



Response to Barriers to Entry Working Papers

10 June 2013
[X]

1. Introduction

- 1.1 We note that the CC has found generally low barriers to entry in the PH sector. BMI commends the CC for this finding which is correct and clearly demonstrated by the weight of evidence before the CC.
- 1.2 There are, however, some points where the CC has made assessments that the evidence cannot bear and undertaken contradictory treatments of the evidence.
- 1.3 Notwithstanding the late point of the inquiry, and the very short period the CC has allowed itself to consider the results of this consultation, it is important that these points are addressed in the provisional findings.

2. Entry and Expansion case study: Circle Bath

- 2.1 At paragraph 70 and at paragraph 96 of the case study, the CC determines that: "*the main impediment to Circle's entry and expansion in Bath was the lack of PMI, and in particular the lack of AXA PPP recognition.*" This conclusion is unsupported by the evidence and inconsistent with the observed behaviour of the relevant parties.
- 2.2 Circle apparently determined when considering its investment case that "*it was confident that [it] would be successful in achieving network status with both Bupa and AXA PPP*".¹ However, as the CC notes, "*AXA PPP told Circle it already had a provider in Bath and that in order to recognise Circle there it would need to conduct a formal tender which it had no immediate plans to do*".²
- 2.3 It was well known in private healthcare that AXA PPP tendered its acute network slots and where there were two directly competing hospitals it would typically grant network recognition to only one hospital in a local area. There are longstanding examples of this across the UK that the CC has been referred to: Spire Leeds is in the AXA PPP acute network but Nuffield Leeds is not; New Victoria Hospital (Kingston) is in, but BMI Coombe Wing in Kingston is not; Spire Southend is in, but BMI Southend is not etc.
- 2.4 Not only would a competent investor in the sector know this, but AXA PPP apparently told Circle directly in unambiguous terms that Circle could not rely on AXA PPP recognition.³
- 2.5 On the basis of the evidence described in the working paper, it is clear that Circle's confidence in achieving AXA PPP network status had no reasonable basis. This factor alone means that it is not credible to regard AXA PPP

¹ Paragraph 28.

² Paragraph 62.

³ *Ibid.*

recognition as the "*main impediment*" to Circle's entry and expansion – Circle knew they did not have AXA PPP recognition and built the hospital anyway.

- 2.6 However, having determined that this was the relevant barrier, the CC goes on to consider that this barrier resulted from: "*the importance to [AXA PPP] of its broader, national commercial relationship with BMI rather than specific contractual terms...*"⁴ This conclusion is also not credible.
- 2.7 The CC notes that this view has arisen from its review of AXA PPP's internal documents. The only document the CC refers to is summarised at paragraph 70. This summary recites three reasons why AXA PPP decided not to include Circle Bath:
- (a) "*[AXA PPP] 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.*"
- 2.8 The criteria at (b) and (c) are derived from the network agreement between BMI and AXA PPP.⁵ These criteria ought to be, and typically are, met before network entry occurs under the agreement. [REDACTED] If AXA PPP considered itself in a weak position opposite BMI, so as to be highly concerned about the "*broader national relationship*", one would have expected AXA PPP to be quite concerned about ensuring compliance with the strict terms of the agreement with BMI. This would particularly be the case for provisions which favoured BMI, perhaps where AXA PPP might fear reprisals if the letter and spirit of these obligations were not complied with. It is striking, therefore, that AXA PPP do not apparently even consider BMI's reaction under the agreement or pricing response to be a factor when considering Circle Bath recognition, let alone a decisive one.
- 2.9 This is consistent with AXA PPP's other submissions. Recall that AXA PPP has not claimed that it lacks sufficient countervailing buyer power opposite BMI.
- 2.10 Leaving the agreement between BMI and AXA PPP to one side, the CC has chosen (a) above (*the broader national relationship that it had with BMI*) as the reason why AXA PPP did not recognise Circle. Other than being the conclusion that is most helpful in supporting the decision the CC is trying to

⁴ Paragraph 97

⁵ [REDACTED]

justify (namely that BMI has market power), there is no justification for why the other two factors – which derive from the actual agreement with BMI - are dismissed or why the national relationship is regarded as particularly important.

2.11 The national relationship between BMI and AXA PPP is in any event quite obviously not the decisive factor in a relevant competition sense:

(a) Circle Bath opened in March 2010. It obtained AXA PPP recognition in October 2011 - 18 months later.⁶ If AXA PPP was so concerned about the "*broader national commercial relationship with BMI*" that this would be the reason it did not recognise Circle Bath in March 2010 – what had changed by October 2011 for this not to matter anymore? BMI was the same size as it was; BMI owned the same hospitals (including "hospitals of potential concern"); the PH market had not changed in any material way (e.g. become significantly less concentrated). If anything, AXA PPP had deepened its relationship with BMI as a result of the Pathways negotiation concluding in March 2011 – which might be expected to make the relationship more rather than less important to AXA PPP. Even if AXA PPP's concern related to the Pathways negotiation (which is pure supposition as no reference to this made) the deal had been completed by March 2011, yet recognition of Circle Bath did not occur until seven months later. If Pathways was the reason, then why the additional delay?

(b) The CC has reviewed the recognition decisions of the other major PMIs. **Not one of them** refers to the "*broader commercial relationship with BMI*" as a motivating factor – certainly not a determining factor - in their decision to recognise Circle Bath. Quite the reverse in fact. As the CC's work shows, any effort BMI made (such as it was) to dissuade PMI recognition failed completely, with each insurer doing exactly as it pleased and all except AXA PPP recognising Circle Bath immediately.⁷ If the "*broader national commercial relationship with BMI*" is the cause of AXA PPP's decision not to recognise Circle Bath, why did it not apply to any other PMI?

2.12 As evidence submitted by BMI has shown, AXA PPP volumes at Bath Clinic fell dramatically and in line with other PMIs as soon as Circle Bath opened.⁸ Circle Bath was therefore able to treat AXA PPP insured patients without network recognition from AXA PPP – circumventing the 'consultant drag' effect. BMI understands from the working paper that Circle Bath, in doing this work, was subsidising the cost of treating these patients. The total amount

⁶ BMI notes that paragraph 73 refers to the investment made by Circle Bath in treating AXA PPP for the short period when it was not recognised. This stops at June 2011 – it is unclear whether this is the date of the email or whether this relates to the date when AXA PPP effectively admitted Circle Bath, with the formal decision being made some months later.

⁷ The CC implicitly recognises that Aviva's initial decision to recognise Circle Bath on the Extended rather than Key list was immaterial.

⁸ [X]

that could have been billed to AXA PPP had Circle Bath been recognised amounted to £775,000 – and even this only reflects the amount it could have *billed* and hence does not equate to the actual costs that Circle incurred in doing this work.

- 2.13 The delay in AXA PPP recognition therefore represented a minor sunk cost of entry, equating to (at most) 2.6% of the total costs of entry.⁹ The CC notes that the "*the finance for the Circle hospital was arranged, seemingly without difficulty*". It is almost impossible to imagine how a cost equating to 2.6% of a sum that was financed "*seemingly without difficulty*" can become the "*main impediment*" to Circle's entry and expansion.
- 2.14 As a general point, the published paper contains no commentary on Circle Bath's profitability [X]. As the CC is aware, [X]; over time, consumers will bear higher prices as a result of reduced capacity utilisation and higher average costs across both facilities. This concern is also consistent with both Aviva and AXA PPP being careful to weigh the need for additional capacity in their decision to recognise Circle Bath. The market opportunity was not (and is not) sufficiently large to support Circle's investment. This error of judgment on Circle's behalf is the direct cause of the problems that Circle has faced in Bath - not barriers to entry.
- 2.15 The CC must not conflate barriers to entry and expansion with Circle's mistakes and the consequences that it has suffered as a result. The CC cannot and should not try to shield Circle from the consequences of its poor commercial judgments.

3. The London Clinic

- 3.1 At paragraph 78, the CC claims "*In our Bath case study, we showed that AXA PPP's decision not to recognise the Circle hospital, because of its broader, national relationship with BMI, restricted Circle Bath's ability to grow profitably.*" As the comments above make clear, the CC has not shown this at all.
- 3.2 BMI does not understand the CC's statement that it is "*not clear*" whether land acquisition problems would be a problem encountered by a new entrant outside central London. BMI notes in this context that the CC does not have any evidence (or at least no evidence that has been made available to the parties to this investigation) that land acquisition would be a problem outside central London. Indeed, in both the Edinburgh and Bath case studies the CC

⁹ Assuming the £30m capital cost associated with designing, building and equipping Circle Bath, as set out in paragraph 11 of Appendix E to the AIS.

explicitly found that land acquisition was not a problem.¹⁰ The only conclusion therefore that the evidence supports is that land acquisition outside central London is not a relevant barrier.

3.3 BMI notes that Bupa's decision to purchase the Cromwell Hospital was motivated by a desire to increase competition and also "*allowing it to direct patients to its own destination facility*". It is telling that Bupa did not invest such a large sum of money in the Cromwell for it merely to be an option amongst many. It fully intended to use its power to direct patients so that they used the Cromwell in preference to competing facilities. Not only is this behaviour questionable for a vertically integrated dominant undertaking such as Bupa, it is also powerful direct evidence of Bupa's absolute ability to direct patients to hospitals that it prefers. This is fully consistent with BMI's submissions that Bupa's buyer power derives from its ability to direct patients – whether at the point of network definition or at point of claim. BMI looks forward to this reality being reflected in the CC's updated analysis of the bargaining framework between PHPs and PMIs.

4. **Edinburgh and the Lothians**

4.1 The CC has recited at length the importance that each of Spire, BMI, Circle and The Edinburgh Clinic gave to the physical location of the facilities they were interested in developing. In particular, each of Spire, BMI and Circle considered that a location near the ERI was important. BMI contrasts this insight with the approach of DTZ in its Draft Report and incorporated by the CC into the profitability working paper, which found many existing private hospital sites to be "commercially wasteful" on the basis that cheaper land was available in the broader area.

4.2 Having now understood the great importance that is attached to the location of private hospitals, BMI trusts that the CC will ensure that this insight is reflected in the approach to land valuation.

4.3 BMI also notes that this case study contains considerable discussion on the effect of economies of scale and the way in which entry can be tailored to suit the size of the market opportunity. The CC describes the efforts of Spire, BMI and The Edinburgh Clinic to do exactly that. The CC also notes that "*[t]he experience of the private hospital operators in Edinburgh provides a number of interesting insights into the dynamics of competition in the private healthcare market both in Edinburgh itself and more generally*".¹¹ BMI agrees with this and would encourage the CC to consider these insights for their analysis in Bath, in particular because the obvious reason for Circle's failure in Bath is that they did not correctly assess the scale of the market opportunity and consequently over-invested.

¹⁰Edinburgh and the Lothians case study, paragraphs 27 and 35. The CC states at paragraph 99(b) of the Bath case study that "*no significant impediments were encountered in identifying a suitable site or obtaining planning permission for the hospital*".

¹¹ Paragraph 76.