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Anticipated acquisition by Digital Healthcare Limited of Orion Imaging Limited

ME/5021/11

The OFT's decision on reference under section 33(1) given on 14 July 2011.  
Full text of decision published 2 August 2011.

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**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. Digital Healthcare Limited (**Digital**) was founded in 1999 and provides image management solutions for the ophthalmology sector, in the UK (predominantly through the NHS) and the USA. Its diabetic retinopathy screening software (DRSS) is called OptiMize, and it is used in 43 screening programmes across England. Digital also has clients in the USA, Australia, New Zealand, Hong Kong and Ireland. Turnover for the financial year 2010 was £2.7 million of which £1.9 million was realised in the UK.
2. Orion Imaging Limited (**Orion**) was acquired by CliniSys Solutions Limited in 2005 and is now part of the CIS Healthcare Group, which provides specialist software solutions for chronic diseases in the UK. Orion only provides retinal screening software, and around 80 per cent of its turnover comes from its DRSS product, which is used in 31 screening programmes in England. Orion's turnover in the 2010 financial year was £1.34 million, of which £1.01 million was realised in the UK.

## **TRANSACTION**

3. Digital proposes to acquire Orion. The parties notified the transaction on 24 May 2011 and therefore the administrative deadline for a decision is 21 July 2011.

## **JURISDICTION**

4. As a result of this transaction Digital and Orion will cease to be distinct. The parties overlap in the supply of DRSS and support services to regional screening programmes in England. The merger creates a combined share of 80 per cent (increment 34 per cent);<sup>1</sup> therefore the share of supply test in section 23(2)(b) of the Enterprise Act 2002 (the Act) is met. 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.

## **MARKET DEFINITION**

5. The parties overlap in the supply of DRSS and support services to regional NHS screening programmes (also referred to as 'schemes'). The aim of diabetic retinopathy screening is to reduce the risk of sight loss among people with diabetes. The screening programme involves a systematic annual screening of all diabetic patients aged 12 or over, using digital photography of the retina, followed by a two or three-stage image grading process to identify the changes of sight threatening retinopathy in the retina.
6. In England<sup>2</sup> there are three models of screening programme that are permitted; fixed sites (usually in hospitals), mobile cameras that visit GP surgeries, and Optometric practices that are authorised to screen. Which system is used will be determined by local factors. However the screening service is provided by the screening programme, it utilises the same DRSS, procured and provided by the local screening programme.

### **Product frame**

7. The parties' view is that there are no close demand-side substitutes for DRSS and support services. Software and support is sold as a bundle, and competing software suppliers are not able to provide support for one another's software because of intellectual property protection on the software code. Moreover, the code is not in the public domain and the

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<sup>1</sup> By number of programmes supplied.

<sup>2</sup> The OFT understands that a similar arrangement exists in Scotland, while in Wales and Northern Ireland the programmes are more mobile/clinic based.

software is regularly updated making any attempt to reverse engineer the code very difficult.

8. Customers confirmed that there are no substitutes available for DRSS, and that competitors do not compete to supply support for one another's software. A competitor's inability to supply support for rival's products was confirmed by two competitors who commented that the cost of building a team to reverse engineer a competitor's software in order to provide support would be a 'non-starter'.
9. The parties submitted that the usable life time of software of the type used for the digital retinopathy screening is expected to be around 20 years. Following the initial licence sale, all that remains for the software vendor is the sale of support and ongoing functional enhancements.
10. The OFT's *Substantive Assessment Guidance*<sup>3</sup> says that the OFT may define a single system market as one in which suppliers of systems encompassing primary and secondary products compete. Systems markets are likely to be defined when customers consider the price of the combined products that comprise the whole system, when making their decision.
11. In the case of the DRSS sold by the parties, Digital's software support services are charged as a fixed percentage of the licence fee and annual changes in the price of software support services reflect any change in the retail price index. Orion sells software support services separately to software, with software support renewed annually. Third party responses suggest that the cost of software support services is a factor in customers' original purchasing decision. This implies that there is a single system market.
12. As DRSS is designed for a very specific application customers have no alternative options. It is not financially viable for competitors to provide support for one another's software, and, additionally, customers appear to take into account the price of software support when making the original purchasing decision. For these reasons, the OFT considers the appropriate product frame to be the supply of DRSS and software support services. The OFT's decision, however, does not turn on software and support being part of a single system market.

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<sup>3</sup> Paragraph 5.2.20 on *Secondary Products*.

## Geographic market

13. The parties submitted that the relevant geographic frame for the provision of DRSS and support services is no wider than England. This is because:
- the parties only overlap in the supply of DRSS to schemes in England
  - while Orion supplies DRSS in Northern Ireland, Digital does not
  - Digital supplies software in Wales, whilst Orion does not
  - there are different functional standards as between England, Northern Ireland, Scotland, and Wales
  - the National Screening Council's ('NSC') guidance only covers England, and
  - all suppliers are capable of supplying to customers within England. Support is normally provided remotely in the first instance, with on-going support being provided thereafter if required.
14. The hypothetical monopolist test, however, goes further than asking whether a party is present; it asks would the party have the incentive to supply to a particular territory following a SSNIP.<sup>4</sup>
15. On further questioning, Digital stated that there were no product development differences between, for example, the software it supplies in England and the software it supplies in Wales. Any variation required by the Welsh health authority is delivered as a change in the standard configuration. Orion submitted that the software for Northern Ireland follows the original NSC model used in England.
16. The OFT considers that the technocratic differences between the requirements of the countries of the UK are not probative. Moreover, they do not appear to be so substantial as to make profitable a SSNIP by a hypothetical monopolist of DRSS in any of the countries in the UK.

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<sup>4</sup> SSNIP — a small but significant and non-transitory increase in price

17. Aside from the technocratic differences noted above, retinopathy screening software is not purchased by the different countries of the UK in the same way.
- In England, the parties are two of the four suppliers<sup>5</sup> originally approved to supply NHS customers.
  - In Northern Ireland, Scotland, and Wales, a single supplier has been selected by the relevant NHS body in each country to supply software to customers in that country.
18. To the extent that the different NHS customers in the UK have somewhat different requirements, and to the extent that England may move towards a single supplier system similar to that found in the other countries of the UK,<sup>6</sup> it may be that it is appropriate to define relevant customer markets. The OFT will define different relevant customer markets in cases in which customers have different preferences. To the extent that there **are** differences in demand across the countries in the UK – for example differences in whether competition is **in** rather than **for** the market - each country's tender competition has been considered in order to assess the effect of the merger.
19. Based on the above, the OFT has assessed the effect of this transaction by looking at its impact on:
- the supply of DRSS and support services in Northern Ireland
  - the supply of DRSS and support services in Scotland
  - the supply of DRSS and support services in Wales
  - the supply of DRSS and support services in England.

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<sup>5</sup> Digital, Orion, CliniSys Solutions and Siemens; CliniSys merged with Orion and Siemens is not currently active in England.

<sup>6</sup> English National Screening Programme for Diabetic Retinopathy (ENSPDR) – Software Improvement Project – A Consultation on Proposals; March 2011

## **COMPETITIVE ASSESSMENT**

20. The parties overlap in the supply of DRSS and service support in England.
21. In Scotland and Wales, national programme managers have held a tender for a sole supplier in that country. Thus competition was **for** the market. The parties advise that competition in Northern Ireland is **for** one contract – Belfast City Hospital. This is therefore effectively competition **for** the market. Conversely, in England there is currently competition **in** the market. However, the English procurement model is currently under review.

### **Supply of DRSS in Northern Ireland**

22. The Diabetic Retinopathy Screening Programme in Northern Ireland chose to use a single supplier, Orion, several years ago.<sup>7</sup> The software was installed in 2009, upgraded in 2010, but has not been fully tested so is therefore not in use. The Programme continues to use an existing product supplied by EyeCap, a third party,<sup>8</sup> instead.
23. Although not involved in the Orion purchase decision, the current manager is confident that, at the time, there were other providers. The manager's view, when contacted by the OFT, was that the merger would not impact on the programme's current software situation.
24. Northern Ireland does not intend to tender for a new software supplier within the next two years

### **Supply of DRSS in Scotland and Wales**

25. The parties contend that they do not overlap in the supply of retinopathy screening software in Scotland or Wales because the programme managers in these countries have selected to use a sole supplier. In Wales, Digital is the sole supplier and in Scotland it is Siemens.

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<sup>7</sup> The OFT understands that the decision to use Orion was made prior to the current manager joining in 2006.

<sup>8</sup> [www.haag-streit.com/index.php?id=106](http://www.haag-streit.com/index.php?id=106) The parties have clarified that EyeCap is an Orion product supplied by Orion to Haag Streit under an existing agreement.

26. NHS Scotland tendered for a single DRSS supplier in 2004/2005. The tender was advertised in the Official Journal of the European Commission and the contract ends in 2012. Factors important in determining the winner were: price, functionality, and quality assurance.
27. Digital, Sysmed, and Siemens all tendered, and the contract was won by Siemens.
28. NHS Scotland is currently developing the procurement scheme to choose the next DRSS supplier for Scotland. Whilst it has not yet decided, the possible choices are:
  - obtain a derogation from tendering and retain Siemens as its supplier or
  - re-tender for the contract.
29. It is in NHS Scotland's hands to select the scheme which it considers most appropriate to obtain the best value for money for its future DRSS needs following current procurement rules. It did not raise any concerns and named the three (if this merger goes ahead, two) bidders of 2004/5 (see paragraph 24 above). Based on the facts of this case and bearing in mind that competition might take place **for** the market, rather than **in** the market, two viable competitors can confer sufficient constraint on each other post merger. The OFT also notes that the barriers to expansion from suppliers in England do not seem insurmountable (see paragraph 34 below). As a result the OFT does not believe that this merger raises substantial competition concerns as to the forthcoming supply of DRSS in Scotland.
30. The Welsh programme coordinator did not respond to our request for information.

### **Supply of DRSS in England**

#### **Competition in the market**

31. The procurement process to select the software providers was carried out in 2003 under the auspices of the NHS Purchase and Supplies Agency ('PASA') on behalf of the ENSPDR.<sup>9</sup> Digital, Orion, CliniSys Solutions<sup>10</sup> and

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<sup>9</sup> English National Screening Programme for Diabetic Retinopathy

<sup>10</sup> Which acquired Orion in 2005

Siemens were all successful and became approved suppliers. Since then each Local Screening Programme has procured a software supplier to manage their screening process, through a European framework contract which was let by PASA. After the initial procurement exercise Programmes pay fees directly to their supplier for support, software support services and occasional product development. The vast majority of supplier revenue is now derived from annual support services charges, which vary depending on programme configuration and local requirements.<sup>11</sup>

32. The original PASA agreement has now expired and prices are therefore bilaterally negotiated between the software supplier and the individual schemes. Digital sells its software with a perpetual licence.<sup>12</sup> As all programmes now have software, it is only software support and software upgrades which attract an additional fee. Support contracts appear to be renewable annually and upgrades are also available on an approximately annual basis (see paragraph 8 above).
33. Local screening programmes are able to choose between approved and non-approved suppliers. This has widened the competitors set and includes, in addition to the remaining approved competitors (the merging parties and Siemens<sup>13</sup>), three other DRSS suppliers identified by the ENSPDR: Health Information Systems Limited;<sup>14</sup> 1<sup>st</sup> Retinal Screen Limited<sup>15</sup> (also known as Health Intelligence Limited); and ProWellness.<sup>16</sup> A third party also named Topcon<sup>17</sup> as a supplier of this type of software. However, to be allowed to include non-approved suppliers in the bidding, the scheme must issue a call

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<sup>11</sup> As noted above at paragraph 8 only the original supplier of the DRSS can provide software support services and upgrades.

<sup>12</sup> The software licences and agreement for support services operated by Digital and other software vendors are in the form of the 'template' contracts that were prepared by the NHS in connection with the award of the National Framework Agreement for Diabetic Retinopathy Screening Software Solutions, awarded by the NHS Purchasing and Supply Agency on 19 January 2004.

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[www.medical.siemens.com/siemens/en\\_GB/gg\\_hs\\_FBAs/files/HIE/SIC\\_DRScreeningScotland\\_e.pdf](http://www.medical.siemens.com/siemens/en_GB/gg_hs_FBAs/files/HIE/SIC_DRScreeningScotland_e.pdf) Siemens appears to have opted not to compete in the English market having won the tender to supply the Scottish market.

<sup>14</sup> [www.hisvector.com/](http://www.hisvector.com/) — HISL was formed in 2004 by the spin-out of the team from Kings College London and Guy's & St Thomas' Hospitals NHS Trust, having formerly been a team specialising in developing clinical information systems, especially for diabetes, embedded into the Medical School. HISL supplies [ ] diabetic retinopathy schemes in England.

<sup>15</sup> [www.1stretinalscreen.com/](http://www.1stretinalscreen.com/)

<sup>16</sup> [www.prowellness.com/?s=3&id=4](http://www.prowellness.com/?s=3&id=4) — The OFT has been told that ProWellness has one customer in England.

<sup>17</sup> [www.topconmedical.com/](http://www.topconmedical.com/)

for competition under the relevant procurement rules, and the software has to incorporate all of the technical specification set out by the UK National Screening Committee.<sup>18</sup>

34. The ENSPDR recently concluded that:<sup>19</sup>

'(t)he Diabetic Retinopathy Screening (DRS) software market is considered to be static as most Local Screening Programmes are equipped with software, from one of the four main suppliers who between them have almost captured the entire market. Although there have been some cases of programmes switching suppliers, this has not significantly affected the market share of the existing suppliers'.

### Market Shares

35. Table 1 provides market shares for England based on the number of customers in England that each supplier has.

**Table 1: Market shares by number of schemes, England**

Supplier	Number of schemes	Market share (%)
Digital	43	47
Orion	31	34
<b>Combined</b>	<b>74</b>	<b>80</b>
HISL	[ ]	[ ]
1 <sup>st</sup> Retinal Screening	[ ]	[ ]
ProWellness	[ ]	[ ]
Siemens	0	0
Other <sup>20</sup>	[ ]	[ ]
<b>Total</b>	<b>92</b>	<b>100</b>

36. The parties' combined market share of 80 per cent, increment 34 per cent, is at a level which would typically give the OFT cause for concern. However, in this case, market shares may not accurately reflect the level of

<sup>18</sup> UK National Screening Committee, Workbook 4.3, last updated June 2009: [www.retinalscreening.nhs.uk/userFiles/File/DiabeticRetinopathyScreeningWorkbookRelease43\\_2009-06-23.pdf](http://www.retinalscreening.nhs.uk/userFiles/File/DiabeticRetinopathyScreeningWorkbookRelease43_2009-06-23.pdf)

<sup>19</sup> Page 11, Software Improvement Project – Consultation Responses

<sup>20</sup> The OFT understand that there is a further provider of DRSS called Topcon.

competition between the parties since few schemes switch their supplier once a software supplier has been chosen. The parties have submitted that since inception only seven schemes out of the 92 in England have changed supplier:

- two as a result of adjacent regional schemes merging
- one switch from an in-house software solution, and
- one caused by a new manager wishing to change software supplier.

The reasons for the remaining three are unknown. Moreover, as the product market is software, there would appear to be no barriers to competitors expanding supply.

37. This confirms that a very small percentage of schemes are marginal customers. It is unlikely that the switching by these schemes realistically constrains the parties' pricing in the second part of the systems market (support). Customers told us that the per annum cost of on-going support services costs around 27 per cent of the software purchase price.
38. Customers responding to our market testing were generally concerned about the impact of the merger on competition. Although, the vast majority of respondents did not intend to hold a tender for their DRSS within the next two years. Moreover, few customers were aware that if they did decide to switch, they could use non-approved suppliers. This has led, in the few cases where customers have switched, to customers not holding open tenders but instead simply migrating to Digital from Orion's software.
39. One competitor told us that, although some schemes were choosing to switch away from Orion, the merger will prevent competition at the margin to supply those customers. The merger, however, does not change this insofar as customers are likely to migrate to Digital rather than tender for a new supplier, given customers' lack of awareness of alternative suppliers.
40. The ENSPDR has stated that unsatisfactory price rises from the parties post merger would lead it to seek funding from the Department of Health to enable it to hold a central competition for software. This would indicate that the ENSPDR could arrange a competitive tender post-merger:

'To guard against [any future price increases] the National Programme will review the situation in 18 months and consider applying for funding to the DoH to procure centralised software. This will remain a threat to DHc [Digital] as the ENSPDR could state that price increases leading to dissatisfaction in the future with software amongst programmes is not delivering the benefits expected.'

41. Although the ENSPDR currently has no formal role in IT procurement for individual programmes, it is plausible that the procurement processes could aim to co-ordinate at the national level to resist any attempted price increase.

#### Competition for the English market

42. The ENSPDR has recently closed a consultation on options for the future supply of DRSS. One of the options considered is a move to a single national supplier, along similar lines to the other countries in the UK.
43. A theme in the consultation document is that the ENSPDR believes that currently there is too much competition;<sup>21</sup> and wants to avoid attracting even more competitors.<sup>22</sup> The concern about the extent of competition arises because the ENSPDR believes that suppliers may not have a sufficiently large customer base to incentivise investment and development.
44. The consultation document included four long term options (plus the option for respondents to recommend other options):
  - **Contract consolidation by region/supplier.** There would be a single national contract template, but contracts would be held by a regional authority on behalf of local schemes. It was noted that this option would facilitate synchronisation of contracts and might therefore make it easier to transition to a single provider at a later date.

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<sup>21</sup> For example, on page 21 the consultation says that the 'objective of this Option is to...deliver a reduction in the number of suppliers and derive economies of scale nationally that will allow for development'.

<sup>22</sup> For example, on page 21 the consultation says that 'any EU procurement notice might also attract suppliers who are not already engaged in the Programme, which might further exacerbate the challenges caused by a large number of suppliers in a small market'.

- **Software procurement at the regional level.** Regions would tender for single region-wide screening system and could also have regional requirements.
- **Consolidation with regional procurement where required.** That is, if a region already has a single supplier then it could effectively consolidate the contracts into one manageable contract.
- **Procurement of a single national system.** This option would involve significant short term data migration costs, but greater returns from investment. The consultation document describes this as 'an option to work towards as market forces may well drive the supplier base in this direction.'

45. Several third parties told the OFT that they believed that the ENSPDR was likely to eventually choose a single national supplier of DRSS.

46. As discussed above, the ENSPDR has identified four competitors to the merging parties, and the OFT has been advised of a fifth. Moreover, the ENSPDR did not raise any concerns and it appears comfortable that there is no 'tipping point' due to switching costs<sup>23</sup> – that is, it believes that it could switch away from the merged parties even though this would involve significant data migration.

## **BUYER POWER**

47. As discussed above, the ENSPDR believes that there is at least some ability to centralise purchasing and open competition for the market. The ENSPDR believes that this threat gives it the ability to resist any potential price increases on the part of the merged entity.

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<sup>23</sup> See OFT/CC joint Merger Assessment Guidelines, paragraph 5.8.6.

## THIRD PARTY VIEWS

48. Customer's views were mixed. Where relevant third party comments have been referred to above. Some third parties saw the merger as an opportunity, creating a better system, possibly one where England follows the procurement model of the other countries in the UK. Other third parties welcomed the merger, considering it would allow the parties to support each other in areas where they struggle; others thought that the size of the merged entity would stifle competition, while some thought the merger would see other suppliers taking a greater interest in the market.

## ASSESSMENT

49. The parties overlap in the supply of DRSS and service support primarily in England, where there is competition **in** the market for the provision of DRSS to regional screening programmes. The parties also overlap as potential competitors **for** the market for the provision of DRSS in Northern Ireland, Scotland and Wales.

50. The supply of DRSS, in England, is perceived to be a mature and saturated market by market participants. There is little opportunity for suppliers to win new contracts, third parties confirmed that Programmes changed suppliers only very rarely, and that therefore, the bulk of the revenues earned come from software support services and upgrades.

51. Only Scotland, and Wales, are likely to carry out a procurement exercise in the near future, (within two years) and third parties have identified a number of alternative suppliers to the incumbents<sup>24</sup> that could compete **for** these markets. The OFT also understands that Northern Ireland does not intend to tender for a new DRSS supplier within the next two years, therefore, there appears to be no loss of competition to supply this market at this time. On this basis the merger does not appear to give rise to a realistic prospect of a substantial lessening of competition for these customers.

52. In England, where competition is currently **in** the market rather than **for** the market as in the other UK countries, the merged entity will still face

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<sup>24</sup> Note that for Scotland the incumbent is neither of the merging parties.

competition from existing DRSS suppliers, for any programmes that decide to switch supplier. In addition the ENSPDR is planning to review the market 18 months after the merger and would consider applying for funding from the Department of Health to enable it to carry out a centralised software procurement exercise should any price increases negate any short term benefits realised by the merger.

53. Consequently, the OFT does not believe 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**

54. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.