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Medical devices- BSC's version

### **“They are small engineers in Ireland”**

We did not steal technology, we realized a legal sanction- this is BSC's defense line in its legal battle with Israeli Medinol. However, during a conversation with journalists from THE MARKER, the director and CEO of the company had difficulties explaining internal correspondence between managers of the company in Ireland, they admit that it is embarrassing and claim that they did not know anything”.

By: Guy Rolnick and Natan Lipson, Boston

Pete Nicholas sits calmly on his leather couch in front of his work desk. “Anyone wants coffee” he asks, “how much sugar?”. He apologizes and excuses himself for a moment from the room and returns after a minute with a paper cup in his hand.

Just a few minutes ago this man, who is busy with the business of preparing coffee, left a directors meeting of the company he founded 22 years ago. A company that transformed him into one of the richest and most powerful people in the U.S.- the giant medical equipment BSC, whose present market value is 11 billion dollars and annual sales are north of 2.5 billion dollars. In this meeting Nicholas, who personally holds 35 million shares of BSC worth 1.5 billion dollars, announced that he would be decreasing his involvement in the company and will transfer further authority to the VP he appointed two years ago, Jim Tobin.

Tobin was also present in the meeting, sitting to the right of the boss. He seemed less comfortable, but did not show any signs of pressure.

In general, when visiting the company headquarters, located in the outskirts of Boston, there is the impression that the word pressure does not apply to the world of BSC. Here everyone displays a quiet decency. Although BSC is a hi-tech company, its luxurious executive suite is conservatively decorated- in line with traditional American corporate image; the wood is dominant, the space is large and quiet, and floors covered with wall-to-wall carpets. No one runs and no one raises his or her voice. Everyone wears a suit and tie. Here, no one has heard the term “dress down”.

For a moment it is possible to err and forget that BSC in the mist of a much publicized lawsuit, that not only presents the company and its managers in an unflattering light but also threatens indictment for serious offences.

In this struggle BSC faces its Israeli partner Medinol, with whom it entered into a contract in 1995. Medinol, founded in December 1992 by Kobi and Judith Richter and Gregory Pinchasik, developed a stent.

From its founding, Medinol decided to concentrate solely on the development and manufacturing of stents. It left the global marketing of the product to a large multinational partner that would carry out the task. In the summer of 1995 Medinol entered negotiations with such an MNC giant- J&J, but the negotiations did not materialize into a deal.

Immediately following the fallout of the talks with J&J BSC entered the picture, and the two sides signed two agreements- and investment agreement and a supply agreement. In the investment agreement it was decided that BSC will purchase 11.5% of Medinol's shares for 40 million dollars. 25 million of which were invested in the company and the remaining balance was paid out to the existing shareholders. In time, BSC purchased additional shares and its holdings in Medinol increased 22%.

The Supply Agreement specifies that that BSC will exclusively market Medinol's stent worldwide for 10 years; that Medinol will be responsible for developing the stent, and BSC responsible for developing the accompanying delivery system.

The Supply Agreement also specified that Medinol will transfer to BSC an automatic stent manufacturing machine to be used if Medinol's manufacturing capability in Israel. The agreement further specifies that if Medinol will fail to meet its supply obligations, BSC will be allowed to use the machine in order to produce the quantity ordered from Medinol- plus 25%. The machine was built and transferred to BSIL.

Medinol began selling stents in 1996. In August 1998 the FDA approved sale in the U.S. Close to the time of approval BSC stock hit a record high. 1999 was the first full year in which the stent were sold in the U.S. 1999 was also a record-breaking year for stent sales. Since then sales began to dramatically decline, and rumors of the severe conflict between the two sides surfaced.

The first public expression of the magnitude of the conflict was the complaint Medinol filed in New York on April 5, 2001 against BSC and a few of its senior managers. Medinol included in the claim BSC, Nicholas, senior VP Mick Berman, CFO Larry Best, VP James Corbett, and VP, internal comptroller Janet Kelly, senior VP Paul LaViolette, Seven Paidosh, and senior VP and legal advisor Paul Sandman. Tobin was not among the defendants. Medinol blamed them- in part or in full- in conspiracy, defamation, tortuous interference with a contract, aiding and abetting breach of fiduciary duty, fraud, aiding and abetting fraud, negligent misrepresentations, and misappropriation of trade secrets. Medinol also claimed that BSC and its managers violated several U.S. federal laws with in the RICO law.

All of the accusations are related to a central claim: Medinol claims that BSC build an automatic stent manufacturing machine by reverse engineering the machine that was sent to BSIL. In other words, Medinol accuses BSC in stealing its technology. The code name of the program, Medinol claims, was BBD- the abbreviation of Bringing a Better Deal for Boston Scientific.

Now, in a conversation with Nicholas and Tobin, they form the immediate impression that they are trying to distance themselves from the affair. "For a number of years I am in the process of minimizing my involvement in the company", Nicholas says surprisingly at the beginning of the conversation. "The transfer of responsibilities includes the responsibility over Medinol". "I entered in the middle of the movie. Things were managed inappropriately", Tobin hurries to clarify. This "movie" is a thriller that is still evolving, but even a conversation with Nicholas and Tobin does not help to clarify its misty parts.

#### **How was the connection between you and Medinol formed?**

Nicholas: "in 1994 –1995 we purchased Scimed that dealt with cardiology. Cardiology in those days was based on catherization, and the company was a leader in the field. In the same period the stent market developed.

"SciMed did not correctly assess this market. It thought that it would gain 5-10% market share. In the meantime, J&J entered the field and launched its first stent with great success. Guidant also entered the stent market, and Cook followed, but Cook did not enjoy as great a commercial success.

"After we realized that the stent market will be big, we investigated our own development plans and realized that we are behind. Art Rosenthal was the first that raised Medinol's name. We know that they negotiated with J&J and that the deal fell though. I don't know why- only they know.

"After the failure of the negotiations with J&J Medinol looked for a partner. We were global leaders in the field of cardiology. We met with Judith and Kobi Richter and we discovered two charming and nice people. Kobi and Judith are determined people. Kobi was very ambitious. They conquered my heart with the commitment and seriousness they displayed.

**You describe them as positive people. But in the counter-claim you submitted in the district court in Jerusalem you claim that the Richters managed Medinol in a "way that lacks naivety, that disregards the rights of the minority, and breaches trust".**

“It is like a chicken in the hen house. You don’t notice it during the process, until one day you enter and the whole henhouse is full of chicken droppings.”

**When did the relationship start to go bad?**

“It was a gradual process, but already in the beginning- from mid 1996- we understood that there was a problem. Already then we had supply problems with Medinol.” “The relationship between BSC and Medinol was organized in such a way that they were given the responsibility for the technical development, and the regulatory, marketing and sales side was given to us. As soon as we started to work they demanded full and meticulous documentation of the shipments. They were very tough and aggressive in their demands for accuracy, and sometimes they even hurt people without meaning to.

“ The problems in our relationship increased with the years. In the early years, I defended Medinol. I told my people that we must conserve our relationship with Medinol. When we began to market in the American market problems resurfaced, until the relationship became one directional- we met they demands, but they did not meet the demands that were agreed. They did not, for example, fill their duties in the clinical trials- and this is the reason for their significant profitability.

“Until today, I think that Kobi doesn’t understand what influence his actions has on other people. He does not understand the impression he makes on people. They acted in a very rude manner.

“In 1999, after they again could not meet the orders we stent them, I traveled to Jerusalem and met with Kobi and Judith. ‘ whatever happens- don’t threaten us with order delays. Don’t do it’ I said to Kobi. ‘We don’t delay any orders’ he replied, and from the side Judith sent him an amused look, it was a comic situation. “These delays forced us to hold large inventories- for defense. By delaying the orders they held us hostage”

**So why did you decide to continue to be their partners?**

“As we approached the approval of the stent in the U.S. we were ecstatic and we didn’t have time to deal with the complaints our workers had regarding their behavior.

**And after that?**

“ I am to blame. I told myself that there are crazy people, and that we have to live with this”

**Where does the conflict stem from?**

“I think it stems from pride, maybe frustration. In any case, I am convinced today that the relationship cannot be mended. We cannot reconstruct it. We are beyond the point where that is possible.

**What is BBD?**

“No one remembers what BBD is. I don’t know- people work on projects and invent different code names. I only came across this code name recently, when I read Medinol’s claim, and I thought it stood for “Build a Better Development”. We called this project “The Alternative Line Project”.

**How come you don’t remember? The word and its exact meaning- Brining a Better Deal- appeared on the document that Tobin himself handed over to the Richters in a meeting that was held here, in these offices, on April 18, 2000.**

Tobin: “ I forgot about it”.

**What was the essence of the project?**

Nicholas: “The purpose was to set up an independent manufacturing line- that’s what I thought” (later he said: “the project was a defense mechanism against disturbances in the supply of stents from Medinol”).

This is BSC’s line of defense- not the theft of technology, but rather the legitimate realization of a legal sanction- realization of the section that allows the company to use the machine it received in order to manufacture stents if Medinol cannot supply the orders.

Hiding the project, BSC claims, stems from the fear that Medinol will discover it and will immediately stop the supply of stents, and maybe out of hope that the relationship between the two companies

would improve.

**Internal BSC correspondence that reached Medinol raises the possibility that the person that ran the project thought that it was problematic. In one of the letters, the project manager Stephen Paidosh wrote: “Eric and I are more and more busy in telling white lies to our people about this activity, in order to keep them in the dark”. What is your response to these documents?**

Nicholas: I would say that they made things up and did not understand what happened,. Someone copied Medinol’s machine and I didn’t know about it. It is possible that someone decided to take things into their own hands and do something, I don’t know.

**But Paidosh ties you directly to the project- in the continuation of his letter he writes: “Pete Nicholas has not yet decided how far he wants to proceed with this, since this would be a shame if Medinol found out about it”**

“I am flattered to think 15 thousand BSC workers think that we know everything that happens in the company, but in reality this is not the case. The people responsible for the project were small engineers in Ireland that we weren’t part of the loop.

**What do you think of this correspondence?**

“They don’t look good, they’re embracing.”

**Do you think that any part of what was done in Ireland was against the law or the contract with Medinol?**

“ I think that what they did was not illegal or against our agreements with Medinol”

**Did BSC undertake an investigation to learn how the project was born and who was responsible for it?**

“ I think not. It is not important for us to know who these people are”.

**Why did you not report to your investors of this conflict in an routine and encompassing way? This relationship resulted in sales of 699 million dollars in 1999- approximately 20% of your sales then.**

“It was not important enough. Our relationship with Medinol is not so central in our business.”

The harsh conflict between BSC and Medinol was never meant to get published- right after the meeting between the Richters and Tobin in April 2000 intensive negotiations took place between Medinol and BSC designed for BSC to buyout Medinol and gain full ownership.

But the deal never took place. In fact, BSC claims that Medinol decided to sue it because of the failed talks, or more accurately- that BSC would not pay the Richters the price they demanded.

**Is it true that in the beginning of 2001 during the negotiations your bankers evaluated Medinol’s at 8 billion dollars?**

Tobin: “We did not have bankers. We did not work with any one person specifically.

**Allen Swartz from Bear Sterns was not your banker?**

“Swartz was not our banker but advised us as a friend. Our CEF, Larry Best read the analyst report and said it is nonsense. “ When the negotiations began, Kobi Richter presented us with a presentation in which he evaluated Medinol’s value at 11 billion dollars. Right after this he said he was willing to settle for 8 billion”

**Kobi Richter claims that in 199 BSC offered to purchase Medinol for 1.2 billion dollars.**

Nichoals: We offered to pay half a billion dollars cash and another 700 million dollars within three years, conditional to predefined milestones. Conversely, Kobi offered that we buy Medinol for 750 million dollars, but immediately and in cash. The negotiation went on and took a lot of time, and we moved forward in our plans to develop our own stents.

Tobin: “Medinol’s value is like an ice cream cone, that melts with time”. In the past we had a significant technological gap with Medinol, but since them it has significantly decreased. Had we purchased Medinol in the beginning of 2001 we could have gained greater market share. But since

then we have been very successful with our own stent- the Express- and Medinol's advantage to us is small.

**Mr. Tobin, is it true that you told Nicholas that he should not have been satisfied with merely gaining Medinol's technology but rather in gaining its profit margins?**

"I don't understand where this story about Medinol's rare profitability comes from, they do not have any operational advantage. Our technology is different from Medinol's but similar to it in its efficiency. We are able to manufacture our stent at a much lower price than \$35 per unit. Not as low as Medinol, but once you take into account that the price of every unit is 1, 200 dollars, we are talking very high profitability.

"I am convinced that if other stent manufacturers would reveal their profit margins, we would discover that they too have very high profit margins in stent manufacturing.

**Mr. Nicholas, if you had the power to make anything you wanted happen, what would you choose?**

I would like to separate from the Richter couple, that is what I would like.