

Anticipated acquisition by Omnicell, Inc./MTS Medication Technologies, Inc. of Surgichem Limited

The OFT's decision on reference under section 33(1) given on 14 March 2014. Full text of decision published 20 May 2014.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. Omnicell, Inc. (**'Omnicell'**) is a supplier of automation and software solutions for patient medication and supply management for acute care hospitals, post-acute nursing, long-term care facilities, and domiciliary patients (that is, patients in the community). In May 2012, Omnicell purchased MedPack Holdings, Inc., which is the parent company of MTS Medication Technologies, Inc (**'MTS'**).
2. MTS is a provider of adherence packaging¹, adherence support products for patients and carers and technological solutions that support the dispensing process in the pharmacy. MTS products range from heat-seal and pressure-seal (or cold-seal) packaging to automated packaging technology. Its UK subsidiary, MTS Medication Technologies Limited, had a turnover for 2012 of approximately £[].
3. Surgichem Limited (**'Surgichem'**) is a supplier of adherence packaging and adherence support products for patients and carers and is currently owned by Bupa Care Homes (CFG) plc (**'Bupa'**). It is mainly active in the UK. Surgichem's UK turnover for 2012 was approximately £[].
4. MTS and Surgichem are referred to below as the **'Parties'**.

¹ Adherence packaging products are used to repackage a patient's pharmaceutical medicine requirements to help the patient take the correct medicine at the correct time. Such packaging is typically used for elderly or disabled patients or those with a complicated treatment regimen. These products are also referred to as Monitored Dosage Systems (**'MDS'**).

TRANSACTION

5. Bupa, MTS, and Omnicell entered into a sale and purchase agreement on 6 December 2013 pursuant to which MTS will acquire the share capital of Surgichem Limited from Bupa for a consideration of £12 million (the 'Merger').
6. The Merger was notified to the Office of Fair Trading ('OFT') on 16 January 2014. The administrative deadline is 12 March 2014. Completion of the Merger is conditional on OFT clearance.

JURISDICTION

7. As a result of the Merger, the Parties will cease to be distinct. Surgichem constitutes an 'enterprise' for the purposes of section 23 of the Enterprise Act 2002 (the 'Act').
8. The Parties submitted that the share of supply test in section 23 of the Act is met. The OFT considers that the merged entity will have a combined share of approximately [60-70] per cent (with a [20-30] per cent increment (by volume)) in the supply of adherence packaging in the UK and that therefore the share of supply test in section 23 of the Act is met.²
9. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation, which if carried into effect, will result in the creation of a relevant merger situation.

BACKGROUND

10. Both Parties supply a variety of products designed to help domiciliary and care home patients comply with their medication regimens (that is, take the correct medication and correct dose at the correct time). The Parties' products include plastic or card-based packaging, components and equipment necessary to assemble the packaging, trolleys, and support products for patients and carers (such as sheets recording the patients' prescription). MTS also supplies machines that facilitate the filling and sealing of adherence packaging.
11. Adherence packaging is sold to pharmacies which then supply domiciliary patients and care homes. General practitioners, care homes, and local care agencies may influence the purchase decision on whether to supply adherence packaging (and what type) to a patient. Generally, it is the pharmacies who make the decision about what type of adherence packaging to purchase for domiciliary patients, whereas care homes may request specific packaging for their patients. Separately, NHS Scotland runs tenders for the supply of

² As reflected in Table 1 below.

adherence packaging and some clinical commissioning groups procure adherence packaging equipment. In most cases in the UK (with the exception of adherence packaging covered by NHS Scotland tenders), the cost of adherence packaging is borne by the pharmacy (whether the final customer is a domiciliary patient or a care home patient).

Products sold by the Parties

Packaging

12. The Parties' packaging products comprise a card (in the case of MTS) or plastic sheet (in the case of Surgichem) covered with a plastic blister pocket holding the separate doses of medication (pills) and labelled with medication times.³ They come in two forms: single dose and multi-dose.⁴ The OFT understands that single dose packaging is more commonly used in care homes and multi-dose packaging for domiciliary patients. However, some third parties who replied to the OFT's market investigation said that single and multi-dose packaging are used for both types of customers. Therefore, in practice, a clear-cut distinction between customers using single and multi-dose packaging cannot be drawn.
13. MTS's products are card-based and sold under the brand name Easyblis.⁵ They include disposable weekly pill packs and monthly care packs, which can be either heat-seal or pressure-seal. Weekly pill packs are split into four doses per day, with seven days in total. Monthly care packs are split into seven days of single doses, over a four week period.
14. Surgichem's products are plastic-based and sold under the brand name Nomad.⁶ Similarly to MTS, Surgichem supplies disposable weekly packs (Nomad Clear). It also supplies packs for use in care homes (Nomad Concise).
15. The Parties' packs are available in different sizes to accommodate different dosages or volumes of medication.

Machines for adherence packaging

16. MTS supplies three types of machines: heat-sealing machines, semi-automated filling machines, and de-blistering machines. Surgichem does not currently sell

³ Some products also hold liquid medications.

⁴ Single dose contains one type of medication only, to be taken by the patient at the relevant time, whereas multi-dose packaging will contain several medicines, to be taken at the same time.

⁵ Further information available on MTS's website at <http://www.mts-mt.co.uk/packaging>

⁶ Further information available on Surgichem's website at http://www.Surgichem.co.uk/ec_products.php?category=7

these machines but it has developed a semi-automated filling and heat-sealing machine.

Trolleys and cabinets

17. Both MTS and Surgichem supply trolleys and cabinets to pharmacies who then sell them to customers (in most cases, to care homes). They are designed to store medication (including in adherence packaging) securely and to facilitate the distribution of medicines by care home staff.
18. With respect to cabinets, Surgichem supplies self-administration cabinets (designed for use in patients' rooms), controlled drug cabinets (which are designed specifically for the care home industry for the safe storage of controlled drugs), and medication wall cabinets. MTS resells cabinets and trolleys that it sources from a third party supplier who also sells trolleys and cabinets to UK customers. MTS only supplies cabinets on request from a customer. Surgichem sources its cabinets and trolleys from a third party manufacturer in [] and is a major supplier in the UK.

Other products

19. The Parties also supply platens or templates and rollers for pressure-sealing. They also sell associated products such as medication administration record sheets, hangers, labels, and bags.
20. Surgichem also supplies pharmaceutical fridges for the storage of medication in pharmacies, surgeries, care homes, and laboratories. MTS does not sell fridges.

COUNTERFACTUAL

21. The application of the substantial lessening of competition (SLC) test involves a comparison of the prospects for competition with the merger against the competitive situation without the merger (the counterfactual).⁷ The OFT considers the effect of the merger compared with the most competitive counterfactual providing always that it considers there to be a realistic prospect of that situation. The OFT will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that the prospect of prevailing conditions continuing is not realistic (that is, because the OFT believes that one of the merger firms would inevitably have exited from the

⁷ *Merger Assessment Guidelines, A joint publication of the Competition Commission and the Office of Fair Trading*, OFT1254, September 2010, ('**Merger Assessment Guidelines**') at section 4.3.

market) or where there is a realistic prospect of a counterfactual that is more competitive than prevailing conditions.⁸

22. In this case, the Parties have not argued that Surgichem was an exiting firm. The OFT has however considered whether Surgichem may be more competitive in the supply of adherence packaging and the supply of machines for adherence packaging absent the Merger.

Surgichem's card-based adherence packaging

23. As outlined below, the Parties' customers who organise tenders for their requirements in adherence packaging told the OFT in response to its market investigation that they demanded card-based products in their recent tenders and that they have historically used card-based products.⁹
24. The Parties submitted that Surgichem was unable to submit a bid in three large tenders []¹⁰ as it did not have the specified card-based adherence packaging product.¹¹
25. However, Surgichem also informed the OFT that it received an invitation to tender from [] on 24 January 2013 which required a card-based adherence packaging product. As Surgichem was unable to guarantee supply of the card-based product in time for the start of the [] contract, it withdrew from the tender on 22 February 2013. On 28 February 2013, Surgichem sent the specification for the card-based product to a manufacturer in []. Despite withdrawing from the [] tender, Surgichem submitted that it continued to develop its card-based product together with its chosen manufacturer. First samples of its card product were provided in May 2013 and the artwork was completed in November 2013.
26. Given Surgichem's relatively recent efforts to develop its card-based adherence packaging product, the OFT has considered whether, absent the Merger, there is a realistic prospect of Surgichem competing in tenders for such products.
27. Surgichem submitted that, based on its manufacturer's cost proposals, it was never in a position to bring its card-based product to market and compete in a commercially viable manner due to the high cost price it had been quoted by

⁸ *Merger Assessment Guidelines*, at paragraph 4.3.5.

⁹ Some of these customers told the OFT that there were a number of reasons for requiring card-based products, including the ability to brand card-based adherence packaging with their own company information, the necessity for the product to be disposable, and the ability to accommodate dispensing labels. The tender documents from some of these customers indicate that they demand a bespoke product with very detailed specifications. These customers told the OFT that they do not currently tender for plastic-based products.

¹⁰ [].

¹¹ As set out below, Surgichem has developed a card-based product to bid for the [] tender but it did not have the specified card-based adherence packaging in time.

the [] manufacturer.¹² According to Surgichem, it has not placed orders for the card-based product it developed together with its chosen manufacturer in [], nor has the product been marketed or sold.

28. Despite its continued efforts to develop the card-based product following its withdrawal from the [] tender, Surgichem also submitted that it has not incurred any development costs for this product, as samples of the product were easily made by one of Surgichem's suppliers in []. It also stated that discussions with the [] manufacturer were limited and took place by telephone or email. Based on Surgichem's submissions, the only costs it incurred so far had been for the artwork, which amounted to £[].
29. In response to questions from the OFT relating to Surgichem's rationale for its continued efforts to develop its card-based product following its withdrawal from the [] tender, Surgichem submitted that it had asked its [] manufacturer to produce samples with a view to using these samples to []. According to Surgichem, its continued development efforts were primarily designed to [].
30. The OFT has considered Surgichem's submissions in this regard and has also taken into account the following considerations:
 - a. Despite requests from the OFT, the Parties did not provide any evidence supporting the submission that [].
 - b. The OFT has also not been provided with evidence corroborating that Surgichem had continued to develop its card-based product []. For instance, the OFT has been informed that [] as there were no Board meetings in 2013.¹³
31. The OFT notes that:
 - a. Surgichem's recent internal documents (dated September 2013) refer to statements [].¹⁴

¹² Surgichem submitted that the delivered cost price for the card-based product to customers in the UK would be []p, while some buying groups are quoting []p per card.

¹³ Surgichem told the OFT that its directors are not actively involved in the running of the business, as they are appointed by Bupa as Surgichem's parent company. They provided board minutes for 2011 and 2012. When requested by the OFT to provide additional board minutes concerning in particular the development of its card-based product, Surgichem stated that no []. It also stated that there have not been any management report meetings, or any documents reflecting communication between senior management on the subject, in the 18 months prior to February 2014. The OFT however notes that Surgichem provided some 2013 board reports, which were however not responsive to the OFT's questions relating to the development of the card-based product by Surgichem.

¹⁴ Surgichem's September 2013 sales report states [].

- b. It has not found any board documents of Surgichem corroborating its submission that []. In addition, the OFT is, for instance, not aware of external communication between Surgichem and []. The OFT has also not been provided with any internal communication evidencing that Surgichem [].
- c. The OFT has only received limited evidence to support Surgichem's submission that it could not realistically compete for competitive tenders for large customers. As stated above, Surgichem estimated that the delivered cost price to UK customers of the card-based product would be []p per unit and stated that some buying groups are quoting []p per card and that pricing for competitive tendering is likely to be less than that figure. Based on the breakdown of costs for this product provided by Surgichem, the OFT notes that the element representing the largest part of the total costs is the actual card [].¹⁵ The OFT notes that the card itself represents around [] per cent of the overall cost of the product. In this regard, the OFT notes that the only evidence provided by Surgichem on the cost of the card is []. [] does not give any further details or context [] for example, []. Surgichem did not supply any further evidence such as emails or internal documents in support of [].

32. Taking the evidence in the round, the OFT considers that there is a realistic prospect of a counterfactual that is more competitive than prevailing conditions in that Surgichem would have the ability to supply card-based adherence packaging absent the Merger and may bid for card-based adherence packaging tenders. The OFT will take this into account when assessing the competitive effects of the Merger.

¹⁵ Surgichem stated that import duty and shipping costs from [] would amount to [] per cent and []p shipping cost per card. The blisters that Surgichem sources from a supplier in the UK then amount to []p each. On this basis, Surgichem estimated that the total manufacturing price would amount to []p each. Surgichem then told the OFT that shipment within the UK would represent another []p per card.

Surgichem's filling and sealing machine

33. Surgichem told the OFT that, in January 2009, it bought the prototype machinery and the IP rights for a semi-automated filling and heat-sealing machine. This means that one part of the machine fills the blister packs and the blister packs are then transferred manually to the heat sealing machine. In its current set up, Surgichem's machine fills [] blister packs per minute. Surgichem also said that if its machine was attached to a full scale pharmaceutical production unit it would fill up to [] blister packs per minute[].
34. Surgichem stated that []. Surgichem submitted that due to the speed and size this machine is more suited to the US market where packaging volumes are much higher than in the UK.
35. The OFT has not it found it necessary to conclude whether there is a realistic prospect that Surgichem would be more competitive in the supply of adherence packaging machines absent the Merger given its findings that there is no realistic prospect of a substantial lessening of competition in the supply of adherence packaging machines.

MARKET DEFINITION

36. The Parties are both active in the sale of adherence packaging, trolleys and cabinets, and adherence support products to customers in the UK.¹⁶
37. The OFT has not identified concerns in relation to the supply of trolleys and cabinets and adherence support products¹⁷ to customers in the UK. Therefore, the OFT has not considered these products further.

Product scope

38. The OFT has considered whether the product scope could be wider than adherence packaging. The Parties submitted that Pharmacy Plus offers a product that competes with adherence packaging. This product involves the care home using the original manufacturers' packaging with a bar code scanning device when dispensing medicines. The Parties submitted that a number of care homes have switched from adherence packaging to the Pharmacy Plus product, although no evidence was provided to support this. In addition, the OFT was not able to get a response from Pharmacy Plus.

¹⁶ Only Surgichem supplies fridges to customers in the UK. Therefore, the OFT has not assessed further the supply of fridges to customers in the UK.

¹⁷ Such products include medication administration record sheets, metal hoops, stickers, cards, bags, dividers, hangers, name labels, storage bags, binders, and other consumables.

39. The OFT notes that Pharmacy Plus is addressed to care homes. The OFT notes that based on its market investigation similar barcode systems are not used by pharmacies. The OFT also notes that no third party mentioned Pharmacy Plus during its market investigation.
40. In addition, the OFT notes that no customer of the Parties who replied to its market investigation indicated that they would source or provide an alternative to adherence packaging to a patient if there is an increase in the price of all adherence packaging. None of the Parties' customers who replied to the OFT's market investigation said that they would consider any substitutes.
41. On this basis, the OFT considers that the product scope should be no wider than the supply of adherence packaging.

Segmentation by type of customer

42. The Parties submitted that a separate customer group can be identified within the adherence packaging market by reference to large pharmacy chains which hold formal tenders in order to appoint suppliers of adherence packaging for domiciliary patients and for care homes, to a lesser extent.¹⁸ The Parties refer to recent tenders from [] customers []¹⁹).
43. The OFT notes that customer segmentation may be appropriate when firms have the ability to price discriminate such that the effects of the merger on competition to supply a targeted group of customers may differ from its effects on other groups of customers.²⁰ In this case, the OFT notes that large pharmacy chains can be identified as they tender for their products and have specific requirements for their products (for instance that they are card-based). In addition, for two of these customers the products are bespoke.²¹
44. The Parties further noted a number of distinguishing features of 'tender customers', including:
 - The contracts resulting from such tenders tend to involve very large volumes and, as a result, be priced lower than the supplies agreed without a formal tender;²²

¹⁸ The Parties stated that the [] contract that MTS has won is for []. The [] contract is focused mainly on [] though it also covers []; however, in relation to [] use a number of different suppliers other than MTS []. Further, [].

¹⁹ The Parties submitted that [].

²⁰ See *Merger Assessment Guidelines*, at paragraph 5.2.28.

²¹ As further stated below, the OFT notes that [] differs from other tenders in that [].

²² The Parties stated that [].

- All such customers have a strong preference for, and currently purchase, card-based adherence packaging;²³
 - For two of these tenders, minimum purchasing requirements apply (or will apply);
 - Supplies are made to a central depot, (for [], there is flexibility for deliveries);²⁴
 - Specification of exact requirements as part of the tender, with some of these customers requesting bespoke products. For example, the OFT has received information from two of these tendering customers during its market investigation which shows that they demand a product that is branded with their own company information and in a size that they specify.²⁵
45. Further, the OFT notes that the effects of the Merger on these customers who tender may differ from other customers, due in particular to: (i) their specific product preferences; and (ii) the suppliers that are able to supply such products.
46. Based on the above, and adopting a cautious approach, the OFT notes that the conditions of competition may differ sufficiently between customers who tender for their requirements and the other customers for it to consider the effects of the Merger on these two customer groups, separately.
47. The OFT has not found any evidence of tender customers reselling to customers who do not currently tender for their requirements.

Segmentation by type of end customers (domiciliary and care home patients)

48. The OFT notes that the Parties' due diligence report refers to two key end-user segments within adherence packaging in the UK: care homes and (multi-dose packaging) for domiciliary patients. The OFT has therefore assessed whether it is appropriate to also segment the market between these end-users, care homes on the one hand, and domiciliary patients, on the other hand (in addition to the segmentation for the primary customers of the Parties, as outlined above).

²³ As noted by the Parties and confirmed by these customers, they currently purchase and specify card-based adherence packaging (and not plastic-based products).

²⁴ See footnote 21 above.

²⁵ Although the OFT notes that these sizes may already be, or can be adopted as, the standard packaging size for other suppliers.

49. As noted above, customer segmentation may be appropriate when firms have the ability to price discriminate such that the effects of the merger on competition to supply a targeted group of customers may differ from its effects on other groups of customers.²⁶ In this regard, the OFT notes that care homes and domiciliary patients are not direct customers of the Parties, which may potentially limit the extent to which they can be targeted through differential pricing.
50. The Parties submitted that generally multi-dose packaging²⁷ is used for domiciliary patients and single-dose packaging is used for care home patients, although multi-dose products are also used for the latter.²⁸
51. During its market investigation, the OFT received mixed evidence from third parties as to the relevance of the distinction between: (i) multi-dose for domiciliary patients; and (ii) single-dose packaging for care homes. The Parties and some of their competitors told the OFT that they supply a specific range of packaging for care homes, which can be mounted on a metal flip binder,²⁹ which is not used to supply domiciliary patients. Other third parties told the OFT that they only have one product that they sell to both domiciliary and care home patients. Therefore, it may be possible for some adherence packaging suppliers to price differentially to care homes and domiciliary patients, due to differences in the products that they sell to them. While the extent to which there is the ability to price discriminate is unclear, the OFT has nevertheless considered whether the conditions of competition are materially different between the care home and domiciliary sectors. It has found that:
- a. The three largest suppliers of adherence packaging, MTS, Surgichem, and Venalink sell products to be used for both types of end customers.
 - b. The supply arrangements between Boots and Manrex (see paragraph 62 ff) are specific to the supply to care homes, meaning that Boots/Manrex are active to a material extent only in the supply to care homes.ⁱⁱ However, when Manrex are excluded from the calculation of share of supply estimates (see paragraphs 64 ff), the Parties have a

²⁶ *Merger Assessment Guidelines*, at paragraph 5.2.28.

²⁷ For instance, MTS's 'multi-dose packaging' is a weekly pack allowing for four doses of pills per day (over seven days). Its so-called 'single-dose packaging' is a monthly pack split into seven days of single doses over a four week period (28 days).

²⁸ Surgichem supplies multi-dose packaging to care homes (namely their Nomad MDS product) and Protomed's *Biodose* product (which can be used for solid and liquid medicines and is used in care homes) is also multi dose.

²⁹ For example, Surgichem provides the Nomad Concise range for care homes. MTS also offers a range of products specific to care homes. The metal flip binder is particularly relevant where the care home is using trolleys designed for that type of packaging. The OFT also notes that Boots have a specific range for care homes using the Manrex solution (see paragraphs 62 ff of the decision).

similar share of supply for supplies to care home and domiciliary patients.

52. The OFT notes that a survey prepared for the Parties during due diligence indicates that the majority of pharmacies who buy both single-dose packaging (predominately used in care homes) and multi-dose packaging (predominately used for domiciliary patients) buy them from a single supplier. The OFT notes that with respect to these pharmacies, suppliers of adherence packaging compete for all of these pharmacies' requirements and a supplier of adherence packaging would only be considered if it could supply packaging for both types of end customer. The conditions of competition would therefore not vary between single and multi-dose packaging.
53. Based on the above, the OFT recognises that some adherence packaging manufacturers may be able to charge different prices to pharmacies for products depending on whether they are supplied to a care home or to domiciliary patients. However, the full extent to which this is the case is not clear and the OFT notes, in particular, that this is not the case for all suppliers (or for all of their products). Therefore, the OFT considers that it may not be appropriate to segment the market by type of end customer. In any event, as noted above, the OFT notes that a possible segmentation by type of end customer would not significantly change its competitive assessment.³⁰ The OFT has noted differences, where relevant, in its assessment.³¹

Geographic scope

54. The OFT notes that the Parties are both active in the supply of adherence packaging to customers located in the UK. However, the Parties have indicated that it is not necessary to manufacture packaging in the UK, with MTS currently manufacturing its packaging in the US. This was confirmed by some third parties, which indicated that they manufacture adherence packaging outside of the UK. Therefore, since one of the Parties is not currently manufacturing in the UK, but is currently supplying into the UK, the OFT does not consider that it is necessary to manufacture in the UK.
55. The Parties noted that the procurement of adherence packaging for use in the NHS varies as between Scotland and the rest of the UK. They indicated that NHS Scotland has run tenders for the supply of adherence packaging whereas in England, any such procurement is conducted by individual foundation trusts.

³⁰ The OFT notes that, based on the evidence available to it, the key difference in the conditions of competition is the presence of Manrex in the supply to care homes. For reasons outlined below, the OFT has excluded the Boots/Manrex supply arrangements from the 'merchant market'. []

³¹ See for example, Table 1.

In particular, [] have tendered for packaging equipment. MTS is not aware of any other tenders for adherence packaging organised by individual foundation trusts in the last five years. Despite, these distinctions within the UK, the Parties submitted that the geographic scope for the supply of adherence packing is at least UK-wide and that there are no regional markets within the UK.

56. The majority of third parties who replied 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 of adherence packaging. A customer explained that location within the UK was not important as all the adherence packaging products are delivered to it by courier. Another supplier stated that location did not matter as long as the supplier could deliver nationally (UK).
57. The majority of third parties who replied to the OFT's market investigation indicated that quality and service aspects were important when choosing an adherence packaging supplier. In addition, Surgichem emphasised the value-added services that it offers. Third parties indicated that companies establish a reputation for quality and service and new players, or those not currently active in the UK, would lack that reputation. The OFT considers that this is an additional factor limiting the geographic scope of competition.
58. Based on the above, the OFT considers that the relevant geographic scope for the supply of adherence packaging is UK-wide.

HORIZONTAL ISSUES

Customers who do not currently tender their adherence packaging requirements

Shares of supply

59. The OFT understands that there is no third party independent data on the market for the supply of adherence packaging in the UK. The Parties provided their best estimates based on a number of assumptions. The OFT also used sales estimates provided by competitors who replied to its market investigation.

Discussion of the Parties' methodology for share estimates

60. The Parties estimated the total number of patients using adherence packaging in the domiciliary and care home sectors as a basis for their share of supply estimates.³² The OFT notes that the Parties' methodology may have

³² In particular, the Parties assumed that (i) all pharmacies purchase the same volume of adherence packaging as MTS's customers; and (ii) that individuals in residential care and care home patients consume similar quantities of medication. The Parties did not provide any evidence to substantiate these assumptions.

overestimated the size of the supply of adherence packaging in the UK attributing a large share (around [20-30] per cent of the market) to the 'others' category.

61. Specifically, out of the [20-30] per cent share of supply represented by the 'others' category the OFT has only been able to identify a few suppliers (on the basis of information from the Parties and third parties who replied to its investigation) which only represent a very small proportion of the sales attributed to the 'others' category. Therefore, the OFT considers that the Parties' own estimates of their shares of supply may underestimate their actual position in the supply of adherence packaging in the UK.

Manrex supply

62. The Parties argued that Manrex should be taken into account as a competitor of the Parties when calculating shares of supply for non-tender customers. They submitted that Manrex is the originator of almost all Boots' adherence packaging used in care homes and that Boots actively distributes Manrex's products to other pharmacies in competition with the Parties. The Parties referred to four examples of independent pharmacies sourcing and selling the Manrex system.
63. Based on third party replies to the OFT's market investigation, the OFT notes that Boots holds an exclusive licence to distribute Manrex packaging in the UK. It manufactures Manrex packaging under the licence and currently sells the Manrex system to a limited number of independent pharmacies. [] Boots indicated that it only uses Manrex packaging in the care home environment, and does not manufacture Manrex products for use in the domiciliary environment.
64. The OFT received mixed evidence from third party responses to its market investigation on the constraint that Manrex poses on the Parties. On the one hand, a customer indicated that Manrex is one of their suppliers. On the other hand, the majority of customers who replied to the OFT's market investigation did not list Manrex as a possible supplier. In addition, the OFT considers that the limited evidence provided by the Parties to the OFT is not sufficient to conclude that Manrex constrains the Parties.³³ Therefore, on the basis of the evidence it has found, the OFT has, on a cautious basis, excluded the sales made by Manrex for the purposes of estimating shares of supply.³⁴

³³ Please refer to paragraphs 79 ff below.

³⁴ In any event, the OFT notes that if all the Manrex sales in the UK were included in the share estimates (that is, including the Boots self-supply) the Parties would still have a combined share of supply of all adherence packaging of above [50-60] per cent. In addition, the OFT notes that based on

Share estimates for non-tender customers

65. In addition to Manrex, the Parties listed other suppliers of adherence packaging, including the following: Biodose (Protomed), HD Medi, Dosebliss³⁵, Venalink, Shantys, Medimax, and Pivotell. As set out in Table 1 below, the Parties have attributed [20-30] per cent of the market to 'others', which they stated includes Shantys, Dosebliss, Medimax, and Pivotell. The Parties told the OFT that they were not able to provide share of supply estimates for each of these suppliers. The OFT contacted third parties to confirm the Parties' share estimates, but did not obtain responses from all competitors. Based on third party responses to its market investigation, the OFT estimated that the Parties' combined share of the overall supply of adherence packaging market (covering both tender and non-tender customers) would be around [80-90] per cent.
66. Table 1 below shows the Parties' shares of supply (based on their own estimates) in adherence packaging in the UK to customers who do not tender for their supply of adherence packaging in 2013.

Table 1: 2013 Shares of supply in adherence packaging in the UK (for customers who do not currently tender their adherence packaging requirements)

Company	Care homes	Domiciliary	Combined	
	Share of supply (per cent)	Share of supply (per cent)	Number of units	Share of supply (per cent)
Surgichem	[30-40]	[30-40]	[]	[30-40]
MTS	[20-30]	[30-40]		[20-30]
Combined	[50-60]	[60-70]		[60-70]
Protomed	[0-10]	[0-10]		[0-10]
Venalink	[0-10]	[0-10]		[0-10]
HD Medi	[0-10]	[0-10]		[0-10]
Others	[20-30]	[20-30]		[20-30]

Source: Parties' estimates by volume

67. The OFT considers that a combined share of supply and an increment at the level (combined share of [60-70] per cent with a [20-30] per cent increment) observed in this case are sufficient to give it cause for *prima facie* concerns over unilateral effects. However, the OFT notes that if the products are sufficiently differentiated such that there is little competitive interaction between

the Parties' submission, which uses the number of patients, rather than volume (and including Manrex products) the Parties' combined share of supply amounts to [60-70] per cent of the overall market.

³⁵ See paragraph 119 below.

the Parties this reduces the likelihood of unilateral effects concerns. Therefore, the OFT has analysed the available evidence with a view to determining the extent to which the Parties exert a competitive constraint on each other.

Closeness of competition

Different business models

68. The Parties submitted that the majority of MTS' sales are to the large chains and buying groups whereas a large proportion of Surgichem's turnover is derived from sales to independent pharmacies not purchasing through a buying group, as its business model is more heavily focused on direct contact with its customers. According to the Parties, the difference in business models is also reflected in their respective promotional efforts, noting that MTS uses telesales techniques whereas Surgichem relies more on individual pharmacy visits using its direct sales team. The Parties submitted that they largely target distinct groups of customers and, as such, are less close competitors than suggested by their shares of supply.
69. The Parties submitted that there are at least nine buying groups with a total membership of over 6,000. They argued that this accounts for the vast majority of independent pharmacies (even allowing for a small minority being a member of more than one group). Nevertheless, the Parties also stated that pharmacies who are members of a buying group may purchase adherence packaging from a supplier that is different from their buying group's appointed supplier.
70. The OFT notes that the evidence provided by the Parties suggests that customers exercise a choice between purchasing through a buying group (to benefit from a discount) or through a supplier like Surgichem to get value-added services.³⁶ In particular, Surgichem told the OFT that the reason why some customers would purchase adherence packaging from Surgichem – thus not benefiting from buying groups discounts on suppliers like MTS – is not only based on the quality of Surgichem's products but also on the services provided by Surgichem to pharmacies. Surgichem explained the [] its variable profit margins³⁷ and its higher prices by the close relationship it has with customers and the value-added services it provides to pharmacies (that is, advice to

³⁶ Surgichem told the OFT that such buying groups do not provide services similar to those provided by Surgichem.

³⁷ The Parties told the OFT that they did not have precise information on their variable profit margins. Surgichem told the OFT that its variable profit margins for its Nomad Clear product were between around [] and [] per cent. An internal document refers to Surgichem's profit product level margins, these were, Multi-med clear [] per cent, Single Dose concise [] per cent, M-M reuse (MDS) [] per cent. Surgichem and MTS told the OFT that they could not provide net margin data.

pharmacies to grow their business with Surgichem) that other suppliers like MTS do not provide.

71. Therefore, the OFT considers that despite the Parties' business models being different, they do compete to a significant extent with respect to independent pharmacies who have the option of purchasing through a buying group and are competing strongly. Moreover, the OFT notes that it is not clear whether and if so, to what extent, buying groups may provide better prices to their members.³⁸ In particular the OFT notes that the MTS price to the Numark buying group is []p per unit, whereas the Surgichem CRM sales database shows it was making sales of its Concise product for []p per unit and of its Clear product for []p per unit.ⁱⁱⁱ
72. In addition, the OFT has also found some evidence within the Parties' internal documents that suggests that they compete for similar customers. For instance, Surgichem's internal [] minutes³⁹ indicate that MTS had []. These minutes refer to [].
73. MTS also provided a price approval form that refers to MTS's visit to a pharmacy. The explanation given for [].
74. Based on the evidence above, the OFT therefore considers that any differences in the Parties' business models and the customer groups they target are not sufficient for the OFT to conclude that the Parties do not exert a competitive constraint on each other consistent with their respective shares of supply.

Switching and win/loss analysis

75. The OFT notes that the Parties have not been able to provide the OFT with full and comprehensive data on customers won from, and lost to, competitors ('win/loss data'). In the absence of comprehensive win/loss data, the OFT has analysed the information available to it which includes: (i) data on non-tender customers where MTS sent an offer to a customer; (ii) illustrative examples provided by Surgichem of customers switching away from Surgichem; and (iii) internal documents from Surgichem and MTS. The OFT has used this evidence to assess closeness of competition between the Parties.
76. The Parties argued that their internal sales records show that they lose business to each other, or adjust their prices to compete with each other, to a much lesser extent than would be suggested by their respective shares of supply. As such, they submit that competition concerns should not arise as a

³⁸ The OFT also notes that buying groups negotiate prices on behalf of their members for a number of medicines and related products. Adherence packaging is not their focus.

³⁹ Surgichem's [] include the following statements [].

result of the Merger. As noted in paragraph 67, the Parties' combined shares of supply and the increment associated with the Merger is sufficient for *prima facie* competition concerns to arise. Given that the Parties' combined share of supply is in excess of [60-70] per cent, the OFT would need to be satisfied that there is little competitive interaction between the Parties for competition concerns not to arise. The OFT has analysed the evidence provided by the Parties in turn, below.

MTS's data for customers who do not currently tender

77. MTS provided information on customers with whom they negotiated a price but did not participate in a formal tender. The OFT notes that MTS did not provide information on who the incumbent supplier was. Therefore, the data cannot be interpreted as giving an indication of actual switching patterns. MTS identified [] instances [] in 2012 and 2013 and [] in 2010 and 2011) of these negotiations and was able to provide the names of competitors involved in these negotiations. The number of times each competitor participated (based on MTS's understanding of which suppliers it was competing against) and was successful in these negotiations according to MTS is detailed in Table 2 below.

Table 2: MTS' data for customers who do not currently tender

	Competitor	Winner
[]	[]	[]
[]	[]	[]
[]	[]	[]
[]	[]	[]
Proposal rejected		[]

Source: MTS

78. The OFT considers that this evidence suggests that Surgichem competed against MTS in [] instances when MTS submitted an offer to a customer, that is, []. However, the OFT notes that this evidence also shows that []. No other supplier was noted as winning or competing against MTS.

Analysis of Surgichem's internal data

79. The Parties also argued that the review of their internal data shows that suppliers other than MTS strongly influence Surgichem's pricing decisions. They submitted that this review also demonstrates that Surgichem encounters MTS, when competing for supplies to individual customers, much less frequently than would be suggested by the share of supply figures. The OFT notes that the Parties submission is based on two main types of evidence:

- Surgichem provided a limited number of illustrative examples of customers switching to a rival between June 2011 and June 2013. The OFT notes that the Parties did not submit that [].
- Surgichem also provided data from []. This data shows that around [] per cent of [] due to competition with MTS, [] per cent to [], [] per cent to [] and [] per cent to [].⁴⁰

80. The OFT considers that the internal data provided by the Parties suggests that the competitive interaction between them is not at so low a level as to negate concerns over the Merger giving rise to unilateral effects, in view of the other evidence.

Review of Surgichem's sales reports

81. The OFT also reviewed sales reports provided by Surgichem. These show that Surgichem was actively targeting [] in 2011. These also show that Surgichem was targeting [] and [] customers in 2011 and that [] was more regularly referred to in 2012 and 2013. There are also some references to [], for instance there were [] references to them in 2013. Although this information is not exhaustive and is not always clear that these sales reports are reflecting [], the OFT considers that this evidence suggests that MTS and [] are both competing with Surgichem, as is [].
82. The OFT also analysed Surgichem's 2013 sales reports from 2013 to calculate how many times Surgichem tried to win business from a pharmacy currently using another supplier, and how many times another supplier tried to win business from a pharmacy currently using Surgichem.
83. The data in the sales reports in Table 3 shows that Surgichem most often attempted to win business from []⁴¹, and that MTS most often attempted to win business from []. Other than [] no other suppliers were mentioned in these sales reports.

⁴⁰ However, the OFT notes that [].

⁴¹ The OFT notes that Surgichem currently purchases an adherence packaging product capable of containing liquids called Multimedts from a third party. [].

Table 3: Episodes of ‘competition’ based on Surgichem’s sales reports

	Surgichem competing against	Surgichem facing competition from
[]	[]	[]
[]	[]	[]
[]	[]	[]
[]	[]	[]

Source: OFT based on Surgichem’s sales reports provided to the OFT

84. Based on the results shown in Table 3, the OFT considers that Surgichem’s internal sales documents suggest that Surgichem is competing strongly with [], and to a lesser extent with [].⁴²

Third party responses

85. The OFT received mixed evidence from third parties who replied to its market investigation. Some third parties indicated that the Parties are competitors to each other as they both supply adherence packaging. Other customers, however, highlighted the differences between the Parties’ respective products.
86. Approximately a third of the Parties’ customers who do not currently tender and a majority of their competitors who responded to the OFT’s market investigation raised concerns, including about a possible price increase as a result of the Merger.

Conclusion on the supply to customers who do not currently tender

87. Although there is some evidence that the extent of competition between the Parties may not be accurately reflected by shares of supply, the OFT considers that the evidence, taken in the round, points to significant competition taking place between them. Even if the degree of competition is less than the shares of supply suggest – and the evidence is unclear on this – the OFT considers the evidence points to a degree of competition sufficient for the loss of that competition arising from the Merger to give rise to unilateral effects concerns, such that post-merger, the merged firm may have the ability and incentive to increase prices and/or decrease service or quality aspects of its competitive offering.
88. As a result, the OFT considers that the Merger gives rise to a realistic prospect of a substantial lessening of competition in the supply of adherence packaging to customers who do not currently tender for their requirements.

⁴² The OFT also notes that Surgichem’s competition with [].

Customers who currently tender their adherence packaging requirements⁴³

89. The Parties submitted that Surgichem does not supply adherence packaging to large chains pursuant to tenders. Therefore, the activities of MTS and Surgichem do not overlap here.
90. Table 4 below shows the Parties' share of supply estimates for 2012 and 2013. Surgichem was not selling a card based adherence packaging product in either year, so was not making sales to these customers.

Table 4 – Share of supply in adherence packaging for customers who currently tender their adherence packaging requirements.

	2012		2013	
	Number of units	Share of supply (per cent)	Number of units	Share of supply (per cent)
MTS	[]	[40-50]	[]	[90-100]
Venalink	[]	[50-60]	[]	[0-10]

Source: Parties' estimates

91. The Parties submitted that shares of supply would change significantly if suppliers other than MTS are successful in any future tender [] (which resulted []). The OFT recognises that shares of supply may not provide a good indicator of competitive strength in this market due to the small number of relatively high value contracts, and the relatively lumpy nature of the tender process and so has analysed other evidence on the extent of competition between the Parties.
92. The Parties identified [] customers who currently tender for their adherence packaging requirements: [].⁴⁴ The Parties submitted that MTS [] bid for each of these contracts and that Surgichem has not submitted a final bid in any of them. Surgichem submitted a preliminary bid for the [] contract but later withdrew as it was concerned about its ability to supply the products in time for the start of the contract.
93. Third parties who replied to its market investigation indicated that the only other credible bidder to MTS for these three customers was Venalink.

⁴³ The OFT has focused its assessment on the loss of actual potential competition, noting that it assessed the potential for loss of perceived potential competition but has not identified concerns in this area. In particular, the OFT notes that it has not found evidence that [].

⁴⁴ See paragraphs 24 ff.

Potential competition from Surgichem

94. In assessing whether a merger leads to unilateral effects from a loss of 'actual potential competition', the Authorities will consider the following questions:
- a. Would the potential entrant be likely to enter in the absence of the merger both in absolute and relative terms?
 - b. Would such entry lead to greater competition?⁴⁵
95. The OFT has assessed whether Surgichem was likely to enter the market for the supply of card-based adherence packaging products to tender for customers absent the Merger when considering the counterfactual. As set out above, the OFT found that Surgichem had developed a card based product in response to the [] tender, continued to develop it when it withdrew from the tender, and had a finalised product by November 2013. Taking the evidence in the round, the OFT considers that there is a realistic prospect that Surgichem would be more competitive in the supply of card-based products to tender customers absent the Merger.⁴⁶
96. As discussed in paragraphs 27 ff, Surgichem has argued that its card based product would not be price competitive. However, it has only been able to provide limited evidence to support this. In the absence of further evidence, the OFT considers that the extent to which Surgichem's product would have been price competitive and would have been capable of affecting competition is unclear.
97. In addition, the OFT notes that []. Therefore, its overall reputation (for quality, service, and reliability), as well as the relationships it has with pharmacies in the UK may give it an advantage over other suppliers seeking to enter or expand into card-based products, and makes it a more credible competitor. The OFT considers that Surgichem is well positioned to enter this market in the foreseeable future (see below the assessment of entry)
98. The OFT notes that no large customers of the Parties who replied to the its market investigation raised concerns about the Merger. However, the OFT notes that there are currently only two credible suppliers to tender customers, and that Surgichem's entry will lead to an additional competitor. As such, absent the Merger there may be an increase in the number of potential suppliers from two to three, which the OFT believes may result in an increase in

⁴⁵ *Merger Assessment Guidelines*, at paragraph 5.4.15.

⁴⁶ See paragraph 32.

competition through increasing the extent of rivalry between suppliers over time to the benefit of customers (through, for example, reduced prices).⁴⁷

99. The Parties stated that according to MTS, [] are planning to run tenders for adherence packaging this year. [] The OFT believes therefore that the number of customers who may benefit from such an increase in competition would be greater.
100. The OFT recognises that the loss of Surgichem as an independent supplier of adherence packaging for customers who currently tender for their packaging requirements may give rise to a reduction in competition relative to that which would have prevailed absent the Merger. However, the OFT has not found it necessary to conclude whether the reference test is met in this regard given its conclusion above on the impact of the Merger on customers who do not currently tender.

ENTRY AND EXPANSION

101. Entry or expansion of existing firms can mitigate the initial effect of the merger on competition, and in some cases may mean that there is no substantial lessening of competition. In assessing whether entry or expansion might prevent a substantial lessening of competition, the OFT considers whether such entry or expansion would be timely, likely and sufficient.⁴⁸

Possible expansion of adherence packaging in the UK

102. The Parties submitted that the supply of adherence packaging is likely to grow significantly, due to an aging UK population and increased life expectancy. The Parties estimated that the supply of adherence packaging in the UK is growing at approximately ten per cent a year for domiciliary care and three to four per cent a year for long term care. The OFT notes that this is supported by the due diligence report, and by a third party who replied to the OFT's market investigation.
103. The Parties submitted that this will therefore make the market attractive to new entrants as any difficulties for an entrant associated with winning business from customers with an existing supplier (and with a low propensity to switch) will be

⁴⁷ The OFT notes that under certain conditions two competitors may be sufficient to result in a competitive outcome but does not believe that such conditions are met in this case. For example, see the conditions for a pure bidding market set out by Klemperer (Bidding Markets, *Occasional Paper No. 1*, UK Competition Commission, 2005 (reprinted in *Journal of Competition Law and Economics*, 2007 and *Handbook of Competition Policy*, P. Buccirossi (ed.), 2008)).

⁴⁸ *Merger Assessment Guidelines*, at paragraphs 5.8.1 to 5.8.3.

mitigated by significant numbers of new customers with no existing supplier (and therefore more easily 'won').

104. The OFT notes that although adherence packaging is ultimately supplied to domiciliary and care home patients by pharmacies, the Parties compete to supply adherence packaging to pharmacies. As a result, the extent to which any increase in demand for packaging may enable entry due to being able to 'win' new customers (as opposed to customers with an existing supplier) will instead be determined by the number of new pharmacies, as those will be the immediate customers for which any new entrant will compete. Therefore, the OFT notes that growth in the number of patients alone may not increase the prospect for entry.

105. In relation to any future change in the number of pharmacies, the Parties also provided data showing that 1,100 new pharmacies opened in the UK between January 2009 and October 2013, although the OFT notes that the evidence on future growth of pharmacies is very uncertain. For example, in contrast to the Parties arguments, the NHS England's chief pharmaceutical officer suggested that the government may want to consider cutting the number of pharmacies⁴⁹ and some commentators predicted that the number of pharmacies may fall by as many as 900 in the coming years.

106. In summary, it is not clear that the increase in demand for packaging would facilitate entry by other suppliers.

Entry for non-tender customers

107. Barriers to entry are specific features that give incumbent firms advantages over potential competitors. The OFT notes that where entry barriers are low, the merged entity is more likely to be constrained by entry.⁵⁰

Timeliness of entry

108. The OFT usually considers that to be timely entry must occur within two years.⁵¹ The majority of third parties who responded to the OFT's market investigation indicated that time for entry would be significant and, to reach a scale in which a supplier is able to compete, beyond this time frame. One competitor of the Parties, for example, stated that entry would take three years.

⁵⁰ *Merger Assessment Guidelines*, at paragraphs 5.8.4.

⁵¹ *Merger Assessment Guidelines*, at paragraph 5.8.11.

Likelihood of entry

109. The Parties suggested that barriers to entry are relatively low for a number of reasons. First, they submitted that the manufacture of adherence packaging can be sub-contracted (for instance, Surgichem sources from third party suppliers in []), which is relatively simple and does not require significant upfront investment and shipping costs are low. Second, they submitted that it is straightforward to build a database of potential customers as such information is publicly available. Finally, they submitted that intellectual property does not act as significant barrier to entry and that there are no regulatory standards.
110. The OFT notes that, in relation to the first of these, it is common for manufacturing to be subcontracted in the industry, and that although some products are protected by IP rights, most are not. As a result, significant upfront costs in manufacturing capacity are not required, as reflected in the estimates of the costs of entry in paragraph 117. The OFT notes that Surgichem outsources its adherence packaging production to []⁵². Therefore, the OFT considers that the option of subcontracting the manufacture of adherence packaging may lower barriers to entry, as new entrants do not need to invest in manufacturing capacity.
111. In relation to identifying prospective customers, the OFT notes the Parties' argument that it is easy to construct a database of potential customers, as pharmacy information and contact details are in the public domain. However, the OFT considers that being able to identify prospective customers is not the same as being able to compete for and win business to supply these customers. Third parties corroborated this. For instance, one of the Parties' customers who replied to the OFT's market investigation stated that although adherence packaging products are simple products to make, the issue is to demonstrate to customers that they are of good quality, for instance that they do not interact with the medicine or allow the medicine to degrade.
112. Some of the Parties' competitors that replied to the OFT's market investigation told the OFT that it is difficult for a new entrant to get new customers. One of these competitors stated that adherence packaging is a mature market, referring in particular to care homes. It explained that the majority of care home patients have their medication dispensed with adherence packaging and that a new entrant would have to convince both pharmacies and care homes to switch. Another competitor told the OFT that the initial customer base is difficult to obtain, adding that (i) the confidence a customer places in the quality of the

⁵² Surgichem source trolleys and cabinets from manufacturers in [] and were able to provide shipping invoices to demonstrate shipping costs. They also provided a cost breakdown for their card based product, which was to be sourced from [] showing a shipping cost of [] per unit.

product is key and (ii) that a new entrant would need an innovative product, heavy promotion and third party references.

113. Some customers of the Parties who responded to the OFT's market investigation also referred to issues in relation to their ability to switch supplier. For instance, some customers of the Parties told the OFT that their ability to switch suppliers is limited by care homes' request for a particular supplier. One of the Parties' customers also told the OFT that care homes would expect them to pay for heat sealing equipment and trolleys if they were to switch suppliers.
114. Furthermore, the Parties themselves have acknowledged that a new entrant would need to gain credibility and a reputation in the supply of the products or a similar product, which has been supported by customers who responded to the OFT's market investigation. In order to obtain a small relative supply position of around five per cent, a new entrant, according to the Parties, would need to establish a presence through winning accounts with independent pharmacies.
115. In relation to IP and regulatory barriers, the OFT found that although some products are protected by IP rights, based on third party replies to the OFT's market investigation these tend to be differentiated products such as those capable of containing liquids. The OFT found no evidence that IP rights were common for standard adherence packaging (that is, not capable of holding liquids). The Parties submitted and the Medicines and Healthcare products Regulatory Agency confirmed that there are no regulations governing the manufacture of adherence packaging.
116. The OFT also notes a number of additional points suggesting that entry is not likely.
117. First, while estimates of the cost of entry submitted by the Parties were low in absolute terms,⁵³ and it was noted that a potential entrant already producing related products would incur lower costs to enter the adherence packaging market, the majority of competitors of the Parties who replied to the OFT's market investigation indicated that it would be very difficult for a supplier to enter the market for adherence packaging and grow a five per cent share of supply. One third party estimated that it would take around three years and cost between £300,000 and £500,000.⁵⁴ The evidence from third parties who replied

⁵³ They estimated that to do so, a new entrant would need: (i) office and warehouse space (no more than £50,000 per annum); (ii) tooling (between £15,000 and 20,000); (iii) building a sales team (£200,000-£250,000); and (iv) marketing spend (between £100,000-120,000).

⁵⁴ Based on MTS's turnover and market share, a company with a five per cent market share would have an annual turnover around [].

to the OFT's market investigation leads it to consider that this mainly applies to customers who do not currently tender.

118. Second, the OFT found no evidence of recent entry having taken place.
119. The Parties referred to Dosebliss as a recent entrant, although they were not able to provide evidence that it has made any UK sales. The Parties stated that Dosebliss is actively marketing in the UK, and attended a pharmacy show in Birmingham in September 2013. They also stated that Dosebliss offers a card-based product similar to that of MTS, and provided a sample of the product to the OFT. In addition, the Parties also stated that Dosebliss has credibility as a proven reliable partner to many international customers. The OFT understands based on its website that Dosebliss is based in the Netherlands and did attend the pharmacy show in Birmingham. The OFT attempted to contact Dosebliss to discuss its intentions to supply adherence packaging in the UK, but was unable to make contact with this company.
120. The OFT notes that when asked to list all companies who entered the supply of adherence packaging in the UK in the last five years, no third party who replied to the OFT's market investigation was able to identify Dosebliss as a supplier or potential supplier. As such, the OFT has not been able to find evidence that Dosebliss is a credible entrant into supply of adherence packaging in the UK.
121. Indeed, no third party was able to point to any entrant who has begun supplying adherence packaging in the last five years other than Protomed (see below).

Sufficient

122. To be considered a competitive constraint, entry or expansion should be of sufficient scope to deter or defeat any attempt by the merged firm to exploit any lessening of competition resulting from the merger.⁵⁵
123. The one episode of entry over the last five years identified by third parties who replied to the OFT's market investigation, is that of Protomed, through the Biodose product.
124. The Parties stated that Protomed focuses on supplying to pharmacies for use in care homes and that, in relation to care homes, Protomed has made significant inroads, as evidenced by statements on its website. They also argued that it is a successful business making progress in the market in light of Quantum Pharmacy Solutions⁵⁶ paying £[] for a [] per cent stake in it. Third parties

⁵⁵ *Merger Assessment Guidelines*, at paragraph 5.8.10

⁵⁶ A firm specialising in synergies between surgeries and pharmacies.

indicated that Biodose was an innovative and differentiated product that is more expensive than other products on the market.

125. The OFT also refers to its comments at paragraphs 117 ff above in relation to the difficulty for any entrant to reach a position of around five per cent of the market.
126. The OFT notes that Protomed's share of supply, as estimated by the Parties, is only [0-10] per cent, despite being active for five years. However, even with a relatively low share of supply, the evidence supplied by the Parties and discussed in paragraphs 75 ff suggests that Protomed (Biodose) is a competitor to them. Since the Merger will result in the combination of the two largest players in the market, with a share of supply increment of [20-30] per cent, even if entry of a similar scale to Protomed were to occur, the OFT considers that it would not be sufficient to replace the constraint lost as a result of the Merger.

Conclusion

127. Therefore, on the basis of the evidence it found, the OFT does not believe that entry will be:
- a. timely, as third parties have indicated that entry to any material degree will take in excess of two years,
 - b. likely, as there has only been one episode of entry in the last five years, with no third party identifying any other potential entrants in to the UK market, or
 - c. sufficient, as the OFT notes that although the Parties' internal documents suggest that they view Protomed as a competitor, its overall share of supply is around three per cent. Given that the increment associated with the merger is around [20-30] per cent, even if entry were to occur, the OFT considers that it would be insufficient to replace the constraint being lost as a result of the Merger.

Entry into the supply of adherence packaging to tender customers

128. The OFT considers that most of the analysis outlined above also applies to tender customers. In particular, tender customers suggested that before awarding a contract to a new entrant, they would want to be able to verify that they had the ability to supply them and that their products were of sufficient quality. In this regard, the OFT notes that Surgichem may have been better placed than new entrants given the overall reputation it has and its relationships

with pharmacies. Third party competitors who replied to the OFT's market investigation did not indicate that new entrants could enter more rapidly by targeting tender customers. The OFT also notes that tender customers generally have lower prices than non-tender customers, as such it may be difficult for any new entrant to target them as it would not have any pre-existing economies of scale in manufacturing. However, the OFT has not found it necessary to conclude on barriers to entry for tender customers given its findings on SLC for these customers.

Expansion

129. The Parties argued that the production capacity used (but not owned) by Surgichem will not exit the market through the Merger because Surgichem outsources all of its production. They argued that the same manufacturers currently used by Surgichem could be used by other competitors post-Merger and indicated that MTS may decide to consolidate its production after the Merger, releasing this capacity on to the market.
130. A significant number of competitors of the Parties who replied to the OFT's market investigation stated that they outsource the manufacture of adherence packaging products. None of the Parties' competitors who replied to the OFT's market investigation raised the possibility of capacity constraints as a barrier to expansion. Therefore, the OFT considers that the additional spare capacity that would be released on to the market, should the merged entity consolidate manufacturing, would not make expansion easier, as capacity is not currently constraining rivals' ability to expand.
131. The OFT notes that irrespective of capacity, third party competitors who replied to its market investigation told the OFT that reputation is an important factor to gain market share. The OFT notes, on the basis of third party replies to its market investigation, that there may be an incumbency advantage for suppliers who have already established a reputation for quality and who have a number of customers using their products (similar to the ones new entrants have to face).⁵⁷ The OFT also notes from third party replies that there are barriers to switching as pharmacies may not be able to switch suppliers (or not for all their purchases) as care homes often have a preference for a particular supplier (or type of packaging).
132. The OFT has not found any evidence to show that the Parties' shares fluctuated over time for customers who do not tender.

⁵⁷ *Merger Assessment Guidelines*, at paragraph 5.8.5.

133. Based on the above, the OFT considers that the evidence it has found does not show that the prospect of expansion by competitors would be sufficient to prevent an SLC.

BUYER POWER

134. With respect to customers who do not currently tender, the Parties argued that independent small pharmacies have a significant amount of buying power. This results to a large extent from buying groups which serve to protect the pharmacies against price increases and will continue to do so after the Merger. The Parties also stated that even outside of the buying groups independent pharmacies are able to negotiate discounts off the retail list price. They argued that this is shown by MTS's actual average sales prices to independent pharmacies other than buying group customers, by reference to MTS's retail list price of []p per pack, in that MTS's average sales price to such customers was []p in 2013 (and in 2012 it was []p).

135. The OFT notes that it is not clear whether and if so, to what extent, buying groups may provide better prices to their members. In particular the OFT notes that the MTS price to the Numark buying group is []p per unit, whereas the Surgichem CRM sales database shows it was making sales of its Concise product for []p per unit and of its Clear product for []p per unit.^{iv} In addition, buying groups do not appear to provide the level of added-value service in relation to adherence packaging that, for instance, Surgichem offers.

136. The OFT also notes that any negotiations buying groups conducts on behalf of their members in respect of adherence packaging is only part of the service proposition offered by buying groups. Buying groups negotiate prices for a variety of medical products, with pharmacies having the option to purchase from them or from the supplier directly. The Parties provided extracts from buying groups' promotional material that suggest that overall they offer lower prices to their members. The OFT notes that this evidence largely referred to pharmacy products other than adherence packaging. Therefore, the OFT considers that the extent to which it is probative of buyer power for adherence packaging is unclear.

137. In addition, in purchasing from a buying group, the pharmacy would forgo some of the value added services that a supplier can provide, such as marketing directly to care homes. Surgichem emphasised that these value added services are an important part of its business model. Therefore, the OFT considers that the evidence available to it suggests that buying groups do not offer buyer power sufficient to allay any concerns over a substantial lessening of competition for customers who do not currently tender.

138. Based on the above (and in particular the limited evidence on the ability of buying groups to obtain better prices for their members for adherence packaging and the fact that they do not provide any value-added services to customers similar to those provided by Surgichem), the OFT considers that the evidence is not sufficient to allay concerns over a substantial lessening of competition for customers who do not currently tender.
139. With respect to customers who currently tender, the Parties argued that they are sophisticated customers with strong buying power. They stated that even without Surgichem was a bidder, in the tender so far conducted they have achieved substantial reductions in prices. The OFT nevertheless notes that the supply of card-based products by Surgichem may enable these customers to negotiate better prices. Given its findings for tender customers, the OFT has not found it necessary to conclude whether buyer power would be sufficient to allay concerns over a substantial lessening of competition for these customers.

Conclusion on countervailing factors

140. The OFT considers that the evidence on countervailing factors (entry/expansion and buyer power) is not sufficient to allay concerns over a substantial lessening of competition for customers who do not currently tender.
141. Given its findings for tender customers, the OFT has not found it necessary to conclude whether countervailing factors would be sufficient to allay concerns over a substantial lessening of competition for these customers.

THIRD PARTY VIEWS

142. The OFT contacted customers and competitors of the Parties.
143. Customers who currently tender their adherence packaging requirements and responded to the OFT's market investigation did not raise concerns about the Merger.
144. Approximately a third of the Parties' other customers and a majority of their competitors who responded to the OFT's market investigation raised concerns about a possible price increase as a result of the Merger. The OFT took these concerns into account in its competitive assessment.
145. Third party comments have been included where relevant in the decision.

ASSESSMENT

146. The Parties are both active in the supply of adherence packaging in the UK. The OFT considers that the share of supply test in section 23(3) of the Act is met with respect to the supply of adherence packaging in the UK.
147. The OFT has assessed the impact of the Merger on the supply of adherence packaging for customers who currently tender for their requirements and other customers, separately. The OFT considers that it may not be appropriate to segment the market by type of end customer and that, in any event, a possible segmentation by type of end customer would not significantly change its competitive assessment. The OFT considers that the relevant geographic scope for the supply of adherence packaging is the UK.
148. Absent the Merger, the OFT considers that there is a realistic prospect that Surgichem will supply its card-based adherence packaging product. The OFT has taken this into account when assessing the competitive effects of the Merger.
149. With respect to customers who do not currently tender for their adherence packaging requirements, the OFT has identified competition concerns given the level of the Parties' combined share of supply and evidence (including the review of the Parties' internal data and third party responses) suggesting that the Parties are strong competitors. The OFT considers that the Parties' combined share of supply (around [60-70] per cent) and the increment (around [20-30] per cent) are sufficient to give it cause for *prima facie* concerns over unilateral effects. Therefore, the OFT notes that even if the degree of competition is less than their shares of supply suggest (although this is unclear), the evidence gives rise to concerns due to unilateral effects arising from the Merger. The OFT concluded that the Merger would give the merged entity the ability to increase prices and/ or degrade the quality of its products and/or decrease service levels for customers who do not currently tender. The OFT considers that the evidence on countervailing factors (entry/expansion and buyer power) is not sufficient to allay concerns over a substantial lessening of competition for these customers.
150. With respect to customers who tender for their requirements of adherence packaging, the OFT considers that there is a realistic prospect that Surgichem would have the ability to supply card-based products absent the Merger and may bid for card-based adherence packaging tenders. The OFT also found that Surgichem is well positioned to enter the supply of card-based products to tender customers given its overall reputation (for quality, service and reliability) and its relationships with pharmacies in the UK, conferring it an

advantage over other suppliers seeking to enter or expand into card-based products. The OFT recognises that the loss of Surgichem as an independent supplier of adherence packaging for customers who currently tender for their packaging requirements may give rise to a reduction of competition. However, the OFT has not found it necessary to conclude whether the reference test is met for customers who currently tender given its conclusion on the impact of the Merger on customers who do not currently tender.

151. Consequently, the OFT believes that it is or may be the case that the Merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

152. This Merger will therefore **be referred** to the Competition Commission under section 33(1) of the Act.

ENDNOTES

ⁱ The OFT clarifies that no board reports exist for 2013 []. In addition, the OFT clarifies that Surgichem provided some 2013 board minutes.

ⁱⁱ The OFT clarifies that the agreement between Boots and Manrex is not a supply arrangement as such in that Boots do not receive any products from Manrex. The agreement between Boots and Manrex gives Boots the right to produce and sell the Manrex system in the UK.

ⁱⁱⁱ The OFT clarifies that Surgichem's CRM data shows that it has sold Concise for []p per unit.

^{iv} The OFT clarifies that Surgichem's CRM data shows that it has sold Concise for []p per unit.