

**PROPOSED ACQUISITION BY OMNICELL, INC ("OMNICELL") / MTS MEDICATION TECHNOLOGIES, INC. ("MTS") OF SURGICHEM LIMITED ("SURGICHEM")**

**SURGICHEM'S INITIAL SUBMISSION TO THE COMPETITION AND MARKETS AUTHORITY**

**A Introduction**

- 1 This initial submission is intended to supplement the arguments presented by Omnicell and its subsidiary, MTS, in their initial submissions to the Competition and Markets Authority ("**CMA**") in respect of their proposed acquisition of Surgichem from BUPA Care Homes (CFG) plc ("**Bupa**"). It should therefore be read in conjunction with the submission made by Omnicell and MTS, which contains a more comprehensive explanation as to why the proposed transaction may not be expected to result in a substantial lessening of competition ("**SLC**") on any market in the UK for the supply of goods or services. Bupa and Surgichem have reviewed a non-confidential version of the Omnicell/MTS submission and agree with the arguments and evidence set out therein.
- 2 This submission is structured on the basis proposed by the Competition Commission ("**CC**") in its letter dated 14 March 2014. In particular:
- (a) Section B provides an overview of Surgichem's background, including its history and details of its organisational and financial structure;
  - (b) Section C provides information relating to the transaction, including the commercial rationale and timeline for the negotiations;
  - (c) Section D contains an analysis of the relevant markets and competitive conditions within those markets (supplementing the arguments made in the Omnicell/MTS submission);
  - (d) Section E contains an appraisal of barriers to entry and expansion, which draws on Surgichem's experience of the market;
  - (e) Section F contains an assessment of the counterfactual insofar as it relates to Surgichem; and
  - (f) Section G contains an overview of why the proposed transaction may not be expected to result in a SLC (supplementing the arguments made in the Omnicell/MTS submission).

**B Information on Surgichem**

- 3 SurgiChem Limited was established in 1989 by a community pharmacist as a means to supply a new medication management system to the community and care home markets. It was incorporated into the Bupa portfolio when Bupa acquired the care homes business of its parent company, Care First, in 1997.
- 4 Surgichem has grown its business incrementally and experienced an average of approximately 17% growth year on year for the past seven years (at a rate of approximately £800,000 per year). A large part of this growth is attributable to sales of Nomad Clear, which was launched in 2005 and now achieves average sales of £[REDACTED] per annum. In 2008 Surgichem launched its trolleys, which now have sales of £[REDACTED] per annum. Surgichem has also increased its customer numbers from approximately [REDACTED] in 2005 to [REDACTED] now (predominantly due to sales of Nomad Clear to independent pharmacies).

- 5 Surgichem supplies a range of adherence packaging and adherence support products for use by domiciliary and care home patients, comprising:
- (a) adherence packaging products, which are plastic-based and are sold under the brand name Nomad. Further details of Nomad Clear, which is a disposable weekly pack specifically designed for use by community patients, and Nomad Concise, which is designed for the administration of medication in care homes, can be found on Surgichem's website.<sup>1</sup> These are available in different sizes to accommodate different dosages or volumes of medication;
  - (b) the components required to enable pharmacies to fill and use the adherence packaging, including medication administration record sheets (MARS), metal hoops for trolleys, platens and rollers, dividers, hangers, name labels, stickers, cards, storage bags and other consumables;
  - (c) trolleys and cabinets, which are used for the safe, secure storage of medication in pharmacies, care homes and laboratories ( [REDACTED] ); and
  - (d) fridges, which are supplied to pharmacies, who in turn provide them to their care home customers ( [REDACTED] ).

6 Full details of the adherence packaging products supplied by Surgichem are set out in Annex 1 of the OFT submission and on Surgichem's website. Surgichem currently only supplies adherence packaging for solid medication. Surgichem's products include Nomad Multimed, which at the moment it is only sold for use with solid medication. Surgichem considers that it [REDACTED].  
Surgichem's sales of Nomad Multimed [REDACTED].

7 Surgichem currently employs 21 staff, most of whom are based at its head office in Stockport, where its main warehouse is also located. In 2013, Surgichem achieved turnover of approximately £7.6 million, of which:

- (a) [REDACTED] was for sales of adherence packaging ( [REDACTED] for Nomad Clear, [REDACTED] for Nomad Concise and [REDACTED] for Nomad MDS);
- (b) [REDACTED] was for sales of trolleys and cabinets; and
- (c) [REDACTED] was for sales of fridges.

Surgichem has [REDACTED].

8 One of the key points to note about Surgichem's business is that it does not have any manufacturing facilities and it is therefore entirely reliant on third party suppliers, who contract-manufacture its products. Surgichem's adherence packaging products are contract-manufactured in [REDACTED] and its trolleys and fridges are contract-manufactured in [REDACTED].<sup>2</sup> [REDACTED],<sup>3</sup> these suppliers are not exclusive to Surgichem and will

<sup>1</sup> See [http://www.surgichem.co.uk/ec\\_products.php?category=10](http://www.surgichem.co.uk/ec_products.php?category=10).

<sup>2</sup> Further details of Surgichem's suppliers, and the products they supply are set out at paragraph 6.7 of the OFT submission and question 12 of Surgichem's response to the CC's initial information request.

<sup>3</sup> Surgichem purchases seals from [REDACTED]  
[REDACTED]  
[REDACTED] therefore competitors are also able to use the seals under licence. Within the UK,

therefore remain free to supply provide products to other competing suppliers following the merger (which will not reduce the level of productive capacity available in the marketplace). Such suppliers could also increase their productive capacity with relative ease, in anticipation of supplying an increased volume.

- 9 Surgichem's business is essentially a sales and marketing operation: it purchases components from plastic thermoforming suppliers and other suppliers, stores these in its warehouse and supplies these to pharmacies for use by domiciliary and care home patients. Surgichem has been highly successful in developing and maintaining strong relationships with its customers despite the fact that it employs a small team of only three regional sales representatives and a general sales managers, who report to Mark Chadwick (Managing Director). Please see the organisation chart at Annex 5 of Surgichem's response to the CC's initial information request for full details of Surgichem's employees.
- 10 As the CMA will note from Surgichem's Management Accounts, which were provided at Annexes 22-26 of Surgichem's response to the CC's initial information request, most of Surgichem's costs relate to its [REDACTED] and its expenditure on [REDACTED] are minimal. For example, in Surgichem's management accounts for December 2013, the top three components of Surgichem's operating costs for 2013 were [REDACTED] (approximately [REDACTED]), [REDACTED] (approximately [REDACTED]), and [REDACTED] (approximately [REDACTED]).

### C Information about the transaction

- 11 Surgichem's parent company, Bupa, elected to sell Surgichem on the basis that adherence packaging is not part of its long term strategy.
- 12 The timeline for the sales process can be summarised as follows:
- (a) In April 2013 Bupa considered its options regarding Surgichem – please see the Bupa internal strategy paper provided at Annex 2 of Surgichem's response to the CC's initial information request, which indicates that Omnicell had made an approach to buy Surgichem. Mark Chadwick (MD of Surgichem) was informed by Bupa [REDACTED] that Surgichem was to be put up for sale. Discussions with Omnicell then started [REDACTED]. [REDACTED] were appointed by Bupa and the Information Memorandum (Annex 3 of Surgichem's response to the CC's initial information request) was produced in July 2013.
  - (b) As noted in the Omnicell/MTS submission, the parties signed Heads of Terms on 23 September 2013 and an electronic data room containing both commercial and financial information was opened on the same day.
  - (c) The Share Purchase Agreement ("**SPA**") for the sale and purchase of Surgichem was then signed on 6 December 2013 and the transaction was announced on 9 December 2013. Surgichem's board minutes for 2013 (copies of which were provided to the OFT at Annex 7 of Surgichem's response of 6 February 2014) do not refer to the transaction. A copy of the board minutes of Surgichem's parent company, Bupa Care Homes (CFG) Plc, approving the sale of Surgichem to Omnicell, are attached at **Annex 1**. Also attached at **Annex 2** is an extract of the minutes of Surgichem's ultimate parent company, Bupa Limited, approving the transaction.

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it is possible for seals to be produced without the patent being infringed and there are plenty of alternative

**D The relevant markets**Market definition

- 13 Surgichem has reviewed the arguments set out in the Omnicell/MTS submission on the scope of the relevant markets for the purpose of the CMA's inquiry, in terms of (a) the product market; (b) the geographic market; and (c) customer segments.
- 14 As regards the scope of the relevant product market, Surgichem agrees with the Omnicell/MTS submission that:
- (a) there are three product categories relevant to the merging parties' business activities, namely:
    - (i) adherence packaging (market 1);
    - (ii) dispensing support for pharmacies (market 2); and
    - (iii) adherence support products for patients / carers (market 3);
  - (b) since the OFT did not identify any concerns in relation to the supply of trolleys and cabinets and adherence support products to customers in the UK, only the adherence packaging market (market 1) should be of relevance to the CMA's investigation; and
  - (c) it is not appropriate to sub-divide the market further between card-based and plastic-based adherence packaging products.
- 15 As regards the scope of the relevant geographic market:
- (a) The OFT concluded that the supply of adherence packaging was UK-wide in scope on the basis that the majority of third parties who responded to the OFT's market investigation confirmed the parties' view that geographic location within the UK is not an important factor when choosing a supplier;
  - (b) There are arguments that the relevant market is broader in scope on the basis that:
    - (i) the OFT concluded that it is not necessary to manufacture products in the UK (and this is consistent with the parties' own experience);
    - (ii) there are no significant barriers for overseas suppliers of adherence packaging to enter the UK market (see section E below); and
    - (iii) one customer explained to the OFT that location within the UK was not important at all as all adherence packaging products are delivered by courier.
  - (c) On that basis, the parties submit that the CMA should (at the very least) have regard to the constraint from suppliers located outside the UK when considering the competitive impact of the proposed transaction.
- 16 As regards customer segments, Surgichem agrees with the Omnicell/MTS submission that:

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manufacturers to [REDACTED] who could manufacture seals e.g. other commercial printers, such as Labelform who previously made Surgichem's seals.

- (a) a separate customer group within the adherence packaging market can be identified by reference to large pharmacy chains which hold formal tenders in order to appoint suppliers of adherence packaging for domiciliary patients, namely (currently) the Boots and Lloyds chains and NHS Scotland. This is on the basis that the scale of the large pharmacy chains' requirements enables them, through tendering, to obtain better terms for their adherence packaging requirements (see paragraph 5.2.29 of the Merger Assessment Guidelines);
- (b) it follows that there is a separate customer group for pharmacies which do not purchase adherence packaging products by way of tender; and
- (c) it is not appropriate to segment the market further by reference to the type of end customer (i.e. according to whether the products are supplied to a care home or to domiciliary patients) since conditions of competition do not vary significantly between single-dose and multi-dose adherence packaging products.

#### Competitive conditions

- 17 As noted above, Surgichem has reviewed the arguments set out in the non-confidential version of the Omnicell/MTS submission regarding the conditions of competition in respect of the supply of adherence packaging products to each of the customer groups identified above.
- 18 Surgichem agrees with the arguments made by Omnicell/MTS in respect of the supply of adherence packaging to large pharmacy chains which purchase by way of tender, and the reasons why the proposed transaction would not result in a SLC in relation to this separate customer segment. As noted in the Omnicell/MTS submission:
- (a) Surgichem does not supply domiciliary care adherence packaging to the relevant large chains to any significant extent and does not supply such packaging at all pursuant to tenders to the large chains.<sup>4</sup> Therefore, the activities of MTS and Surgichem do not overlap as regards supplies to these customers;
  - (b) Further, the large chains typically specify a requirement for a card-based product, and although Surgichem has developed a card based product, it has not launched that product and, [REDACTED]  
[REDACTED], as is explained in section F below, which considers the counterfactual;
  - (c) In any event, present levels of competition in relation to large pharmacy chains are sufficient and will not be reduced by the merger. Moreover, there are suppliers who manufacture their own adherence packaging that could compete in that market (and are therefore more credible potential competitors than Surgichem). Dosebliss, for example, manufactures its own card based product and could conceivably tender for supplies and supply such adherence packaging to a large pharmacy chain. Indeed, they could be "sponsored in" by a large pharmaceutical chain in future (if they felt that there was a need for more competitive tension between bidders);
  - (d) Further, large customers also have the option of self-supplying their adherence packaging requirements: for example, the current arrangements between Manrex and Boots are an example of this and Chemistree also appears to have recently

<sup>4</sup> As set out in the Surgichem confidential annex (paragraph 4) at **Annex 3**, Surgichem supplies a very limited amount of adherence packaging for domiciliary patients to [REDACTED]. However, these sales amount to only [REDACTED] per year. Surgichem did not participate in tenders with [REDACTED] for such products

developed its own adherence packaging product (as demonstrated by the product which Surgichem provided to the CMA staff on 25 March 2014).<sup>5</sup> Lloyds has also previously in-sourced its requirements and could do so again.

19 Surgichem agrees with the arguments made by Omnicell/MTS in respect of the supply of adherence packaging to pharmacies which do not purchase adherence packaging products by way of tender. Surgichem refers, in particular, to the arguments set out in sections 4.3 and 7.3 of the Omnicell/MTS submission as to why the proposed transaction would not give rise to a SLC in respect of the supply of adherence packaging to this customer group. Surgichem has the following supplementary comments:

- (a) Surgichem agrees that parties' strategies for the supply of adherence packaging are different (see section 4.2.3 of the Omnicell/MTS submission). Surgichem does not supply any of the large customer groups through tenders (as noted above) and has instead opted to focus primarily on supplying its plastic-based Nomad Clear product range to the community pharmacy sector and on building long-term relationships with these customers through the provision of excellent service quality. As set out in the Surgichem confidential annex (paragraph 10) at **Annex 3**, █% of Surgichem's turnover is derived from independent pharmacies. Its three regional sales managers play an important role in building and developing these relationships, whereas MTS does not have this type of resource.
- (b) Unlike MTS, Surgichem has elected not to compete for bids to supply buying groups.<sup>6</sup> This is because Surgichem has found that this does not fit with its overall strategy of developing long term relationships directly with community pharmacies and smaller pharmacy chains (rather than dealing indirectly with the end customer through the buying group). Although its products were previously in Numark's (a buying group) catalogues, Surgichem found that it still had to promote its products itself, whilst paying a commission of █% to Numark when orders were made through them. For those reasons, Surgichem took the decision in December 2010 to cease supplying members of Numark with its Nomad Clear product.<sup>7</sup> Whilst Surgichem has been approached to bid to supply buying groups, it has declined these opportunities on the basis that it prefers to deal directly with its customers.
- (c) Although it is clear that, taken as a whole, MTS and Surgichem are the two largest suppliers of adherence packaging products to pharmacies which do not purchase adherence packaging products by way of tender, it is not at all clear that they are, in fact, each other's closest competitor. In fact, Venalink's business model is much more closely aligned to that of MTS, in that both companies are vertically-integrated (Venalink is part of Jones Packaging, a major packaging supplier), market card-based adherence packaging products and target the same primary customer groups (i.e. large customers, which participate in tenders, and the major buying groups). In contrast, Surgichem is not vertically integrated and contract-

<sup>5</sup> Between 2009 and 2013, Surgichem supplied adherence packaging products to █. The value of the orders placed by █ were █. Surgichem considers that █ requirements for adherence packaging are likely to be much smaller in comparison to large pharmacy chains such as Boots, Lloyds and Co-Op. This suggests that a pharmacy chain does not need to use large volumes of adherence packaging to make it viable for them to develop their own product.

<sup>6</sup> Whilst Surgichem prefers to make sales directly to customers due to its overall sales approach, it should be noted that buying groups offer an opportunity for suppliers of adherence packaging to promote their products. There are no direct sales costs involved when supplying through a buying group and Shantys, for example, has successfully used this approach.

<sup>7</sup> Surgichem still supplies some pharmacies that are or were members of Numark, however it supplies them directly and not through Numark.

manufactures its entire product range, markets a plastic-based adherence packaging product and is focused on developing direct and long term relationships with pharmacies which do not tender their requirements. It is therefore more closely aligned in terms of its operating model with Shantys, Protomed and others who are not vertically integrated and who market plastic-based products.

(d) This is consistent with Surgichem's internal sales records and customer relationship management (CRM) database, which indicate that, outside of the tender segment, the parties encounter each other much less frequently than would be suggested by their market share figures alone. In particular:

(i) In the Surgichem confidential annex (paragraph 5) at **Annex 3**, Surgichem provided illustrative examples of customers switching to a rival between June 2011 and June 2013, which demonstrates that customers have switched to Biodose, MTS, Venalink, and Manrex, with two additional customers deciding to start purchasing automated filling machines;

(ii) Surgichem provided the OFT with copies of its sales meeting minutes for 2011-2013. The OFT acknowledged at paragraph 81 of its decision that:

*"These show that Surgichem was actively targeting Biodose in 2011. These also show that Surgichem was targeting MTS and Venalink customers in 2011 and that MTS was more regularly referred to in 2012 and 2013. There are also some references to one of Shantys's distributors (Sigma), for instance there were six references to them in 2013. Although this information is not exhaustive and is not always clear that these sales reports are reflecting customer switching, **the OFT considers that this evidence suggests that MTS and Biodose (from Protomed) are both competing with Surgichem, as is Shantys**".*

(iii) Surgichem also undertook a review of its CRM database. As set out in paragraphs 17 onwards of Surgichem's response to the OFT's issues letter, Surgichem's analysis shows that suppliers other than MTS are strongly influential on its decisions to discount from its list price. The majority of discounts were granted to customers making bulk orders. Excluding these bulk discounts:

(A) For Nomad Clear, whilst Surgichem matched MTS's prices in [REDACTED] of the instances, it matched Venalink's prices the same amount and matched Shanty's prices even more ([REDACTED]). Surgichem also matched the prices of Biodose and Mediclear each in [REDACTED] of the instances; and

(B) For Nomad Concise, Surgichem only offered a discount over the period in order to counter the activities of [REDACTED] to ensure that the customer did not switch to [REDACTED].

(iv) The output from the review of the CRM database also indicates that, in absolute terms, the reduction in Surgichem's prices attributable to competition from MTS is very low. As set out in paragraphs 28 onwards of Surgichem's response to the OFT's issues letter, for the approximately [REDACTED] (non-bulk) discounts agreed by Surgichem over the period, the value of the new discounts granted amounted to less than [REDACTED] per annum, of which less than [REDACTED] was driven by competition from MTS, i.e. less than [REDACTED]

per annum. This indicates that the overall level of discounting which is driven by competition between the parties, and therefore the potential price effects post-merger, are very low in absolute terms. In other words, even if the merger might be said to result in a lessening of competition, it is difficult to see how any such reduction would be *substantial*.

- (e) The fact that Surgichem's prices for Nomad Clear are generally higher than MTS' and Venalink's prices is also consistent with the proposition that the business models and strategies of MTS and Venalink are more closely aligned than those of MTS and Surgichem. Whilst Surgichem does not have access to the relevant pricing data, it understands that MTS' and Venalink's card-based products are generally priced at a lower or similar price point to Surgichem's price for Nomad Clear.
- (f) Moreover, as the Omnicell/MTS submission makes clear, there are various alternative suppliers which compete to supply smaller customers, all of whom have comparable quality products to those of the merging parties. These include Protomed (the supplier of Biodose, now owned by Quantum), Shanty's (which supplies the Cambrian buying group and is understood to have increased its production requirements<sup>8</sup>), Boots/Manrex and Multimed. In addition, HD Medi and Dosebliss are very strong suppliers on mainland Europe and are both well-placed to supply in the UK (if they are not already doing so).
- (g) There are also other important constraints on the merging parties, including:
  - (i) buying groups, which provide protection against price rises and indeed secure favourable prices for their member pharmacies from an appointed supplier;
  - (ii) the possibility of in-sourcing (i.e. self-supply): for example, Chemistree has recently in-sourced its own branded adherence packaging product and Lloyds Pharmacy has previously in-sourced its requirements; and
  - (iii) as referred to in section 9.4 of the MTS/Omnicell submission, adherence packaging is a cost for pharmacies for which they are not reimbursed and which cannot be recharged to customers. Pharmacies receive 90p to fill a prescription,<sup>9</sup> so they ensure that the prices they pay for adherence packaging are kept to a minimum. Suppliers of adherence packaging are therefore constrained from raising prices and Surgichem considers that it would be difficult to charge more than 35-40p per product.

20 In developing long term relationships with its customers, Surgichem's experience is that delivering a high quality of service is important (more so than the quality or reliability of the product). The adherence packaging products which Surgichem offers are not technically complex and involve three components that are easy to source:

- (a) plastic blisters are available from thermoforming suppliers in the UK and worldwide and are used for holding medicines within the adherence packs;
- (b) the plastic blisters are sealed with a two-ply die cut plastic sheet; and

<sup>8</sup> Intelligence on Shanty's that suggests it is taking supply of [REDACTED] (demonstrated by [REDACTED] which was provided to the OFT on 21 February, and is reattached at **Annex 4**).

<sup>9</sup> See [http://www.ppa.org.uk/edt/November\\_2012/mindex.htm](http://www.ppa.org.uk/edt/November_2012/mindex.htm).

- (c) the sealed blisters have indications of the dates and times at which doses of medicines are to be taken by the patient (single medicines in the case of single dose packaging and combined doses of different medicines in multi dose packaging).
- 21 As noted in section E below (Barriers to Entry and Expansion), the Nomad Clear and Nomad Concise range of products do not benefit from any material IP-protection<sup>10</sup> and suppliers can easily contract manufacture similar products through arrangements with third party manufacturers. Indeed, this is the model which Surgichem and a number of competitors have chosen to adopt, and that Chemistree also appears to have adopted in in-sourcing its requirements
- 22 Despite the weight which Surgichem places on service quality, price is also very important to developing long term relationships with customers. Indeed Surgichem has generally avoided price increases in recent years so as not to risk changes in its customers' purchasing patterns. It has only implemented one change to its price list since 2007: in October 2012, Surgichem increased the price of Nomad Clear (due to an increase in raw material costs).<sup>11</sup> However, in fact this was not a simple price increase as Surgichem also introduced a lower cost variant of the product (Nomad Clear 2) at a price lower than the previous price. The Nomad Clear and Nomad Clear 2 products are similar, however the lid for the Nomad Clear 2 product is made from card rather than plastic, which helps reduce the cost. Through this dual pricing approach, Surgichem was able to retain customers despite the introduction of an increased price for the higher quality version of the product. Please see also paragraph 6 of the Surgichem confidential annex (**Annex 3**) and question 6 of Surgichem's response to the OFT of 6 February.
- 23 Surgichem does not set its list prices or volume discounts by reference to its competitors' (including MTS') prices; rather it sets these by reference to its margin targets and what it thinks its customers will pay for its products (bearing in mind the "ceiling" imposed by the price of the prescription – see paragraph 19(g)(iii) above). As set out in paragraph 22 above, Surgichem has only implemented one price increase since 2007 in order to minimise the impact on its customers.
- 24 Separately, Surgichem's analysis (see paragraph 19 above) demonstrates that suppliers other than MTS are strongly influential on Surgichem's pricing decisions. This analysis also demonstrates that Surgichem encounters MTS, when competing for supplies to individual small customers, much less frequently than would be suggested by the market share figures.

## **E Low barriers to entry and expansion**

- 25 As above, Surgichem has reviewed (and agrees with) with arguments set out in the non-confidential version of the Omnicell/MTS submission. In its experience, barriers to entry and expansion in the adherence packaging product segment are low. This is consistent with the way in which Surgichem has been successful in establishing and growing its business in the UK with a limited cost base and limited headcount. In particular:
- (a) It is straightforward and cost-effective for a new entrant to enter the market by sub-contracting the manufacture of the adherence packaging to a third party. These are

<sup>10</sup> Intellectual property is not a feature of the industry. The only intellectual property in Surgichem's adherence packaging product is a small lip on the plastic sheet (for which Surgichem holds a patent) and the [REDACTED]. However, neither of these IP rights in any way prevent other parties from designing products that are equally as effective in the market.

<sup>11</sup> Whilst the list price of Nomad Clear increased from £92.45 per box to £99.95, at the same time Surgichem launched its less expensive Nomad Clear 2 product, priced at the reduced price of £91.20 per box.

not technically complex products and, as the Omnicell/MTS submission points out, there are numerous third party suppliers within the UK and overseas which are able to supply card-based or plastic-based adherence packaging products.

- (b) This is consistent with Surgichem's experience in launching Nomad Clear and building its customer base: it launched this product with minimal up-front expenditure (a tooling cost of approximately [REDACTED]; mailshots to approximately 6,000 pharmacies containing a sample of the product and a response card, costing approximately [REDACTED]; with the cost of the initial production run being approximately [REDACTED])). These were followed up with calls to pharmacies. The overall cost of launching Nomad Clear was therefore less than approximately [REDACTED] in total, which includes tooling, artwork and mailshots. Set up costs for other products, including tooling, artwork and mailshots, were [REDACTED] for Nomad Concise, [REDACTED] for Nomad Clear XL, [REDACTED] for Nomad Duo, and [REDACTED] for Nomad Clear 2. New entrants could adopt a similar approach to keep their marketing spend low. In addition, warehousing and storage costs are likely to be low for initial production runs of low volumes, and may not require investment in dedicated spaces.
- (c) Surgichem agrees that container shipping costs (as set out in paragraph 7 of the Surgichem confidential annex, **Annex 3**) are low and there are no significant IP-related or regulatory barriers to entry. Surgichem's ongoing costs are also low: these consist primarily of raw materials, warehousing, staff and distribution/carriage costs, with low annual marketing expenditure. As set out at question 16 of Surgichem's response to the CC's initial information request, Surgichem's spend on advertising and promotional activity is negligible - less than [REDACTED] in 2011 and 2012 and less than [REDACTED] in 2013. Surgichem's advertising and promotional spend for 2013 amounts to only [REDACTED] of its turnover for that year. The same is true for R&D - Surgichem's R&D spend is not significant in proportion to its turnover and R&D spend is not a significant feature of the industry. Please see Surgichem's response of 6 February 2014 to the OFT, in particular the response to question 4 which sets out Surgichem's R&D expenditure for the last 5 years.

26 As noted above, there are already a number of credible suppliers offering adherence packaging products to pharmacy customers in the UK (i.e. those which do not tender their requirements) who could easily increase their output in response to any attempt by the merged entity to raise prices or reduce service quality. The OFT's market test confirmed that capacity constraints do not represent a barrier to expansion (see paragraph 130 of the Decision).

27 The key barrier to expansion which the OFT identified (at paragraph 131 of the Decision) related to a potential incumbency advantage for suppliers which have established a relationship for quality. In Surgichem's view, any incumbency advantage (to the extent it exists at all) is significantly overstated, for the following reasons:

- (a) Firstly, these are not technically complex products, so the importance of a *high quality product* cannot represent a significant barrier to expansion. In any event, there are numerous competing adherence packaging suppliers which have established a track record for supplying a quality product, including Venalink, Shanty's (which supplies the Cambrian buying group) and Protomed (Biodose). Surgichem provided a large range of samples to the OFT and further samples to

the CMA on 25 March 2014.<sup>12</sup> Surgichem looks forward to providing the CMA with further samples of these products at the forthcoming site visit. These suppliers have already invested in the (limited) up-front costs of entering the market and would not face material costs in expanding their operations (as noted in the Omnicell/MTS submission).

- (b) Secondly, to the extent that the OFT is referring to a relationship for *quality of service and reliability*, Surgichem has been successful in establishing and developing long-term relationships with its customers, and providing a high quality service offering, with a small and focused team of three regional sales managers. This should not constitute a material barrier to expansion for a supplier that is already present in the market: if the merged firm were to increase price or reduce service quality, this would represent an opportunity for expansion by the parties' competitors.

## F Counterfactual

### Card-based product

- 28 As the CMA will note from the Decision, the OFT concluded that there was a realistic prospect that, under the counterfactual, Surgichem would have had the ability to supply card-based adherence packaging and may bid for card-based adherence packaging tenders.
- 29 Surgichem provided the OFT with a detailed explanation of the background to its recent efforts to develop a card-based adherence packaging product. The evidence presented to the OFT at paragraphs 4 and following of Surgichem's response to the OFT's issues letter, relating to the cost price for the proposed card-based product, indicates that Surgichem would not be able to supply the product sufficiently cost-effectively in order to enable it to win future tenders to large customers absent the merger. Therefore, the counterfactual should not include the availability of Surgichem's card-based product, which means that there will be no loss of potential competition in relation to large customers who tender their requirements.
- 30 A detailed explanation of the background to, and the costs associated with, the proposed card-based system are set out in Surgichem's response to the OFT's issues letter. Copies of the (limited) internal documents (emails between Surgichem and the manufacturer) which are available in relation to this issue were provided at Annex 3 of Surgichem's response dated 6 February to the OFT's information request and are reattached at **Annex 5** for ease of reference. The key points to note are as follows:
- (a) On 24 January 2013, Surgichem received an Invitation to Tender from [REDACTED] for its MDS consumables contract, which requested proposals for 2 and 3 year periods. On 28 February 2013, following receipt of the Invitation to Tender, Surgichem sent the specification for the card product to a manufacturer in [REDACTED]. The first samples for the card product were provided to Surgichem at the end of May 2013. The final artwork for the card product was completed in November 2013.
- (b) In late 2012/early 2013, Bupa Home Healthcare had asked Surgichem to look into sourcing [REDACTED]. This was the main focus of Surgichem's conversations with its supplier, the card based product was only in the background of these discussions. When the supplier came back with an estimate for the [REDACTED], this was around the time that discussions had begun regarding the

<sup>12</sup> Including the product that Surgichem understands has only recently been developed by Chemistree, which suggests that this is a dynamic and evolving market.

potential acquisition by Omnicell. The first samples for the card product were provided at the end of May 2013 and Surgichem asked the manufacturer to print samples with its branding, to use as a good example of how easily Surgichem could have the card based product made and [REDACTED].

- (c) It soon became apparent, based on discussions with the supplier, that the costs associated with the proposed card-based product would not enable Surgichem to compete effectively in order to win tenders for supply to large customers. The cost "build-up" indicates a "delivered" cost price of [REDACTED] (before Surgichem includes any margin). The cost for Surgichem's plastic "Nomad Clear" product ([REDACTED] per blister pack) is in fact lower than the cost for the proposed card-based product.
- (d) Surgichem understands that some buying groups are quoting [REDACTED] to supply an equivalent card-based product. Surgichem therefore assumes that the prices quoted in order to win competitive tenders from large pharmacy chains by MTS and Venalink is likely to be less than that figure. That being the case, Surgichem does not see how it can realistically win this business.

31 Although it became apparent that the card-based product would not enable it to compete cost-effectively for tenders for large customers, Surgichem continued to explore the potential for a card-based product with the supplier. There were two key reasons for this:

- (a) First, although Surgichem became aware that the product would be more expensive to produce than its existing plastic-based product (Nomad Clear), Surgichem considered that there was a gap in its product portfolio for a card-based product and that some customers might have a preference for a card-based product over a plastic-based product (even at a similar or higher price point). That explains the reference to the card-based product in the internal documents referred to at paragraph 31(a) of the Decision and the fact that there was no external communication from Surgichem to the supplier indicating that it would not purchase the product that had been developed; and
- (b) Secondly, it was not expensive for Surgichem to continue its discussions with the supplier and develop the product: the total cost to Surgichem of developing the product to date amounts to [REDACTED] for a UK supplier to develop the artwork. There was, therefore, no material downside to continuing those discussions. It should be noted that the card based product does not appear in Surgichem's accounts showing its P&L expenditure for R&D, as there were no real development costs, underscoring the ease of product development and low barriers to expansion that exist in the marketplace.

#### Filling and sealing machine

32 The CMA will note that Surgichem has been developing an automated filling and sealing machine (see paragraphs 33 to 35 of the OFT Decision for details). Full details of the machine were provided in question 1 of Surgichem's response dated 6 February to the OFT's information request.

33 As set out in the Surgichem confidential annex (paragraph 1) (**Annex 3**), Surgichem purchased the IP for the machine from administrators. It estimates that the costs to get the machine to a scalable state are nearer [REDACTED]. Surgichem would aim to have a full production model of the machine for sale for [REDACTED], however as the machine [REDACTED]

██████████ it is likely that Surgichem would ██████████  
██████████.

34 The CMA will note in this regard the OFT's conclusion that there is no realistic prospect of a substantial lessening of competition in the supply of adherence packaging machines. For that reason, Surgichem has not provided further details of the machine in this initial submission, but would be happy to answer any questions which the CMA may have on this product at the site visit.

**G Impact on competition**

35 Surgichem has reviewed, and agrees with, the content of section 7 of the non-confidential version of Omnicell/MTS' submission. In particular:

- (a) For the reasons set out in section 7.2, there would be no loss of competition in relation to large customers which tender their requirements for adherence packaging (since Surgichem is not a realistic potential competitor under the counterfactual); and
- (b) Despite the fact that the parties will together have relatively high market shares for the supply of adherence packaging to smaller chains and independent pharmacies which do not tender their requirements, the proposed merger would not result in any SLC for the reasons set out in sections 7.3 and 7.4.

LIST OF ANNEXES

Number	Document
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]