmacies on its own behalf and not as an agent of its clients. It does this so it can generate and retain the net “margin” between what it charges its clients and what it pays network pharmacies. CP 1297; *see generally* Brittany Hoffman-Eubanks, *The Role of Pharmacy Benefit Managers in American Health Care: Pharmacy Concerns and Perspectives: Part 1*, Pharmacy Times (Nov. 14, 2017) (this margin, also called the “pharmacy spread,” is available because PBMs like Express Scripts negotiate separate contracts with network pharmacies and plan sponsors “with neither typically being privy to the other’s contract”).<sup>2</sup>

For this reason, Express Scripts’ and OptumRx’s reliance on *Walthew, Warner, Keefe, Arron, Costello & Thompson v. Department of Revenue*, 103 Wn.2d 183, 691 P.2d 559 (1984), is misplaced. *See* Appellant’s Br. at 25; Amicus Br. at 10, 14. Unlike the circumstances in *Walthew*, Express Scripts is not paying for costs that remain the sole

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<sup>2</sup> Available online at <<https://www.pharmacytimes.com/news/the-role-of-pharmacy-benefit-managers-in-american-health-care-pharmacy-concerns-and-perspectives-part-1>> (last viewed June 4, 2018).

obligation of the client. *See Walthew*, 103 Wn.2d at 185 (law firm's practice was to sign contracts with its clients confirming the client's obligation to pay all costs involved in litigation). Instead, Express Scripts is paying costs that are its own responsibility under its contracts with plan sponsors and retail pharmacies.

The circumstances here are similar to those in *St. Joseph General Hospital v. Department of Revenue*, 165 Wn. App. 23, 267 P.3d 1018 (2011). In that case, the Board of Tax Appeals granted summary judgment to the Department, concluding that St. Joseph General Hospital could not exclude from its gross income amounts it paid to Northwest Emergency Physicians (NEP) for physician services NEP performed under its contract with the Hospital. *Id.* at 26. Although the Hospital was not itself licensed to provide physician services, it was not prohibited from contracting with NEP to perform the services.

From these facts, this Court upheld the Board of Tax appeals, explaining that when a taxpayer contracts to pay over amounts owed to a third-party service provider, the taxpayer may not exclude those amounts from its gross income unless it acts "in an agent's capacity to pass payment from the patient through to [the third-party provider]." *Id.* at 28 (quoting *Washington Imaging Servs., LLC v. Dep't of Revenue*, 171 Wn.2d 548, 552, 252 P.3d 885 (2011)). Moreover, no agency relationship

exists unless the patient was obligated to pay the third-party service provider. *Id.* at 29. In concluding that the necessary agency relationship did not exist, this Court noted that St. Joseph Hospital took on the obligation to pay emergency room physicians for their services. *See id.* (“There is no indication in the record that *patients* had an obligation to pay *the third-party service provider . . .* for the services rendered. In fact, . . . *only* St. Joseph had payment obligations to [the service provider]”). Consequently, the Hospital was not acting as an agent for NEP and could not exclude any of the amounts it paid to NEP from its gross income of the business. *Id.* at 30.

Here, as in *St. Joseph General Hospital*, no agency relationship exists. Because Express Scripts has taken on the responsibility to pay retail pharmacies as part of its PBM business activity, those payments are a cost of its business and are not deductible under the B&O tax code. RCW 82.04.080(1); *Washington Imaging*, 171 Wn.2d at 557; *St. Joseph Gen. Hosp.*, 165 Wn. App. at 29.

**2. Express Scripts meets none of the requirements for pass-through treatment.**

The B&O tax does not apply to amounts “that merely ‘pass through’ a business in its capacity as an agent.” *Washington Imaging*, 171 Wn.2d at 560 (quoting *City of Tacoma v. Wm. Rogers Co., Inc.*, 148

Wn.2d 169, 175, 60 P.3d 79 (2002)). Amounts received by a taxpayer can qualify for exclusion from taxation as a pass-through payment only when: (1) the payments are customary reimbursements for advances made by the taxpayer to procure a service for the client; (2) the payments involve services that the taxpayer did not or could not render; and (3) the taxpayer is not liable for the advances or payments it made to third parties other than as an agent of the client. *Id.* at 561-62 (discussing requirements outlined in WAC 458-20-111).<sup>3</sup> The third element has two components. The taxpayer must prove both that the payment received from the client was made pursuant to an agency relationship and that the taxpayer's liability to pay the funds to a third party constituted solely agent liability. *Wm. Rogers*, 148 Wn.2d at 177-78. Where, as here, the taxpayer independently assumes the liability to pay the third party, the payments it receives from its client are not excluded from taxation "even if the taxpayer uses the payments to pay costs related to the services it provided to its client." *Id.* at 178 (citing *Walthew*, 103 Wn.2d at 189).

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<sup>3</sup> As the Supreme Court recognized in *Washington Imaging*, WAC 458-20-111 is an interpretive rule that explains when amounts received from a client and paid to a third party constitute the taxpayer's "gross income" within the meaning of RCW 82.04.080. The rule's purpose is to distinguish non-taxable "pass through" amounts from amounts that constitute "value proceeding or accruing by reason of the business engaged in" under RCW 82.04.080. See *Washington Imaging*, 171 Wn.2d at 560 (reaffirming concept of Rule 111 as explained in *City of Tacoma v. Wm. Rogers Co.*).

The “ingredient costs” Express Scripts receives from its clients do not qualify for exclusion from taxation under these standards. First, the amounts pertain to Express Scripts’ business of managing its clients’ drug benefit programs, not reimbursement for advances made to procure services from a third party. Second, the amounts do not involve services that Express Scripts did not or could not render. Express Scripts did, in fact, perform pharmacy network contracting and management services, dealing directly with retail pharmacies. Finally, the amounts were not received pursuant to an agency relationship, and Express Scripts’ payments to retail pharmacies were not based solely on agent liability. Instead, the payments were based on Express Scripts’ own contractual obligation to pay retail pharmacies for drugs dispensed to covered members. CP 1297. Express Scripts voluntarily undertook that obligation, and the costs it incurred became part of its costs of doing business.

Express Scripts meets none of the elements required for pass-through treatment of the payments it receives from its business activities. For this reason, it is not surprising that it concedes that it does not qualify for pass-through treatment under the standard set out in *Washington Imaging*. See App. Reply Br. at 7 (referring to the Department’s discussion of *Washington Imaging* and *William Rogers* as a “straw man argument”).

**B. Amicus Curiae Misunderstands the Facts and Misapplies the Law.**

Throughout this litigation, Express Scripts has made it clear that it is not acting as an agent and is not entitled to deduct amounts it pays to retail pharmacies under a standard pass-through theory. *See* App. Reply Br. at 5 (“there is no agency relationship and ESI never purported to rely on Rule 111”). Apparently concerned with Express Scripts’ litigation strategy, OptumRx contends that Express Scripts *is an agent* and that the company can obtain the benefit of pass-through treatment under an orthodox application of that concept. OptumRx is incorrect.

**1. The “pass-through” argument raised by amicus curiae is not properly before the Court.**

Express Scripts makes two novel arguments in this appeal to support its effort to exclude “ingredient costs” from gross income. First, it argues that the holding in *First American Title Insurance Company v. Department of Revenue*, 144 Wn.2d 300, 27 P.3d 604 (2001), establishes an alternative method of qualifying for pass-through treatment that requires none on the elements discussed in *Washington Imaging* and *William Rogers*. *See* Appellant’s Br. at 25-27. Second, Express Scripts argues that it should be taxed like “credit card processors and merchant banks,” which it contends is somehow different from the tax treatment applied to other businesses. Appellant’s Br. at 27. OptumRx does not

present any argument pertaining to either of these claims. Instead, it argues that the gross income at issue qualifies for pass-through treatment under a standard pass-through analysis; a contention that Express Scripts has expressly disavowed. Consequently, OptumRx is making an argument that is not before the Court in this appeal.

It is well established that appellate courts “will not address arguments raised only by [an] amicus.” *Citizens for Responsible Wildlife Mgmt. v. State*, 149 Wn.2d 622, 631, 71 P.3d 644 (2003). “The case must be made by the parties litigant, and its course and the issues involved cannot be changed or added to by friends of the court.” *Long v. Odell*, 60 Wn.2d 151, 154, 372 P.2d 548 (1962) (internal quotations and citation omitted). Under this long established practice, issues raised only by amici “are their own” and are not suited for resolution in an appeal involving different issues. *City of Lakewood v. Koenig*, 160 Wn. App. 883, 886-87 n.2, 250 P.3d 113 (2011).

Furthermore, this appeal involves the grant of the Department’s motion for summary judgment. CP 986. Consequently, RAP 9.12 applies. Under that rule, this Court will only consider “evidence and issues called to the attention of the trial court.” Here, Express Scripts admitted during the summary judgment proceedings that it was not acting as an agent, which is one of the necessary requirements for pass-through treatment

under the standard set out in *Washington Imaging* and *William Rogers*. See CP 912. Amicus OptumRx is not permitted to argue for a different outcome in this case based on its contention that Express Scripts *was an agent* when the facts presented to the trial court were just the opposite.

**2. No evidence supports amicus curiae’s new argument.**

Even if amicus curie could raise new arguments in this appeal—which it cannot—its claim that Express Scripts meets the requirements for pass-through treatment is belied by the evidence. Most notably, the undisputed evidence confirms that Express Scripts is acting as a principal on its own account when dealing with retail pharmacies, not as an agent.

The burden of establishing an agency relationship is on the party asserting its existence. *Hewson Const., Inc. v. Reintree Corp.*, 101 Wn.2d 819, 823, 685 P.2d 1062 (1984).<sup>4</sup> An agency relationship is not presumed. *Blodgett v. Olympic Savings & Loan Ass’n*, 32 Wn. App. 116, 128, 646 P.2d 139 (1982). Nor does it come into existence out of thin air. Rather, facts or circumstances must “establish that one person is acting at the instance of and in some material degree under the direction and control of

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<sup>4</sup> In this case neither party contends that Express Scripts is an agent. Rather, only OptumRx is making that claim.

the other.”” *Washington Imaging*, 171 Wn.2d at 562 (quoting *Matsumura v. Eilert*, 74 Wn.2d 362, 368-69, 444 P.2d 806 (1968)).<sup>5</sup>

The uncontroverted evidence in the record confirms that Express Scripts is not receiving funds in the capacity of an agent. *See, e.g.*, CP 1269 (Express Scripts “contracts for its own account with retail pharmacies to dispense prescription drugs to members of the clients for whom we provide PBM services”); CP 1297 (Express Scripts takes on the obligation to pay retail pharmacies and assumes the credit risk of its client’s ability to pay for drugs dispensed to plan members). The company readily admits it is not acting as an agent. Reply Br. at 5. Yet OptumRx contends that Express Scripts is acting in the capacity of an agent when it pays retail pharmacies for drugs dispensed to plan members. Amicus Br. at 8, 9. However, OptumRx overlooks key facts pertaining to the services Express Scripts performs and the manner in which it accounts for the revenue it receives in exchange for its services.

Express Scripts is one of the largest PBM companies in North America, generating roughly \$100 billion in gross revenue annually on a consolidated basis. *See Mary Anne Pazanowski, Express Scripts,*

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<sup>5</sup> The element of control is the “crucial factor” to establish agency. *O’Brien v. Hafer*, 122 Wn. App. 279, 283, 93 P.3d 930 (2004). Without control, the relationship is one of a buyer and seller of services, for example, not a principal and agent. *Uni-Com Northwest, Ltd. v. Argus Publishing Co.*, 47 Wn. App. 787, 797, 737 P.2d 304 (1987).

*Pharmacies Collide Over Network Cuts*, Bloomberg BNA (March 2, 2017) (although recently overtaken by CVS as the nation's largest PBM, Express Scripts still had total gross revenue in 2016 of \$100.3 billion).<sup>6</sup> Express Scripts provides PBM services under contracts it negotiates with plan sponsors. Its contract with King County is typical. *See* CP 1221. That agreement specifies that Express Scripts will “supply the goods and Services at the price and on the terms and conditions” set out in the contract, and that the County will “pay [Express Scripts] the Contract price [p]rovided herein for the supply of the goods and [s]ervices and the performance of the covenants set forth herein.” CP 1222. The specific services Express Scripts agreed to provide to the County are detailed in Section 5 of the contract and include “set up of the prescription drug program,” “pharmacy benefit management services,” “claims processing,” and “formulary support and rebate management.” CP 1242-44.

Express Scripts charges the County for these services, as detailed in Exhibit A of the contract. CP 1248. Express Scripts bills the County weekly, and accounts for the total amount it receives as gross revenue on its accounting records. CP 1275. Express Scripts explains this accounting treatment in note 1 to its 2007 financial statements, which provides a

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<sup>6</sup> The article is available on-line at <<https://www.bna.com/express-scripts-pharmacies-n57982084674/>> (last viewed March 31, 2018).

summary of the company's "significant accounting policies." CP 1295-1297. In accordance with generally accepted accounting principles, Express Scripts has determined that the total payments it receives must be recognized as revenue. *See* CP 1297 (discussing accounting principles set out in Emerging Issue Task Force bulletin no. 99-19). This includes amounts it bills and receives from its clients for "ingredient costs." *Id.*

Consistent with the financial accounting treatment discussed above, Express Scripts also includes the total payments it receives from its clients as gross income on line 1 of its federal U.S. Corporate Income Tax Return. CP 1301. For the 2007 fiscal year, the total gross income Express Scripts received from its PBM clients was \$9,409,364,181. *Id.* This was the exact amount the company reported on the apportionment worksheet it provided to the Department during the audit. CP 1306. The Department accepted this amount as correct and used it to compute the company's Washington apportioned gross income. *See* CP 1308 (audit schedule showing "Amount Subject to Apportionment" of \$9,409,364,181).

OptumRx offers no meaningful discussion of these undisputed facts, and makes no effort to explain why Express Scripts, if truly acting as an agent for the plan sponsors it serves, would nonetheless be required under generally accepted accounting principles to report all of the amounts it bills and receives from its clients as gross income. By contrast, Express

Scripts provides a candid explanation for its accounting treatment. In earlier briefing, Express Scripts explained that Financial Accounting Standards Boards guidance requires it to “report its receipts on a gross basis” because it was “*acting as a principal on its own account rather than as an agent for other parties to the PBM transaction.*” CP 912 n.17 (emphasis added).

Additionally, one of the primary “indicators of gross revenue” under generally accepted accounting principles is whether the business receiving the payment “is the primary obligor in the arrangement.” CP 763. “Representations (written or otherwise) made by a company during marketing and the terms of the sales contract generally will provide evidence as to whether the company . . . is responsible for fulfilling the ordered product or service.” *Id.*

Here, Express Scripts’ public statements and its contracts with plan sponsors clearly demonstrate that Express Scripts is responsible for fulfilling all aspects of its PBM services, including contracting with and paying pharmacies for the prescription drugs dispensed to plan members. OptumRx simply ignores this fact when it contends that Express Scripts

“acts under the control of [plan sponsors], and thus the payment of the claim is an obligation of the health plan, not the PBM.” Amicus Br. at 9.<sup>7</sup>

**3. Express Scripts is not an agent under Department of Health administrative rules.**

Eschewing the evidence in the record, OptumRx argues that Express Scripts is an agent acting on behalf of “insurers” under recently reissued Department of Health administrative rules. Amicus Br. at 7-9. The argument is flawed because it overstates the impact of the Department of Health’s rules on the B&O tax issue raised in this appeal and because it conflates the concept of a “third-party administrator” with an “agent.”

Contrary to OptumRx’s argument, the Department of Health administrative rules it cites do not require prescription drug benefit plan sponsors to contract directly with retail pharmacies. Nor do they prohibit companies like Express Scripts from undertaking the obligation to pay retail pharmacies for drugs dispensed to plan members. *See generally* WAC 284-170 (current Health Benefit Plan Management chapter of the WAC); *see also* former WAC 284-43 (2010) (rules pertaining to “Health

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<sup>7</sup> OptumRx relies on paragraph 5-3A of Express Scripts’ contract with King County to support its claim that Express Scripts is under the “ultimate control” of the County. Amicus Br. at 9. But that clause of the contract pertains only to “claims processing” and provides that, in the event of a dispute, King County “shall have the final responsibility for all decisions *with respect to coverage . . . and the benefits allowable under the Plan*, including determining whether any rejected or disputed claim shall be allowed.” (Emphasis added). The clause does not give King County control over Express Scripts’ contractual arrangement with retail pharmacies. To the contrary, Express Scripts “contracts for its own account with retail pharmacies.” CP 1269.

Carriers and Health Plans” applicable during the periods at issue in this appeal).<sup>8</sup> The purpose of the Health Benefit Plan Management rules adopted by the Department of Health is to “create minimum standards for health plans and ensure consumer access to the health care services promised in these health plans.” WAC 284-170-110. These rules prevent insurers and plan sponsors from absolving themselves of liability by hiring third parties to perform services on their behalf. But that important health care regulatory policy is not a legal basis for Express Scripts to avoid B&O tax on amounts it bills and receives from plan sponsors.

Although the rules cited by OptumRx do not directly support its argument, OptumRx asserts that they establish that PBMs operating in this state are “merely third-party administrators that operate as agents to assist the carriers in administering their obligations to . . . make reimbursement payment to . . . providers [of] health care services provided to members.” Amicus Br. at 8. The argument presumes that a third-party administrator is the legal equivalent of an agent. Not so. Third-party administrators often operate as independent contractors, not agents. *See, e.g.*, WAC 200-100-

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<sup>8</sup> Under current Washington law, PBMs such as Express Scripts are expressly permitted to pay retail pharmacies for drugs dispensed to plan members. *See* RCW 19.340.010(6)(a)(ii) (defining “pharmacy benefit manager” to include a person “that contracts with pharmacies on behalf of an insurer, a third-party payor, or the prescription drug purchasing consortium” to “[p]ay pharmacies or pharmacists for prescription drugs or medical supplies”).

020(25) (defining “third-party administrator” as “an independent association, agency, entity or enterprise which, through a contractual agreement, provides” enumerated services); WAC 200-110-020(25) (same). And it is extremely unlikely that the Department of Health intended to create by rule a circumstance where third-party administrators hired by health plans are “agents” of the health plans by operation of law.

Here, Express Scripts operates independently of plan sponsors when dealing with retail pharmacies. CP 1297. Thus, even if Express Scripts is “merely” a third-party administrator, it is an independent administrator that has taken on the obligation of “contract[ing] for its own account with retail pharmacies” and paying those pharmacies for drugs dispensed to plan members. CP 1269. Nothing in the Department of Health’s rules preclude Express Scripts from assuming this role, and the “ingredient costs” it incurred are its own costs of doing business and are not deductible under the B&O tax code. RCW 82.04.080(1).

**4. Express Scripts’ liability to pay network pharmacies was not solely agent liability.**

In *Washington Imaging*, the Supreme Court reaffirmed that a necessary condition for claiming pass-through treatment is proof that the taxpayer’s liability to pay a third party was “*solely agent liability*.” *Washington Imaging*, 171 Wn.2d at 562. That key requirement is missing

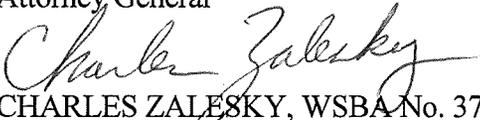
here. Instead, the payments Express Scripts seeks to exclude from its gross income were based on Express Scripts' own contractual obligation to pay retail pharmacies for drugs dispensed to covered members. Thus, even if Express Scripts could be considered the "agent" of plan sponsors as a result of administrative rules adopted by the Department of Health, the company would still not meet the necessary requirements for pass-through treatment because its liability to pay retail pharmacies is not "solely agent liability." *Id.*; see also *Wm. Rogers*, 148 Wn.2d at 177-78 (when a taxpayer assumes the liability to pay a third party, the payments it receives from its client are not excluded from taxation).

### III. CONCLUSION

OptumRx advances a legal theory that is not supported by the facts or the applicable law, and that has been expressly disavowed by Express Scripts. Consequently, this Court should reject the argument.

RESPECTFULLY SUBMITTED this 20th day of June, 2018.

ROBERT W. FERGUSON  
Attorney General

  
CHARLES ZALESKY, WSBA No. 37777  
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**PROOF OF SERVICE**

I certify that I served a copy of this document, via electronic mail, per agreement, on the following:

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I certify that I served a copy of this document, via U.S. Mail, postage prepaid, through Consolidated Mail Services, on the following:

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Chauncey A. MacLean  
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I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 20th day of June, 2018, at Tumwater, WA.

  
\_\_\_\_\_  
Carrie A. Parker, Legal Assistant

# **APPENDIX A**

**CONTRACT #323555**

*As a result of RFP #05-007*

**To provide  
KING COUNTY PHARMACY BENEFITS PROGRAM**

Between

**KING COUNTY  
821 2nd Avenue  
Seattle, WA 98104-1598, USA**

And

**EXPRESS SCRIPTS, INC.  
13900 Riverport Drive  
St. Louis, MO 63043**

This Contract is made and entered into this 21st day of April, 2006 between KING COUNTY, a home rule charter county of the State of Washington, and EXPRESS SCRIPTS, INC., a for-profit corporation incorporated under the laws of the State of Delaware.

The parties hereby agree to the terms and conditions herein, effective on the date noted above.

<b>COMPANY &amp; CONTACT PERSON'S NAME</b>	<b>TELEPHONE NUMBER</b>	<b>FAX NUMBER</b>
Contractor/ Vice President Thomas Mahowald	(952) 837-5118	(952) 837-4676
King County/ Project Manager Kerry Schaefer	(206) 263-5051	(206) 684-1925
King County/Buyer Ovita Bonadie	(206) 684-1055	(206) 684-1470

## EXHIBIT D

### FINANCIAL DISCLOSURE TO CONTRACTOR'S PBM CLIENTS

Contractor is a provider of pharmaceutical benefits management ("PBM") and other related services to thousands of client groups including managed care organizations, health insurers, employer groups, third party administrators and government entities. Contractor's subsidiary companies, some of which provide services related to supporting our PBM services, include Contractor Mail Pharmacy Service, Inc., CuraScript Pharmacy, Inc., Contractor Specialty Distribution Services, Inc., and Phoenix Marketing Group, LLC. This disclosure provides an overview of the revenue sources that allow us to deliver competitive pricing arrangements to our clients.

Contractor offers its clients, either directly or through its subsidiary companies, a variety of services related to the management of prescription drug benefits. The specific services provided to each client are documented under the Pharmacy Benefit Management Agreement, or other similar agreement, with our client. Contractor's PBM services typically include claims processing and adjudication, pharmacy network contracting and management, formulary development and management, rebate management and administration, trend management, and clinical program development and fulfillment. Some of our clients also utilize our mail service pharmacy to provide their members with convenient access to safe and affordable prescription drugs through home delivery. In addition to the administrative fees paid to us by our clients for these core PBM services, Contractor derives revenue from other sources, including arrangements with pharmaceutical manufacturers and retail pharmacies. Some of this revenue relates to utilization of products by members of the clients for whom we provide PBM services.

Network Pharmacies – Contractor contracts for its own account with retail pharmacies to dispense prescription drugs to members of the clients for whom we provide PBM services. The rates paid by Contractor to these pharmacies differ from one network of pharmacies to the next, and among pharmacies within a network. Contractor generally contracts with clients to be paid an ingredient cost for drugs dispensed in a given retail network selected by the client at a uniform rate that applies to all pharmacies in the selected network. Thus, where the rate paid by a client exceeds the rate negotiated with a particular pharmacy, Contractor will realize a positive margin on the applicable prescription. The reverse may also be true, resulting in negative margin for Contractor. In addition, when Contractor receives payment from a client before payment to a pharmacy is due, Contractor retains the benefit of the use of the funds between these payments.

Manufacturer Rebates and Associated Administrative Fees – Contractor contracts for its own account with pharmaceutical manufacturers to obtain rebates attributable to the utilization of certain prescription products by individuals who receive benefits from clients for whom we provide PBM services. Rebate amounts vary based on the volume of utilization as well as the benefit design and formulary position applicable to utilization of a product. Contractor often pays all or a portion of the rebates it receives to a client based on the client's PBM services agreement. Contractor retains the financial benefit of the use of any funds held until payment is made to a client. In connection with our maintenance and operation of the systems and other infrastructure necessary for managing and administering the rebate process, Contractor also receives administrative fees from pharmaceutical manufacturers participating in the rebate program discussed above. The services provided to participating manufacturers include making certain drug utilization data available, as allowed by law, for purposes of verifying and evaluating the rebate payments. The administrative fees paid to Contractor by manufacturers for participation in the rebate program do not exceed 3.5% of the AWP of the rebated products.

Pharmacy Dispensing and Distribution – Contractor has several licensed pharmacy subsidiaries, including our specialty pharmacies. These entities purchase prescription drug inventories, either directly from manufacturers or from drug wholesalers, for dispensing to patients or for distribution

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Contract 323555 Express Scripts, Inc., For Pharmacy Benefits

to physician offices. Purchase discounts off the acquisition cost of these products are made available by manufacturers in the form of both up-front and retrospective discounts. Such discounts are not considered part of the rebates paid to Contractor by manufacturers in connection with our rebate program. While rebates are directly attributable to the utilization of pharmaceutical products by individuals who receive benefits from clients for whom we provide PBM services, product acquisition price discounts are based on a pharmacy's inventory needs and, in the case of specialty pharmacies, the performance of related patient care service obligations. The purchase discounts obtained by these facilities are not based on any client's benefit design. When an Contractor subsidiary pharmacy dispenses or distributes a product from its inventory, the purchase price paid for the dispensed product, including applicable dispensing fees, may be greater or less than the pharmacy's acquisition cost for the product net of purchase discounts. In general, our pharmacies realize an overall positive margin between this net acquisition cost and the amounts paid for the dispensed products.

Pharmaceutical Program Services – Our specialty pharmacies, including CuraScript Pharmacy, Inc. and Contractor Specialty Distribution Services, Inc., receive compensation from manufacturers for their administration of programs related to the distribution of certain pharmaceutical products. This compensation is based on the fair market value of the services provided and is unrelated to the drug formulary development process or drug utilization applicable to the clients for whom we provide PBM services. Examples of these services include (i) administering patient assistance programs for indigent patients; (ii) administering product sample distribution programs; and (iii) dispensing prescription medications to patients enrolled in clinical trials.

Data Reporting – Contractor sells certain data resulting from its PBM and pharmacy services to healthcare data aggregators and similar entities from time to time. We do not sell any data unless we are permitted to do so by the terms of our client contract and by applicable patient privacy laws. In addition, as a condition to receiving access to certain products, a specialty pharmaceutical manufacturer often will require a purchasing specialty pharmacy to report selected information to the manufacturer regarding the pharmacy's service levels and other de-identified dispensing-related data with respect to patients who receive such manufacturer's product. A portion of the discounts or other compensation made available to our specialty pharmacies represents compensation for such reporting. All such reporting activities are conducted in compliance with applicable patient privacy laws.

Other Pharmaceutical Manufacturer Services – Phoenix Marketing Group, LLC specializes in the provision of sample fulfillment, sample accountability, alternative sampling, direct mail fulfillment, and literature fulfillment services for pharmaceutical manufacturers. Because its services involve only warehousing and fulfillment-related functions, this subsidiary entity does not review products clinically and it never uses, sells or has access to Contractor's client or member information. Compensation paid to Phoenix Marketing Group, LLC by pharmaceutical manufacturers is based on the fair market value of such services, as established most often through an "RFP" process, and any such compensation is unrelated to the drug formulary development process or drug utilization applicable to the clients for whom Contractor provides PBM services.

July, 2005

**THIS EXHIBIT REPRESENTS CONTRACTOR'S CURRENT FINANCIAL POLICIES. THIS EXHIBIT MAY NOT BE REVISED OR MODIFIED. CONTRACTOR MAY PERIODICALLY UPDATE ITS FINANCIAL DISCLOSURES TO REFLECT CHANGES IN ITS BUSINESS PROCESSES.**

**ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION**

**June 20, 2018 - 8:44 AM**

**Transmittal Information**

**Filed with Court:** Court of Appeals Division II  
**Appellate Court Case Number:** 50348-4  
**Appellate Court Case Title:** Express Scripts, Inc., Appellant v State of WA Dept. of Revenue, Respondent  
**Superior Court Case Number:** 15-2-00693-0

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