OFFICE OF FAIR TRADING

Completed acquisition by Synergy Healthcare Limited of Shiloh plc

The OFT's decision on reference under section 22 given on 11 October 2005. Full text of decision published 7 November 2005.

PARTIES

1. Prior to the merger **Synergy Healthcare Limited (Synergy)** and **Shiloh plc** were both suppliers of various services to healthcare providers (for instance infection control products (Shiloh) and surgical linen supply (Synergy)). The only area of overlap is in the decontamination and sterilisation of surgical instruments used to undertake surgical procedures (decontamination services). Shiloh's UK turnover for the year ending 31 March 2005 was £44.7m.

TRANSACTION

2. On 5 August 2005 Synergy's offer to acquire the entire issued share capital of Shiloh became unconditional. The statutory deadline is therefore 4 December 2005 and the administrative deadline expires on 12 October 2005.

JURISDICTION

3. As a result of this transaction Synergy and Shiloh have ceased to be distinct. The parties overlap in the supply of decontamination services to NHS hospitals and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met if internal NHS supply of these services is excluded (the parties estimate their combined UK share of supply in such circumstances to be 77.5 per cent). The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

BACKGROUND

4. The OFT has considered a previous acquisition by Synergy in this sector in 2002[1]. The transaction was cleared on the basis that although the parties had a high combined share of supply, the increment was modest and barriers to entry were low with new private sector entry expected by the NHS in response to changes to be implemented following a review of sterilising and decontamination services. It was also noted that the industry was characterised by competitive tendering, giving buyer power to the NHS as the main customer.

5. Neither Synergy or Shiloh provide services in Northern Ireland or Wales. Shiloh is active in Scotland (with the majority of non-NHS in-house supply) but Synergy is not. Due to the lack of activity or overlap (and the absence of concerns from third parties), the position in Scotland, Wales and Northern Ireland is not considered further in this assessment.

The National Programme

6. Since 2002, the Department of Health has embarked upon a national programme to ensure that decontamination services are fully compliant with EU standards by 2007. This follows a review by the DoH of the risk of transfer of new variant CJD via surgical instruments. To achieve this, in May 2003 NHS Estates published 'Strategy for modernising the provision of decontamination services', which recommended that the private sector should provide decontamination services, thereby ensuring the investment and risk management skills required to comply with the CE certified standard.

7. The DoH set up the Decontamination National Team with a view to actively encouraging NHS Trusts to outsource decontamination services to private sector providers. Provision by the private sector is intended to be the main source of decontamination services to the NHS by 2007, with in-house supply by NHS Trusts providing the balance. The DoH estimates that approximately 90 per cent of decontamination services will be provided by the private sector by 2007.[2] The intention of the NHS has been to encourage new entry with a view to converting the NHS from a self-supplier to a consumer of sterile services.

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[1] Proposed acquisition by Synergy Healthcare plc of Hays Clinical Support Services, a division of Hays Commercial Services Limited (10 April 2002) (http://www.oft.gov.uk/business/mergers+fta/advice/clearances+and+referrals/synergy.htm).

[2] Addendum - DoH advises that the correct figure is closer to c.80 per cent (split between joint ventures, PFIs and traditional outsourcing deals) with the NHS supplying the remainder of the sites. All suppliers will abide by the same criteria policed by the Health Care Commission.

Tendering

8. As a result of the National Programme, many of the NHS Trust's decontamination services requirements are put out to tender. Tendering is instigated by advertisement in the OJEU. Those expressing interest are required to complete a selection and pre-qualification questionnaire (SQs and PQQs). The SQs and PQQs are objectively scored based on criteria set by the National Team in agreement with the local Trusts and Strategic Health Authority.

9. Each tender usually comprises a cluster of 3-5 Trusts and is referred to as a project. These projects are advertised in 'waves' of usually 3-4 projects. The first project (for Leeds Bradford and Calderdale Trusts) was tendered ahead of the waves as the Pathfinder project. The contracts are for terms of 12 to 20 years, reflecting the level of capital expenditure required at the outset to build a facility.

RELEVANT MARKET

Product market

10. According to the parties, there are no obvious **demand side substitutes** to decontamination services. On the **supply side**, however, they argue that providers of other cleaning services or other outsourced services could easily commence the supply of decontamination services if existing suppliers increased their prices. Furthermore, they claim that self supply and the ability of NHS Trusts (in certain circumstances) to switch to disposable instruments places some constraint on prices. There is limited evidence to back up the case for disposable instruments however and it is not considered that they provide sufficient constraint to widen the product market beyond the supply of decontamination services.

11. Decontamination services can be provided through one of three sources:

    a. in-house provision by the hospital's sterile services department (SSD) on the hospital premises, operated by the hospital;
    b. outsourced to another NHS Trust; or
    c. outsourced to the private sector either through a service provider, or a public sector/private sector joint venture or partnership or by a private sector provider off the hospital premises (the 'commercial supply' of such services).

12. In 2002, over 95 per cent of decontamination services were provided by the NHS, either in-house or through another NHS Trust. Following the introduction of the National Programme, the number of services outsourced to the private sector has increased substantially, and is set to increase further. Many hospitals do not meet the new decontamination standards and do not have the money to invest in

facilities to meet these standards. They therefore have no choice but to out-source their services. The majority of customer respondents to our enquiry have not considered out-sourcing to another NHS Trust. Thus there is limited evidence that other NHS Trusts provide substantial competitive constraint to the private sector. The DoH has commented that once out-sourced, hospitals will not realistically have the option of returning to in-house provision.[3]

13. Although in-house provision might currently place a competitive constraint on out-sourced commercial provision, it is less clear how much of constraint it will continue to place in future due to the changes introduced by the National Programme. Thus the appropriate frame of reference for this case is taken to be the commercial supply of decontamination services to NHS hospitals.

Geographic market

14. The parties submit that the geographic scope is national, however, they argue it could be wider than this as this is a bidding market in which national and overseas suppliers can compete equally.

15. PASA suggests that the commercial provider will look to build its site centrally to all of the Trusts that it will be servicing within a particular project. Provision of the contract is to provide normal turnaround in 8 hours. According to third parties, decontamination providers tend to be located up to 20 miles away from the hospitals they serve. However, given that bidders are located all around the country and simply set up locally, it appears that the relevant geographic scope for the purposes of this analysis is at least national.

HORIZONTAL ISSUES

Shares of supply

16. On a national basis[4], there is no overlap between the parties. However, given the commercialisation of the sector and the on-going bidding process in England, the OFT considers that UK shares of supply may provide a more useful initial view of the competitive situation as opposed to purely national shares. Synergy estimates that in the UK the combined entity will have around a 77.5 per cent share (7.5 per cent increment) of the supply of decontamination services provided solely by commercial (i.e. non-NHS) suppliers.[5] The remaining shares are split equally

[3] The DoH wish to clarify that this is due to the high levels of service and compliance with the latest standards meaning that once services are out-sourced, hospitals will see no requirement to return to an in-house provision.
[4] In terms of England, Scotland, Wales and Northern Ireland respectively.
[5] It is noted that within England there is no historic overlap between the parties.

between In Health, Sodexho and B Braun. Synergy notes that if Braun's recent tender wins were included, the size of the sector would increase from £25m to £35m-40m, thereby reducing the parties' shares. Given the number of new contracts about to be awarded in England, and the fact that Synergy has not been shortlisted for many of them but Shiloh has, their current shares may not be a particularly accurate proxy for future shares. In a bidding market it is debatable whether shares of supply at any one time reflect market power or the level of effective competition.

17. The OFT has obtained bidding data from both the parties and third parties showing that there have been at least nine companies[6] engaged in the bidding process for the National Programme so far, who have been pre-selected through the qualification process as having the required competencies to service the market. Eleven projects have been advertised to date and the preferred bidder (Braun) announced in one of these so far.

18. Data obtained by the OFT shows that for the Pathfinder project, the merger would not have signified any loss in the number of bidders. The data also shows that while Shiloh has often been short-listed, Synergy has been much less successful. Inhealth appears to be Shiloh's closest competitor in terms of the number of times it has been short-listed against Shiloh.

19. Information from customers suggests that Synergy and Shiloh do not generally tend to bid against each other for non-national project work. This implies that there would be no loss of actual competition for these smaller contracts as a result of the merger. Furthermore, PASA suggests that smaller sites should have several options going forward in terms of their decontamination needs.

Barriers to entry and expansion

20. Synergy estimates that the capital expenditure required to enter the decontamination sector on a scale necessary to gain a 5 per cent share is approximately the first year's revenue, i.e. around £15 million. This cost is more or less the same for a new entrant or an existing provider. Although an existing provider would have experience, expertise and some staff, capital expenditure is required to build a facility and procure and install the equipment. Third party competitors' estimates of the capital expenditure required vary considerably from around £1 million to over £20 million, when taking into account the cost of bidding.

[6] Braun Medical Ltd, LUKI AB, McIndoe Surgical Centre Ltd, Medical Physics, Qinetiq, Shiloh, Sodexho Healthcare, Sterience Ltd, Sunlight Service Group Ltd, Synergy Healthcare.

21. Synergy estimates that a suitable facility of around 20,000 square feet could be fully constructed and operational within 12 months of the contract award as the equipment required is not complex.

22. There have been a number of new entrants bidding for contracts under the National Programme. Given that only one contract has been awarded (to a current provider of decontamination services as opposed to a new entrant), it is difficult to judge how successful these new entrants will be. The DoH suggests that the National Programme will create a new marketplace with entry of some 5/6 new service providers. These new market entrants are from other European countries, from within the UK and from other support service providers trying to enter this marketplace. DoH has identified a significant number (around 12) of new consortiums expressing interest in the programme. In many respects entry is considered to be relatively easy as commercial providers are not required to have established sites prior to bidding. Discussions are currently taking place with a number of potential new entrants from Germany and Sweden, potentially adding to the list of prospective competitors.

23. Competitors, however, have indicated that many of these expressions of interest will not result in new entry if the bidders are not successful in the current rounds of bidding. One competitor has suggested it costs around £0.5m per contract to put in a bid[7]. Given that only one contract has been awarded (to Braun) under the National Programme, it is difficult to predict how successful these new entrants will be.

Buyer Power

24. As in the previous Synergy decision, the NHS Trusts remain the main buyer in this segment. The bidding data suggests that buyer power could be reduced to a certain extent by the merger due to both parties bidding for some National Programme contracts. However, the customer tends to receive far more expressions of interest than the final bidders it invites. Given that Synergy tends not to be short-listed, customers could invite another company to bid instead of Synergy, thereby limiting the effect on the NHS's buyer power.

VERTICAL ISSUES

25. No vertical competition issues arise as a result of this merger.

[7] Others suggest the cost is slightly lower - £1.5 million for 9 projects i.e. £0.17m per bid.

THIRD PARTY VIEWS

26. Very few customers raised competition concerns. Those that are concerned are worried that they did not short-list Synergy but may end up using their services as a result of this acquisition. Some competitors have suggested that they will find it difficult to compete against a combined Synergy/Shiloh.

ASSESSMENT

27. This is a sector which is undergoing considerable change at the present time as the NHS seeks to implement a programme to vastly increase the commercial supply of decontamination services in England. Such changes, and the NHS' promotion of new entry from previously non-established players, means that historic shares of supply are of limited value when assessing the impact of this merger. Bidding data shows that the merger would not signify a loss in the number of current short-listed competing bidders and the NHS considers that it remains on-course for its aim of having a core group of five or six providers bidding for contracts.

28. Some competitors have raised concerns that new entry will not be as successful as the NHS suggests and the merger of two established players will therefore reduce competition in the sector. As only one contract has been awarded so far, it is difficult to judge how effective the new entrants will be. However, the OFT notes the lack of concern from NHS, PASA and most hospital customers, and the limited number of recent competing bids submitted by the parties.

29. 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

30. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.