

PRIVATE HEALTHCARE MARKET INVESTIGATION

Entry and expansion case study 1: Circle Holdings PLC, Bath

Introduction

1. This paper examines the entry of Circle Holdings PLC (Circle) into the private healthcare market in Bath and its purpose is to identify what barriers it encountered in doing so. We begin with a brief description of Circle, its business model and the characteristics of the local market it planned to enter. We then describe Circle's entry plan: its strategy for attracting healthcare business from the private sector and the NHS, the scale of its investment and the risks that it identified. We next analyse the response of the incumbent private healthcare provider, BMI Healthcare Ltd (BMI), and the conduct of the major private medical insurers (PMIs) as Circle sought network recognition for its new facility. Finally, we set out the main conclusions that we draw from this episode in the wider context of our fifth theory of harm: barriers to entry and expansion.

Circle healthcare

2. Circle was set up in 2004, originally as Centres of Clinical Excellence. The feature that distinguished its business model from other private hospital operators' was that, in return for committing to undertake a certain proportion of their work at a Circle facility, consultants would be entitled to an equity stake in the business. Circle told us that [redacted] consultants had entered into contractual commitments.
3. Circle's strategy was to provide healthcare to both private and NHS patients from its facilities, the latter arising from what it saw as the growing demand for independently provided healthcare services created by NHS reforms.

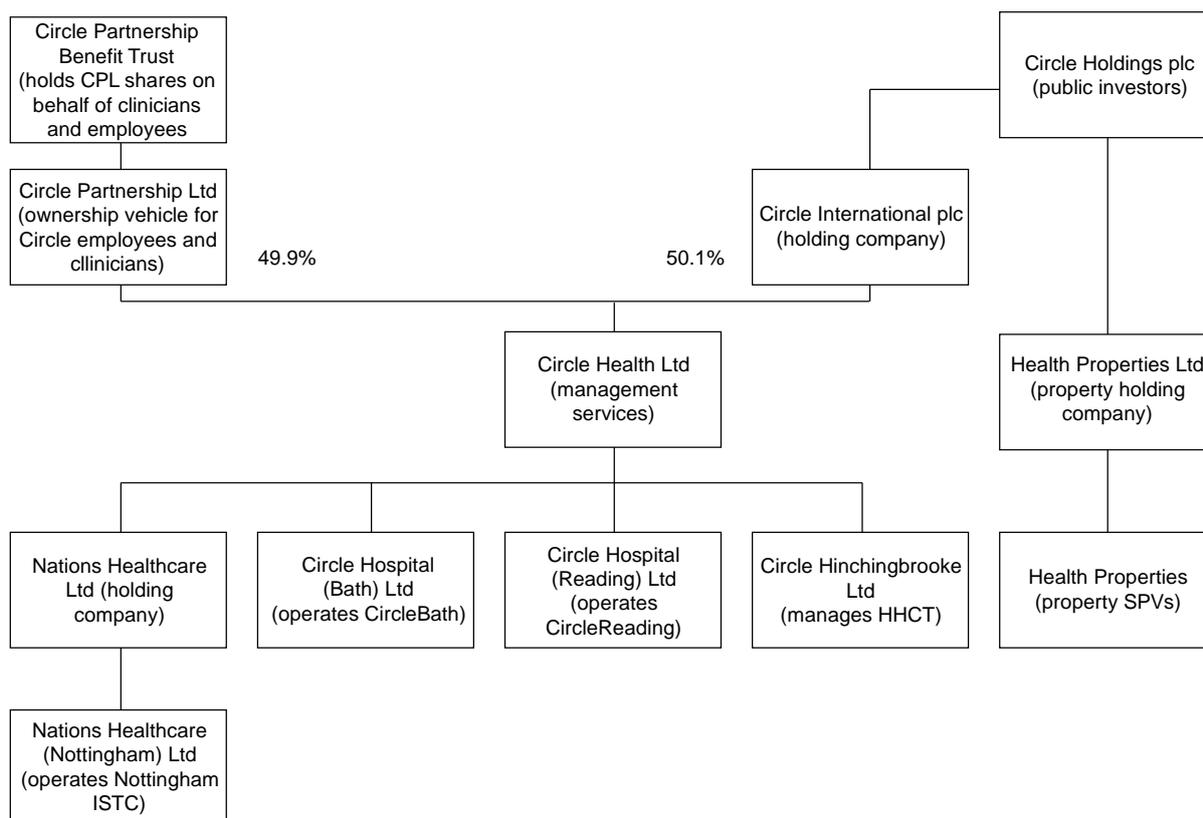
4. Circle's first acquisition was made in 2007, when it bought Nations Healthcare, an operator of three NHS Independent Sector Treatment Centres (ISTCs) in Bradford, Burton and Nottingham. Two of these contracts have now expired, with the Nottingham facility still operated by Circle.¹ In addition to its NHS-focused activities, Circle opened its first private hospital in Bath in March 2010, followed by its Reading hospital in August 2012. At the current time, Circle is seeking to secure sufficient consultant commitments and raise financing for a third private hospital in Manchester.

5. As noted above, Circle's business model relies on consultants committing to undertake a proportion of their work at a Circle facility in return for an equity stake in the Circle Partnership and a role in managing and organizing the delivery of services. The consultant may terminate his/her commitment with 12 months' notice at any time following the first anniversary of the relevant facility's opening. The legal structure of the Circle business is shown in Figure 1.

¹ Circle Holdings, AIM Admission Document, June 2011, p47.

FIGURE 1

Circle group structure



Source: Circle.

6. In addition to the entities shown here, the Group also holds a minority interest in a company that owns the Bath hospital and leases it to the Circle Independent operating business.²
7. The consultants that hold equity in the Circle Partnership have not been asked to provide funding directly: they do not have to pay for shares in the Partnership when they are allotted, only when they wish to sell them. However, their contractual

² The hospitals are leased on 25-year terms.

commitments to bring revenue to any new facilities built in their local area have been pivotal in raising capital from third party debt and equity investors.³

8. Circle has raised funds for the development of the business from three principal sources:
- (a) Circle Holdings Plc was listed on AIM via an initial public offering in June 2011;⁴
 - (b) the Bath hospital was largely funded by bank debt, both senior and mezzanine;
and
 - (c) much of the equipment used in providing services from the Bath (and Reading) hospital(s) is leased under a financing arrangement with GE and Singers.⁵

Local demographics

9. Bath and the immediate surrounding area (North-East Somerset) has a population of around 180,000. Bath is within a 45-minute drive of Bristol, with a population of over 400,000.
10. The Bath area is relatively affluent and healthy, scoring above the England average on virtually all indicators.⁶ Although there are pockets of deprivation, the area is generally prosperous with levels of unemployment that are below the national average. As of June 2012, unemployment in the area stood at 6.2 per cent, compared with a national average of 8.1 per cent.⁷

³ Circle noted that lenders and equity investors had requested copies of consultant contracts prior to agreeing to provide funds to the Group.

⁴ Circle Holdings, AIM Admission Document, June 2011. Circle Holdings Plc raised an additional £47.5 million through a further placement of shares in May 2012.

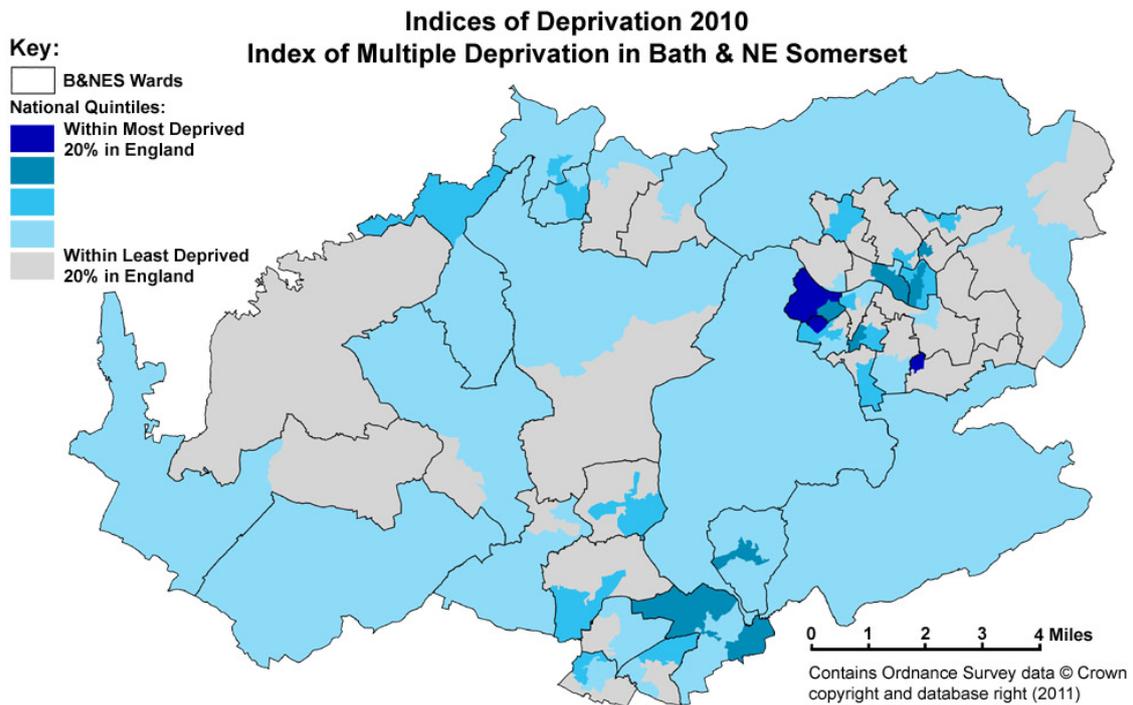
⁵ Circle Holdings, AIM Admission Document, June 2011.

⁶ www.apho.org.uk/resource/view.aspx?RID=117246.

⁷ Source: ONS data: www.nomisweb.co.uk/reports/lmp/la/2038431893/report.aspx?town=Bath#tabempunemp.

FIGURE 2

Indices of deprivation in Bath and North-East Somerset, 2010

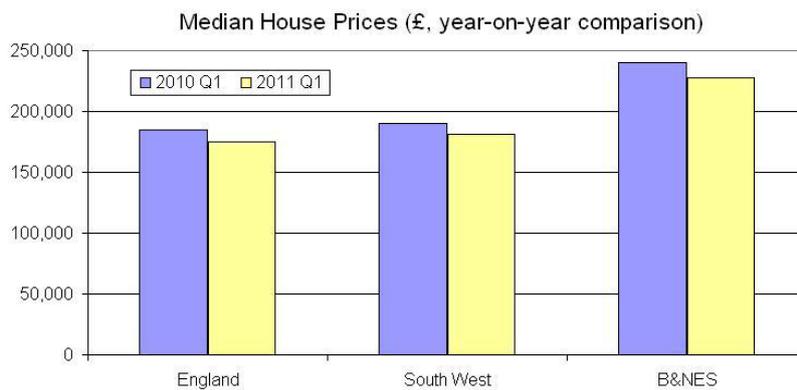


Source: Bath and North East Somerset Council.

- 11. House prices are higher than those in England generally and the South-West region in particular.

FIGURE 3

House prices in Bath and North-East Somerset, 2010 to 2011

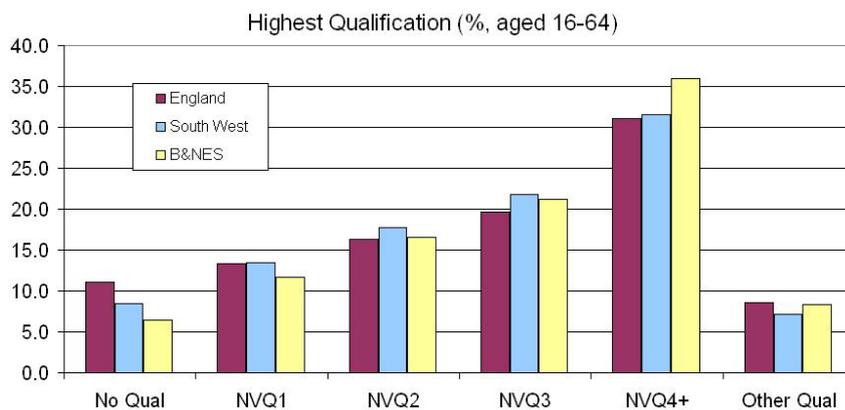


Source: Bath and North East Somerset Council.

- 12. The local population is relatively well educated.

FIGURE 4

Terminal qualification levels, Bath and North-East Somerset, 2011

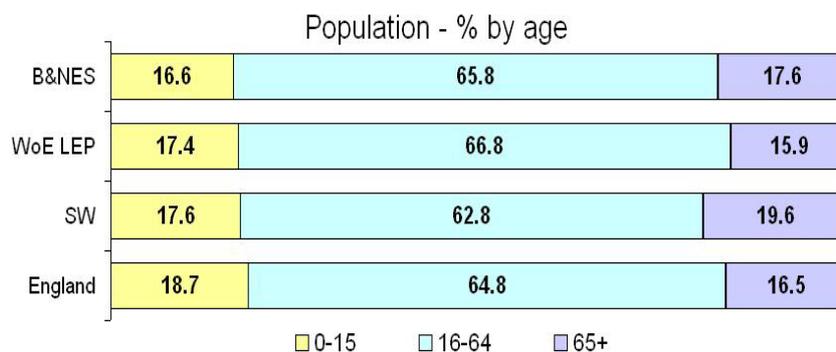


Source: Bath and North East Somerset Council.

13. The local population is older than average for the UK but lower than the South-West region.

FIGURE 5

Population age, Bath and North-East Somerset, 2011



Source: Bath and North East Somerset Council.

Secondary healthcare services in and around Bath

FIGURE 6

Private hospital and PPU locations in the Bath area



Source: Parties and CC analysis.

Private hospitals

14. Private hospital facilities within around one-hour's drive of Bath are shown on the map above. Prior to 2010 there was only one private, acute hospital in Bath, the BMI Bath Clinic, situated approximately 2.5 miles south-east of the city centre. It had 75 beds, a high-dependency unit, static MRI and CT scanners and an endoscopy suite. The building housing the Bath Clinic was bought from Grand Metropolitan plc in the 1990s and converted from hotel to hospital use.

FIGURE 7

The BMI Bath Clinic



Source: BMI Bath website.

15. Further afield, the Nuffield and Spire Bristol hospitals were a 35-minute drive away⁸ and BMI operated a hospital in Swindon, about a 60-minute drive from Bath.

NHS

16. The main NHS hospital in the area was the Royal United Hospital (RUH), a relatively modern, 560-bed facility occupying a 52-acre site roughly 1.5 miles from the city centre. In the early 2000s, the RUH experienced some challenges as regards its financial management and the quality of healthcare provided.⁹ In 2010, the condition of its some of its buildings were the subject of criticism¹⁰ and recent HES statistics suggest that the RUH underperforms the national average in a number of areas, in some cases significantly, for example deaths in low-risk conditions.¹¹ The RUH does not provide private healthcare services other than through a private, assisted

⁸ Nuffield is currently refurbishing the hospital on its Chesterfield site in Clifton, Bristol www.thechesterfieldhospital.com/.

⁹ www.hsj.co.uk/news/ruh-bath-report-pushes-reputation-aside/19557.article.

¹⁰ http://news.bbc.co.uk/local/somerset/hi/people_and_places/newsid_9267000/9267593.stm.

¹¹ www.drfoosterhealth.co.uk/hospital-guide/trust/Royal-United-Hospital-Bath-NHS-Trust-181.aspx?cid=164&ctype=1.

conception clinic (the Bath Fertility Clinic) launched in a joint venture with BMI in 1994.¹²

FIGURE 8

The Royal United Hospital, Bath



Source: RUH website.

Circle's planned entry

Market assessment

17. Circle considered that Bath was an attractive market in which to launch its first private hospital. It believed that: PMI penetration was very high, indicating strong demand; that the Bath Clinic did not represent a serious competitive threat; that the superior facilities of its new hospital would attract NHS patients; and that these facilities, plus its business model, would encourage consultants to treat private patients at Circle Bath. In this context, Circle told us that it had a very active and supportive network of consultants in the Bath area.

¹² The joint venture has ended and RUH now runs the business.

18. The 6,600 sq metre hospital was designed by Fosters and Partners and built at a cost of £33 million on a business park, nine miles south of Bath. It would have four operating theatres, 57 beds (30 overnight and 27 day-care) including two critical care (level 2) beds as well as up-to-date diagnostic facilities including x-ray and ultrasound equipment, a fixed MRI scanner and a mobile high-resolution multi-slice CT scanner. The hospital would be owned by Health Properties (Bath) Limited¹³ and leased to Circle. The majority of medical equipment would be leased from leasing organizations. It was planned to open in September 2009.

FIGURE 9

Circle's Bath hospital



Source: Circle.

Business plan

19. Circle's plan document valued the local market for private healthcare services in Bath at £[£] million in 2006 for approximately [£]. Its strategy was based on the quality of the facilities that it would provide and the support of local consultants who it had or would enlist as 'Partners' (ie consultants with an equity stake in the hospital business

¹³ A company within the Circle Group.

who would commit to undertaking a certain proportion of their private work at the hospital).

20. [REDACTED]

21. The plan set out details of the proportion of local consultants within each speciality who had committed to bringing work to the Circle hospital and the amount of revenue this represented.¹⁴ [REDACTED]

22. Regarding NHS patients, Circle said that the hospital's opening was timed to take advantage of NHS reforms which would, from 2008, permit NHS patients greater freedom to choose where they received treatment. It estimated that local NHS elective surgery spending was approximately £[REDACTED] million in 2007 for approximately [REDACTED].

23. [REDACTED] is shown in Table 1.

TABLE 1 [REDACTED]

[REDACTED]

Source: [REDACTED].

Risk assessment

24. Circle cited a number of risks that it said might impact the forecasts made in the business plan. These included that local competitors might engage in 'guerrilla' tactics, that Circle might not be able to secure the necessary regulatory approvals from the Healthcare Commission (HC)¹⁵ and that it may not be able to secure

¹⁴ Circle's contract with clinicians committed them to undertake a specified proportion of their practice at the Circle hospital in exchange for which they would be awarded shares in Circle Partnership, which would own 49.9 per cent of Circle, the operating company. The other 50.1 per cent of Circle would be owned by Circle International (now Circle Holdings Plc). The extent of the commitment varied but, weighted by revenue, amounted to 65.5 per cent on average, as set out in the Bath hospital plan.

¹⁵ The Care Quality Commission (CQC) replaced the Healthcare Commission, the Commission for Social Care Inspection and the Mental Health Act Commission in 2009.

recognition from the leading private medical insurance providers to become part of their networks.

25. Local 'guerrilla' action, such as objections to Circle's planning application for the new hospital, did not materialize in Bath (unlike Southampton where Circle's application to build a new hospital was taken to appeal). Circle received planning permission for the hospital, involving a change of use for which the plot was zoned, on 13 March 2007. No objections to the application were lodged.
26. Circle told us that some local consultants did come under pressure from the Bath Clinic not to work with Circle. Circle told us that the practicing privileges of one consultant were suspended by BMI Bath. However, BMI told us that this suspension was temporary, pending the clarification of the clinician's role at Circle Bath, and that once this had been established the suspension was lifted.
27. Registration by the HC/CQC does not appear to have been a significant problem though the inspection of the premises was delayed and the regulator required some changes to be made to the facilities. Circle told us that certain additional building works were required in the theatre and recovery areas which contributed to Circle's decision to postpone opening to 1 March 2010.
28. Regarding PMI recognition, Circle said in its plan that both Bupa and AXA PPP, while recognizing all Healthcare Commission accredited hospitals, had networks of provider hospitals. Subscribers who held network policies, which on Circle's estimates accounted for 50 per cent of Bupa policyholders and 95 per cent of AXA PPP policyholders, were restricted to using hospitals registered on these networks. The plan document that in order to capture the volume of private patients projected in its business plan it would have to be registered by both Bupa and AXA PPP. It said that,

to that end, it had been having regular discussions with both Bupa and AXA PPP for the previous 18 months and that feedback from these companies had been consistently positive. It said that it was confident that Circle Bath would be successful in achieving network status with both Bupa and AXA PPP.

Responses to Circle's entry in Bath

29. We now describe the responses of Circle's competitor in Bath, BMI's Bath Clinic, and then go on to set out how the major PMIs responded to Circle's requests for inclusion on their networks.

BMI

30. Circle had two potential competitive advantages over the Bath Clinic: the newness of its facilities and the financial incentives that it was able to provide to its consultant Partners through its equity sharing business model. BMI sought to match these by introducing its own consultant incentive or 'loyalty' schemes and by investing in new equipment at the Bath Clinic.

Consultant 'loyalty' schemes

31. In the period between the granting of planning permission for Circle's Bath hospital and its opening, BMI adopted two schemes that were available to consultants practicing in Bath: the initial scheme, which became known as 'Mark 1' launched in 2007 and the Mark 2 scheme, launched in 2010.

The Mark 1 Scheme

32. BMI group management considered consultant loyalty schemes in 2007 as part of its strategic response to increased competition from other hospital operators, including Circle. A board paper of April 2007, a month after Circle obtained planning permission for its Bath hospital, assessed the severity of the competitive threat to

each of its hospitals. [REDACTED] were considered to be exposed to the highest risks and, accordingly, were proposed as the first hospitals where consultant loyalty schemes would be set up.

33. The Mark 1 scheme combined profit sharing and 'virtual equity' elements which aimed to engage and motivate current and future [REDACTED]. The scheme was designed in part to mimic an equity share plan [REDACTED].
34. The scheme covered a six-year period and entitled consultants to a share of the Bath Clinic's profits, [REDACTED].¹⁶
35. As well as the rolling share of the Clinic's profits and the long-term payment referred to above, consultants would be entitled, depending upon their level of membership, to receive some or all of: [REDACTED].
36. In addition to these benefits, if a Member were to introduce a new consultant to the clinic who subsequently went on to enter into a similar agreement, then the introducing Member/consultant would be entitled to receive [REDACTED].
37. The 'Mark 1' scheme was, unlike Mark 2, contractual. [REDACTED]
38. Consultants were also required to agree that they would not enter into form of any agreement or contract with any Competitor relating to operation of a private medical practice including acquiring any financial interest in such Competitor, although they could retain practicing privileges elsewhere.

¹⁶ [REDACTED]

39. [X] The ethical issues from the consultants' side were considered, including that: patient volume incentives were not acceptable; that consultants would be obliged to disclose any financial interest; and that the value of the payouts under the scheme should not be disproportionate to the consultant's practice income. Subject to a requirement for feedback on the incremental activity that the schemes were generating the committee gave its approval.
40. The terms and conditions of the scheme required the consultant 'comply with the requirements, rules, regulations and guidance of, or issued by, the GMC, including the guidance of the Good Medical Practice (2006), as amended from time to time. In particular, the Consultant shall have regard and comply with paragraphs 72–73 of the Good Medical Practice (financial and commercial dealings)'. The GMC's guidance requires that clinicians with a financial interest in an organization providing healthcare should not allow this interest to influence the way they treat or refer patients and that they should tell the patient about the interest that they have if they are intending to refer the patient to that organization.¹⁷

The Mark 2 Scheme

41. As the scheduled opening of the Circle Bath hospital neared, the Bath Clinic began putting further measures in place to protect both private and NHS revenue. These included: a pilot scheme to subcontract GPs to undertake pre-operative examinations of patients referred by them to the Bath Clinic and to receive payment for these examinations in the event that the patient was treated at the Bath Clinic; some changes to NHS and self-pay pricing;¹⁸ and an additional consultants' loyalty scheme: Mark 2.

¹⁷ Paragraphs 77–80.

¹⁸ Prices for NHS and self-pay work were decreased whilst consultants' fees for this work were increased. In March 2010, BMI Bath Clinic also launched a 'Lowest Price Guarantee,' for self-pay in-patient and day-case treatment.

42. In April 2010, shortly before the (delayed) opening of Circle Bath, Richard Foulkes, the Executive Director of the Bath Clinic, wrote individually to consultants setting out the terms of the new Consultant Engagement Scheme. This Mark 2 scheme would operate for calendar year 2010 [redacted].
43. The letter said that there was to be no formal contract with consultants and that unless the Clinic heard to the contrary it would assume that consultants wished to participate. [redacted]
44. The Mark 2 scheme also differed from Mark 1 in that there were no bars to [redacted].

Cost of the two schemes

45. Payments made under these two schemes are shown in the table below. By the end of 2012 Bath Clinic had made over £[redacted] million in payments.

TABLE 2 **BMI Bath expenditure on consultant loyalty schemes, 2010 to 2012**

<i>Scheme/consultant name</i>	<i>Incentive basis</i>	<i>FY10</i>	<i>FY11</i>	<i>FY12 est</i>
Consultant Engagement Scheme Mk1	[redacted]	[redacted]	[redacted]	[redacted]
Consultant Engagement Scheme Mk2	[redacted]	[redacted]	[redacted]	[redacted]

Source: BMI.

Investment in the Bath Clinic

46. BMI also invested in new equipment at the Bath Clinic, a few months before the opening of Circle Bath.
47. In January 2010 BMI considered a capital expenditure request of £[redacted] for the Bath Clinic to replace the Stack, Light Source and Scopes in the Endoscopy Suite. The request noted that the current scopes (colonoscopes, gastroscopes, cystoscopes and a bronchoscope) were between 10 and 13 years old and that this meant that their image quality was degraded to the point where abnormalities might become

difficult to detect, giving rise to risks of misdiagnosis. It pointed out that new equipment had been installed in the RUH the previous June and that Circle Bath had also been equipped with HD scopes. [REDACTED] It said that this would only become more marked with the opening of Circle Bath the following month and that a failure to invest in new equipment at Bath Clinic would lead to a rapid and sizeable collapse in this specialty, with an associated drop in surgical procedures and Oncology work that could be expected to follow on from Endoscopy.

48. In addition to replacing the Endoscopy equipment Bath Clinic purchased new digital mammography and other equipment costing around £[REDACTED].

The PMIs

49. We next examine the responses of the PMIs to Circle's request that its Bath hospital be included in their networks. This process was straightforward as regards Bupa and WPA but more protracted in the case of AXA PPP and Aviva, as shown below by the documents we have reviewed.

Bupa

50. In 2008 Circle wrote to Bupa with a list of hospital facilities that it intended to provide medical services from together with an indicative schedule of their planned opening dates. Bath was the first and was projected to open in H2 of 2009.
51. Bupa responded that it had a standard process for recognizing new facilities and that it intended to adopt this process with Circle. Bupa confirmed that it was its intention to recognize all the facilities listed by Circle subject to five conditions:
- (a) that the parties agree acceptable prices for the proposed services. Bupa said that its policy was to ensure that new entrants increase competition in local markets;
 - (b) that the parties negotiate and execute a definitive hospital agreement plan (HAP);

- (c) that satisfactory inspection and review arrangements of the proposed facilities were put in place;
- (d) that the clinical standards that Circle would achieve would be included in the HAP; and
- (e) that all necessary regulatory clearances, permits and licences would be obtained by Circle.

52. Bupa signed a three-year agreement with Circle, commencing 1 August 2010, covering Circle Bath as well as Circle's clinics in Windsor and Stratford. Circle told us that the rates agreed were set at a [REDACTED]. As the [REDACTED] rates were much higher than [REDACTED] the rates for [REDACTED] were around [REDACTED].
53. In July 2009 BMI had written to Bupa expressing concerns in connection with Bupa's recognition of Circle Bath. It said that, typically, consultants would contract to undertake 50 per cent of their private work at a Circle hospital and a consultant might therefore be faced with the dilemma that a patient's best interests in terms of hospital referral might be in conflict with the consultant's contractual obligations. It said that the situation would be made worse if, as it seemed to consider likely, not all PMIs recognized the Circle hospital. In these circumstances, where Bupa had, but other PMIs had not recognized Circle's hospital in Bath, Bupa patients would be required to attend the Circle hospital to ensure the individual consultant's contracted case load obligations were met.
54. BMI's second concern related to future pricing of its services as a result of 'adding new footprint to an already over supplied market'. It said that it was committed to investing in its hospitals but that this was predicated on [REDACTED].

55. Bupa's response began by referring to BMI's second area of concern, that relating to the importance of increased Bupa volumes to deliver efficiencies, which it said was part of Bupa's wider discussions and should be dealt with in that context.
56. Turning to the points that BMI made regarding the Circle business model it observed that doctors as a profession were expected to practice consistent with the best interests of their patients and to put that interest before personal financial gain. Doctors were expected to disclose to patients such interests so that there could be no real or perceived conflict when they were advising patients. It went on to say that there were a myriad of arrangements within the private sector that may require consultants to have to warrant such disclosures ranging from free consulting rooms to clinicians owning their clinical facilities in toto or through equity stakes. Bupa noted that BMI had 'recently tried to interest consultants in a contractual model linking their income to hospital profit growth' and concluded that there was nothing inherent in the Circle model that represented a greater issue as regards the ability of patients to exercise informed choice than these current schemes.

WPA

57. On the same day that BMI wrote to Bupa it also wrote to WPA, and in virtually identical terms.
58. WPA responded by, first, setting out its general position that 'WPA has neither supported nor obliged our customers to use networks of 'approved' private hospitals'.
59. The letter went on:
- it is our understanding that many beneficial arrangements have prevailed historically between providers of private medical facilities and Consultants and continue to do so. Indeed, we hear of generous

inducements, for the direction of patients, from and to existing and long established private medical facilities. I sense that if these rumors have foundation, in addition to the matter that you raise, then the BMA Private Practice Committee should urgently consider issuing guidance; and the GMC reconsider their Guide to Practitioners in Private Practice with definitive ethical instruction.

60. Finally, WPA turned to BMI's statement in the last part of its letter, that falling volumes of patients through its facilities as a result of PMIs including new hospitals in their networks could lead to rising prices. WPA again pointed out that it did not operate a network but that if this were to be the outcome it would have to consider adopting networks to contain any such price rises.

AXA PPP

61. AXA PPP told us that it has chosen to recognize healthcare facilities on a selective basis in its Acute and Day-case network, in effect inviting tenders for recognition on its network. Whilst recognition on AXA PPP's Acute and Day-case network does not grant contractual exclusivity to the recognized provider, non-recognized competing providers will not have access will not have access to inpatient and day-case patients funded by AXA PPP who hold a network policy unless the patient is granted a medical exemption, but will nevertheless have access to AXA PPP patients requiring outpatient diagnostics and treatment.
62. In 2008 Circle told AXA PPP that it intended to open a hospital in Bath in September 2009 and began discussions over recognition. AXA PPP told Circle that it already had a provider in Bath and that in order to recognize Circle there it would need to conduct a formal tender which it had no immediate plans to do. [X]

63. [REDACTED], Circle wrote to AXA PPP, setting out a revised proposal, stressing the quality of the services it would provide patients which would be 'in a different league to the local competitor'. AXA PPP did not consider these revised proposals to be 'commercially compelling'.
64. AXA PPP staff visited Circle Bath in January 2010 and, though observing that its location was not ideal, produced a favorable report on the hospital's facilities and the likely patient experience noting that: 'As far as anyone can enjoy going to a hospital, patients will like what they see and experience.' [REDACTED]
65. In addition to trying to engage AXA PPP in price negotiations Circle adopted other tactics to try and take discussions further.
66. Circle began treating AXA PPP patients at its own expense since, if it had not done so, consultants might not have treated Bupa patients at Circle Bath even though Bupa had recognized the hospital. This was because consultants practicing at Circle Bath might not wish to split the list of patients that they were operating on between two different hospitals. If they could treat Bupa patients at either the Circle or BMI hospitals but AXA PPP patients only at the Bath Clinic, they would tend to treat both at the BMI hospital.
67. In addition, Circle instructed lawyers to consider the merits of making a complaint under the Competition Act arising from the difficulties that it was facing in entering the market. [REDACTED]
68. [REDACTED]

69. In September 2010 AXA PPP, after Circle Bath had opened, met Circle again and AXA PPP undertook to carry out a full review of Circle's commercial proposition taking into account existing provision in Bath. [REDACTED]
70. However, according to AXA PPP internal documents, AXA PPP decided not to include Circle Bath on the grounds that:
- (a) it had to take into account the broader national relationship that it had with BMI;
 - (b) AXA PPP did not need additional provision in the Bath area based on existing subscriber numbers there; and
 - (c) Circle Bath did not offer any additional services to the BMI Bath Clinic.
71. AXA PPP wrote to Circle, informing them of its decision on 18 November 2010 citing the second and third grounds. The letter stated that as a result of its analysis AXA PPP had concluded that they had no need for additional provision in the Bath area on the basis of their current insured population and that they were satisfied with their existing network provision. AXA PPP had therefore decided not to add Circle Bath to its network [REDACTED]. The letter hoped that the existing good working relationships within the outpatient contract¹⁹ would continue and that if any of AXA PPP's corporate clients expressed a desire to specify Circle Bath as their preferred provider then AXA PPP would seek to accommodate this.²⁰
72. Internal AXA PPP correspondence at the time noted that while Circle Bath was continuing to treat AXA PPP members on an in-patient and day-case basis at no cost to AXA PPP, Circle had indicated to it that this was not sustainable. [REDACTED]²¹ While Circle was treating its policyholders at its own expense, therefore, AXA PPP was benefitting from cost savings related to these treatments [REDACTED].

¹⁹ Circle Bath was recognized for outpatient work and was also part of AXA PPP's scanning and ophthalmic networks.

²⁰ Circle subsequently wrote to around 20 of AXA PPP's corporate clients setting out the benefits of Circle Bath.

²¹ [REDACTED]

73. A Circle email quantified the cost of this treatment. It said that from its opening in 2010 up until June 2011, 557 individual AXA PPP members had been treated at Circle Bath as outpatients, day-case or in-patients. It said that had these patients been billed for their treatments in full the total would have amounted to £775,000.
74. In October 2011 AXA PPP told Circle that it intended to recognize Bath and, following final negotiations, did so with effect from 1 January 2012. Circle told us that the terms agreed were not materially different from those offered previously. [✂]
75. [✂]

Aviva

76. Aviva has two main hospital lists. Its Key list of hospitals as well as its more extensive, premium extended list containing, additional, generally more expensive hospitals. The majority of its customers hold a product that provides access to the hospitals on its Key list. A smaller proportion of customers hold a product that provides access to its extended list and can choose to access one of the additional hospitals recognized on this list.
77. Although Aviva was willing to list Circle Bath on its extended network it did not wish to include it on the Key list of hospitals. This position (ie limited recognition) appears to have been adopted towards the end of 2009 and represented a change of view (ie away from not recognizing) based on its concerns about what it felt were commercially unattractive pricing terms in circumstances where it considered additional capacity was not required.
78. In the event, Aviva did decide to recognize Circle Bath on its extended network only, (though Circle subsequently claimed that they had understood that they had been

asked to prepare their price proposals on the basis of full recognition). Circle continued to press for recognition on the Key list.

79. In May 2010, following a visit to Bath by Aviva, as was the case with AXA PPP, Circle had gained the impression that Aviva wished to list Bath on the Key network but that their contractual arrangements with BMI were an impediment to doing so.

80. On 25 May Circle emailed Aviva:

We concluded the meeting by saying that we would like to see if we can help you get around any problems that you may experience in your providing full network recognition to Circle Bath. It would be helpful if you could show us the extent of the problem that needs resolving and in any event, as discussed, work with us to come up with an interim solution which allows your members to benefit from the facility.

The letter went on to tell Aviva that Circle had taken advice from competition lawyers from whom they would be hearing shortly.

81. Aviva's response to Circle denied that Aviva was somehow constrained in what degree of recognition it could or would grant Circle Bath because of any contractual obligations to BMI. Aviva made clear that its position on recognizing Circle Bath on its Key list would be determined internally and on the basis of its commercial interest. In the meantime, the letter said, Circle Bath's place on the extended list properly aligned Aviva's PMI product with the quality of the proposition that Circle offered.

82. [REDACTED]

83. Aviva responded that it did not consider itself constrained by any agreement with BMI and neither did it wish to be drawn into a dispute between Circle and BMI.

84. Against the background of a possible dispute between Circle and BMI a discussion took place between Aviva and BMI which prompted Aviva to write to BMI clarifying his position. Aviva said that its concern arose from BMI's request 'to agree that we will not "recognize" the Circle/Bath hospital on our Trustcare or Key hospital lists'. Aviva said that the hospitals that comprised Aviva's hospital lists and the manner in which Aviva worked with other providers of hospital services must be a matter for Aviva. Aviva said that it had taken legal advice, which supported its view that such a restriction might be unlawful given the strong position that BMI enjoyed in the UK and in the Bath area in particular.
85. BMI's response reflected a different interpretation of their discussions. It said that these arose because Aviva approached BMI in the context of its commercial tariff negotiations and pursuit of a means of BMI providing additional discounts in return for incremental volume from Aviva. It said that, in order to achieve the volume hurdles that had been agreed, Aviva decided to exclude a number of hospitals from its Key hospital list in order to generate the required volume to BMI. BMI explicitly denied that it had asked Aviva not to recognize Circle Bath.
86. Aviva's incentives to meet the volume hurdles it had agreed with BMI were significant. Aviva had negotiated what it described as a 'game changing' four-year deal with BMI in 2008 which was designed to deliver substantial discount benefits to Aviva if volume thresholds were successfully achieved but would result in penalties if they were not. As originally envisaged, Aviva was targeted to increase turnover with BMI by an incremental £[REDACTED] million. Doing so would, on Aviva's estimate, add £[REDACTED] million a year to its margin: failure to do so would result in price increases from BMI going forward [REDACTED]. In the event, this proposed agreement with BMI was not finalized and the eventual agreement that was signed was more modest in the rebates on offer and penalties for failure to meet them were removed.

87. Discussions continued across the summer and, following negotiation, Aviva agreed that: Circle Bath would be recognized as part of Aviva's MRI network, subject to the proviso that this should not negatively impact Aviva customers who would not be eligible for follow-up treatment at Circle Bath.²² In the event of complaints from customers about this arrangement Aviva retained the right to reverse this decision.
88. In the first week of September, [REDACTED], the parties were moving closer to an agreement based on more attractive pricing arrangements for Aviva, a longer-term contract, the prospect of an open book cost model, joint efforts to influence consultant behaviour and targeting reductions in AVLOS. On pricing in particular Aviva discussed with Circle the need to be competitive generally and that Aviva would need to review the current Bath tariff to ensure that Aviva was no worse off commercially by including Circle Bath on its core hospital list.
89. Final terms, reached in November, included that all other Circle facilities would be recognized on the Key network as they came on stream, that all new facilities would be competitive in their local market and that Aviva would not be liable for any charges arising from Circle treating patients in Bath whose policies did not provide them with access to Circle Bath.
90. These features were reflected in the terms of the agreement recognizing Circle Bath as part of Aviva's Key network as from January 2011.

The effect of Circle's entry

Market share

91. [REDACTED]

²² Circle had also started treating Aviva patients at its own expense, as it had done with AXA PPP patients. Since the volume of Aviva patients was lower, and the contribution to 'out of network' care was higher, however, this cost Circle far less than the initiative with AXA PPP patients.

FIGURE 7

Circle Bath and Bath Clinic share of net revenue, 2009 to 2012

[REDACTED]

Source: CC analysis.

92. [REDACTED]

TABLE 3 **Circle Bath and Bath Clinic net revenue, 2009 to 2012**

	<i>£ million</i>			
	2009	2010	2011	2012 est
Circle		[REDACTED]	[REDACTED]	[REDACTED]
BMI	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: Parties submissions.

FIGURE 8

Circle Bath and Bath Clinic net revenue (£ million), 2009 to 2011

[REDACTED]

Source: Parties' submissions.

TABLE 4 **Circle Bath and Bath Clinic revenue breakdown, 2009 to 2012 (Circle)**

	<i>£'000</i>			
	FY09	FY10	FY11	FY12 est
BMI private revenues	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
BMI NHS revenues	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Circle private revenues	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Circle NHS revenues	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: Parties' submissions.

Notes: [REDACTED].

FIGURE 9

Circle Bath and Bath Clinic Revenue breakdown, 2009 to 2012 (£'000)

[REDACTED]

Source: Parties' submissions.

93. [REDACTED]

94. In aggregate terms, BMI told us that, taking into account an estimated 7 per cent decline in the volume of private healthcare activity in the period concerned, the Bath

Clinic suffered a [X] per cent decline in activity (cases) as a result of Circle's entry. In some specialties it told us that the effect was quite sudden and dramatic. BMI told us that in February 2010 all its ophthalmic surgeons opted en masse to cease consulting at Bath Clinic and to undertake their private practice solely at Circle Bath. It told us that in the same month several consultants in a range of specialties (including orthopaedics, general surgery, urology and gastroenterology) commenced splitting their private patients with Circle Bath and that [X] out of [X] consultants moved their entire private practice to Circle.

95. The financial impact on the Bath Clinic resulting from Circle's entry is shown below. Following a [X], Bath Clinic's EBITDA fell by [X] per cent and its EBIT fell by [X] per cent. The decline in profitability is magnified by the operational gearing of the business, i.e. the existence of a number of fixed (or semi-fixed) costs.

TABLE 5 Bath Clinic net revenue and profitability, 2009 to 2012

	FY09	FY10	FY11	FY12	FY09-FY12 change %
Net revenue	[X]	[X]	[X]	[X]	[X]
Gross contribution	[X]	[X]	[X]	[X]	[X]
EBITDA	[X]	[X]	[X]	[X]	[X]
EBIT	[X]	[X]	[X]	[X]	[X]

Source: BMI.

Conclusions

96. The main impediment to Circle's entry and expansion in Bath was the lack of PMI, and in particular AXA PPP, recognition. AXA PPP was important to Circle Bath in its own right since it had a 25 per cent share of the PMI market but, as a result of 'consultant drag,' Circle faced the prospect that consultants would continue to treat their Bupa patients at the Bath Clinic rather than split their lists.
97. Form the documents we have reviewed, AXA PPP's decision not to recognize Circle Bath when it opened would appear to have been based on the importance to it of its

broader, national commercial relationship with BMI rather than specific contractual terms which would have obliged it to incur higher hospital charges at the Bath Clinic as a result of recognizing Circle Bath.

98. By not recognizing Circle Bath, AXA PPP may have put itself at competitive disadvantage with, for example, Bupa (which had recognized Circle Bath): potential users of private hospital facilities in Bath may have chosen to switch to Bupa from AXA PP:P since the former offered Circle as an option for treatment but AXA PPP did not. However, the number of subscribers and hence revenue that AXA PPP would have stood to lose as a result would have been small, certainly in comparison with the bigger deal it was negotiating with BMI at the time regarding the new AXA PPP Corporate Pathways product.
99. Other potential barriers were less important:
- (a) finance for the Circle hospital was arranged, seemingly without difficulty. The consultant/partner model was successful in attracting the support of consultants and this in turn gave sufficient comfort to investors for them to back the project;
 - (b) no significant impediments were encountered in identifying a suitable site or obtaining planning permission for the hospital;
 - (c) NHS business was available in Bath in quite significant volume; and
 - (d) while the CQC licensing process did cause some delays these were minor.