Coloplast A/S
and
SSL International plc

A report on the merger situation

COMPETITION COMMISSION

Coloplast A/S and SSL International plc

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Presented to Parliament by the Secretary of State for Trade and Industry by Command of Her Majesty
June 2002

Web site: **www.Competition-Commission.org.uk**

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[1]These members formed the Group which was responsible for this report under the Chairmanship of Mr A J Pryor.

Note by the Department of Trade and Industry

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which she considers would not be in the public interest to disclose and which, in her opinion, would seriously and prejudicially affect certain interests.

The omissions are indicated by a note in the text or, where space does not permit, by the symbol ✂.

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Summary and Conclusions

1 Summary

1.1. On 14 January 2002 the Secretary of State for Trade and Industry referred to us the completed acquisition by Coloplast A/S of the continence care business of SSL International plc. We were asked to report by 13 May 2002. Our terms of reference are set out in Appendix 1.1.

1.2. Coloplast A/S was founded in 1957 and is a Danish company that develops, manufactures and markets ostomy products, continence care products, wound dressings, skin-care products, breast forms, special dressings and special textiles for women. It has a wholly-owned UK subsidiary, Coloplast Limited, that distributes ostomy care, continence care and wound care products in the UK.

1.3. SSL International plc was formed in 1944 and took its current name in 1999 following a merger with London International Group. In addition to its continence care business, which was sold to Coloplast, SSL manufactures and markets medical and consumer healthcare (including family planning) products, footcare products, over-the-counter drugs and surgical products.

1.4. On 29 September 2001 Coloplast A/S acquired, for £80 million, the continence care business of SSL International plc involving the design, packaging, marketing, supply and distribution of intermittent catheters, incontinence sheaths and leg and night bags for collection of urine (urobags) and ancillary activities. As part of the transaction an agreement giving SSL exclusive distribution rights in the UK for sheaths supplied by the Mentor Corporation (Mentor), a US company, was novated in favour of Coloplast A/S. This included exclusive distribution rights in the UK for Mentor's market-leading silicon Clear Advantage sheath.

1.5. The overwhelming majority of intermittent catheters, sheaths and urobags used in the UK are supplied under the National Health Service (NHS). The market is divided into two sectors—hospitals and the community.

1.6. The hospitals sector represents about 10 per cent of the total cost to the NHS of continence care products. However, it has an importance for manufacturers going beyond this. First, there is a widespread belief that hospital sales can serve as a gateway to community sales, because users of incontinence products in hospitals often continue to use those same products once in the community. Second, hospital trials and the use of products within hospitals provide a route by which companies can increase recognition and acceptance of their products by clinicians. Manufacturers bid in response to periodic open tenders by the Purchasing and Supply Agency (PASA) to have their products included on the National Contract for hospitals in England, and under similar arrangements in other parts of the UK.

1.7. The community sector accounts for about 90 per cent of the total cost to the NHS of continence care products, which are obtained through pharmacies or Dispensing Appliance Contractors (DACs). In order for dispensers to be remunerated for appliances supplied under prescription in England and Wales, the appliances must be listed in the Drug Tariff. Manufacturers apply to the Department of Heath (DoH) for listing of their products and negotiate to establish the price at which they will be included. Subsequent price increases are controlled under an agreement between the DoH and the Association of British Health-care Industries. There are similar arrangements in Scotland and Northern Ireland.

1.8. We concluded that the relevant product markets are defined narrowly, with intermittent catheters, sheaths and urobags in separate product markets from each other, from other continence care products and from other treatments for incontinence. The products included in those markets are those that are listed on the Drug Tariff, or on the National Contract, and the equivalent arrangements in Scotland, Wales and Northern Ireland. We concluded that the geographic market for these products is the UK.

1.9. As a result of the acquisition the market share in the UK of Coloplast A/S and its subsidiaries (Coloplast) rose from 34 to 92 per cent for sheaths, from 6 to 58 per cent for urobags and from 19 to 26 per cent for intermittent catheters.

1.10. In our view the greatest effect on competition is in the market for sheaths, where, in addition to giving Coloplast a very high market share, the acquisition has resulted in the elimination of Coloplast's main competitor and given it control of the market-leading brands of latex and non-latex sheaths. All other suppliers of sheaths have small market shares, which they have failed to grow over several years, and we saw no evidence that would lead us to expect that they would become large players in the near future. New entrants face manufacturing, marketing and regulatory barriers. We found no similar combination of factors in the markets for urobags and for intermittent catheters.

1.11. A number of Coloplast's competitors also expressed concern over its acquisition of additional DAC outlets and of the Thackray nursing service. We concluded that the impact of these does not give rise to competition concerns in relation to the retail or wholesale of continence care products in the UK, and in the absence of such concerns we do not judge that it should give rise to concerns over vertical integration. We do not expect that Coloplast will seek to curtail the independence of Thackray nurses and their ability to recommend products of other manufacturers, which would not appear to be in its commercial interest.

1.12. We considered the effects on the public interest in relation to the supply of sheaths both to hospitals and to the community.

1.13. The price at which sheaths are supplied to NHS hospitals arises from tendering pro??cesses, and the purchasing power of PASA and the equivalent bodies in other parts of the UK depends upon the availability of substitutes from alternative suppliers. Due to concerns over latex allergy, PASA told us that provided, as it expected, a full range of sizes was available in non-latex sheaths, it would not envisage a need to include any latex sheaths on the National Contract following the next tender round for which it will be inviting bids in March/April 2003. We judge that the options open to PASA at that time will not be sufficient to offer a realistic alternative to inclusion of Coloplast non-latex sheaths on the National Contract. As a result we expect that the acquisition will, through its impact on competition, result in the cost of non-latex sheaths to NHS hospitals in the UK being higher than would otherwise have been the case.

1.14. Despite the effect of the merger on competition in sheaths, we do not expect the acquisition to lead to higher prices for sheaths in the community. Prices are in effect controlled through the arrangements by which pharmacies and DACs are remunerated under the Drug Tariff in England and Wales, and under equivalent arrangements in Scotland and Northern Ireland. Nor do we expect any adverse effect on innovation quality and service. Whilst we do not believe that some degree of product rationalization can be ruled out, we do not expect the rate of product withdrawal as a result of the merger to be detrimental to the public interest.

1.15. We do not believe that the detriment identified in paragraph 1.13 will be outweighed by any benefits to the public interest. We therefore conclude that the acquisition by Coloplast of the continence care business of SSL is expected to operate against the public interest.

1.16. We believe that it would be possible to impose a price cap on the supply of Coloplast non-latex sheaths to NHS hospitals until the expiry of the Mentor agreement in 2007, so as to ensure that prices do not rise in the interim. However, we take the view that amending the Mentor agreement in relation to Clear Advantage to facilitate competition in the supply of non-latex sheaths offers a better approach providing that it can be achieved without unreasonable economic damage to Coloplast. We further take the view that changes to the Mentor agreement would best be achieved through negotiation between Coloplast and Mentor. The aim of the negotiations should be to secure either divestment of the Clear Advantage brand, leaving Coloplast with the right to source the silicon sheaths but market them under a different name, or divestment of the Clear Advantage brand and product, which would involve terminating the Mentor agreement with respect to the silicon sheaths. Either of these would appear to us to represent an acceptable way to address the detriment that we have identified.

1.17. We accordingly recommend that Coloplast be required to give an undertaking to the Director General of Fair Trading (DGFT) that it will use its best endeavours to negotiate an agreement with Mentor accordingly. We further recommend that should no agreement acceptable to the DGFT be in place within six months of the date of publication of this recommendation, then the DGFT take such other action as he deems appropriate, having regard to the specific nature of the detriment we have identified, the need for speedy resolution in view of the impending hospital tender round, the effect of the acquisition by Mentor of the urology business of Sims Portex announced on 6 May 2002, and the need for any action to be proportionate. A price control remedy, together with an undertaking not to renew the Mentor agreement beyond 2007, will continue, despite its drawbacks, to be among the options available for consideration.