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COMMERCE COMMISSION

Decision No. 537

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

SOUTHERN CROSS OXFORD HOSPITAL LIMITED

and

THE OXFORD CLINIC

The Commission:	Paula Rebstock Denese Bates QC Donal Curtin
Summary of Application:	The acquisition by Southern Cross Oxford Hospital Limited of the assets of the Oxford Clinic business in Christchurch.
Determination:	Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.
Date of Determination:	11 November 2004

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EXECUTIVE SUMMARY

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 8 October 2004. The notice sought clearance for the proposed acquisition by Southern Cross Oxford Hospital Limited (Southern Cross) of the assets of the Oxford Clinic business in Christchurch.
2. Southern Cross is a new company which would be 50% owned by Southern Cross Hospitals Oxford Partnership Limited, a wholly-owned subsidiary of The Southern Cross Health Trust (Trust), and 50% owned by Oxford Clinic Holdings Limited.
3. In this proposed joint venture, for the purposes of the present Application, the Commission considers the relevant markets to be the provision of private:
   - day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch; and
   - in-patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch.
4. In the provision of private in-patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch, the proposed joint venture would increase Southern Cross's market share by [ ]. Oxford Clinic is not a facility designed for in-patients and Southern Cross' main competitor is St George's Hospital. Consequently, the Commission considers that the proposed joint venture is unlikely to lead to a substantial lessening of competition in the in-patient market.
5. The Commission has mainly focussed on the provision of day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch. In this market, post joint venture, the Commission considers that there would be sufficient existing competition from St George's Hospital and countervailing power from surgeons and health insurance companies.
6. The Commission also considered whether the acquisition would foreclose access to surgeons to a potential new entrant. The Commission found that this was unlikely to be the case, as surgeons have no formal contracts with private hospital providers, most surgeons performed surgery at more than one private hospital and in New Zealand there is a wide of pool of gynaecology and endoscopy surgeons that new entrants could source from.
7. A final key consideration was the impact of the proposed acquisition on the health insurance market. The Commission found that while the Trust and Southern Medical Care Society, which provides health insurance, are associated, the proposed acquisition is unlikely to have a significant impact as, post joint venture, the proportion of funding Southern Cross would obtain from the Society would increase by [ ].
8. On balance, the Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the provision of private:
   - day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch; and

- in-patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch.

9. Accordingly, pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Southern Cross of the Oxford Clinic business in Christchurch.

THE PROPOSAL

10. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 8 October 2004. The notice sought clearance for the proposed acquisition by Southern Cross Oxford Hospital Limited (Southern Cross) of the assets of the Oxford Clinic business in Christchurch.

PROCEDURE

11. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice under s 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 11 November.

12. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

13. The Commission's approach to analysing this proposed acquisition is based on principles set out in the Commission's Merger and Acquisition Guidelines.[1]

STATUTORY FRAMEWORK

14. Under s 66 of the Act, the Commission may grant clearances for acquisitions where it is satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a market. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]

15. The Commission considers that it is necessary to identify a real lessening of competition that is not minimal.[3] Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis, the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

16. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years.

17. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced service, quality or innovation, for there to be a substantial lessening, or likely substantial lessening, of competition, these also have to be both material and sustainable for at least two years.

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[1] Commerce Commission, *Mergers and Acquisition Guidelines*, January 2004.
[2] Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission (1992) 4 TCLR 713-722.
[3] See Fisher & Paykel Limited v Commerce Commission (1996) 2 NZLR 731, 758 and also Port Nelson Limited v Commerce Commission (1996) 3 NZLR 554.

ANALYTICAL FRAMEWORK

18. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
    - with the acquisition in question (the factual) ; and
    - in the absence of the acquisition (the counterfactual).
19. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual scenarios, in terms of:
    - existing competition;
    - potential competition; and
    - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Southern Cross Oxford Hospital Limited (Southern Cross)

20. Southern Cross is a new company which would be 50% owned by Southern Cross Hospitals Oxford Partnership Limited, a wholly-owned subsidiary of The Southern Cross Health Trust (Trust), and 50% owned by Oxford Clinic Holdings Limited. This is shown in Figure 1.
21. The Trust is a charitable trust which owns nine hospitals[4] and has partnerships in another three[5]. It does not provide any surgical services, nor does it contract surgeons to do so.[6] The Trust is licensed to use the "Southern Cross" brand by The Southern Cross Medical Care Society (Society).
22. The Southern Cross Hospital (Southern Cross) in Christchurch is primarily an in-patient facility for the provision of private healthcare services. Around half of the procedures performed at the facility are orthopaedic procedures. The balance is general surgery, urology, eye surgery, ear, nose & throat surgery and plastic surgery.

The Oxford Clinic Holdings Limited (Oxford Clinic)

23. The Oxford Clinic comprises The Oxford Clinic Limited and The Oxford Clinic Day Hospital Limited which have the same shareholding structure. Each company has 600 shares split as follows in Table 1 below.

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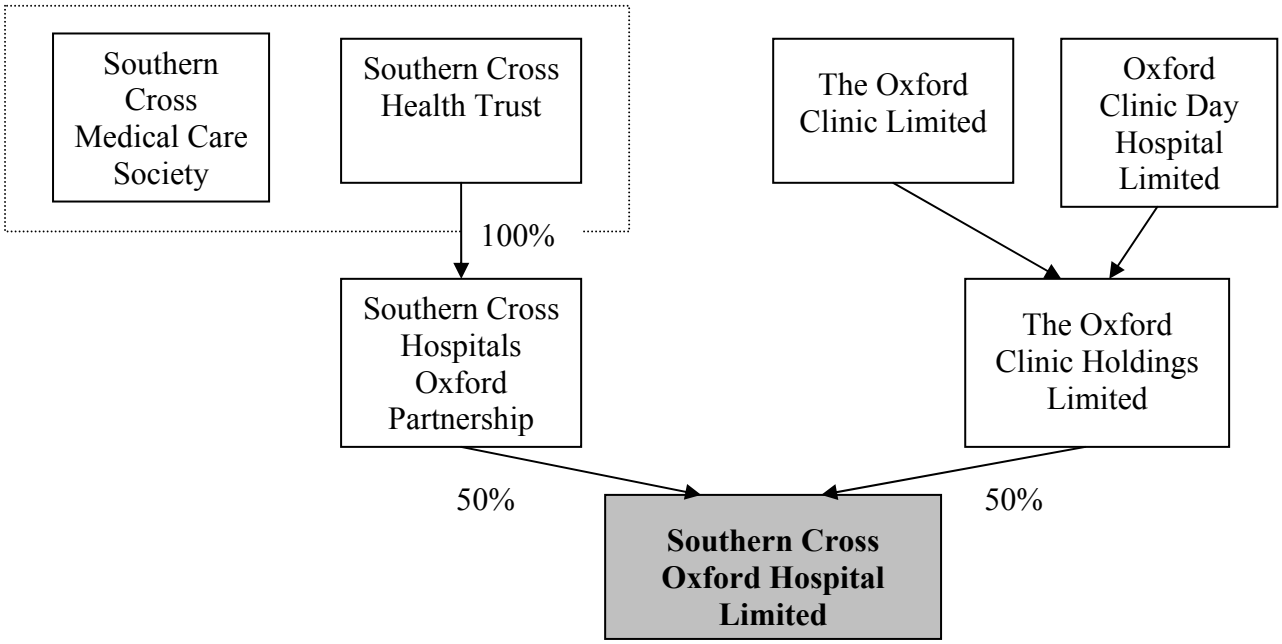
[4] Brightside, Christchurch, Hamilton, Invercargill, New Plymouth, North Harbour, Palmerston North, Rotorua and Wellington. These were previously owned by The Southern Cross Medical Care Society.
[5] Gillies Hospital (Auckland), Mercy Angiography Unit (Auckland), and Norfolk Southern Cross Hospital (Tauranga).
[6] The only limited exception being some DHB and ACC arrangements.

Table 1: Shareholders in the Oxford Clinic

Shareholder	Shareholding
Suzanne Suckling	100
John Doig	100
Michael East	100
Paul Fogarty	100
Michael Laney	100
Richard Perry, Julia Perry and Graeme Davey	100

24. The Oxford Clinic Day Hospital provides facilities for the provision of secondary elective healthcare services, primarily on a day stay basis. The procedures performed at the Oxford Clinic are mostly gynaecology, with some general surgery and endoscopy.

Figure 1: Diagram to Show The Parties Involved in This Proposed Joint Venture



Other Relevant Parties

St George's Hospital (St George)

25. St George is an Incorporated Society with charitable trust status established by the people of Canterbury. It has no shareholders. The hospital is registered to care for surgical, medical and maternity patients mostly from the private sector. It also contracts to provide a range of surgical and obstetric services to public patients funded by the Government.

Public Hospitals

26. The public hospitals in New Zealand are owned by the District Health Boards (DHBs). The DHB responsible for public hospitals in Christchurch, is Canterbury. The public hospitals in Christchurch are:

    - Christchurch Hospital: an acute and elective hospital with 700 beds and 12 operating theatres;
    - Christchurch Women's Hospital: an obstetric and gynaecology hospital; and
    - Burwood Hospital: elective orthopaedic hospital and spinal injury rehabilitation centre.

ASSOCIATION

27. A preliminary question the Commission must determine is whether the Trust and the Society are associated. Section 47(2) provides that, for the purposes of s 47(1), a reference to a person includes two or more persons that are interconnected or associated.

28. Sections 47(3) and (4) stipulate that two or more corporate entities are associated if one, either directly or indirectly, is able to exert a substantial degree of influence over the activities of the other. The Commission is of the view that, in this context, a substantial degree of influence means being able to bring real pressure to bear on the decision making process of the other.

29. In coming to a view on association, the Commission must consider each case on its particular facts. Among the factors the Commission usually takes into account in determining association are the:

    - nature and extent of ownership links between the companies;
    - presence of overlapping directorships;
    - rights of one company to appoint directors of another; and
    - nature of other shareholder agreements and links between the companies concerned.

30. The Commission also considers the interaction between these various factors. For example, the Commission assesses the nature and extent of the communications between persons, the apparent influence of one person on the key strategic decisions of the other.[7] The question the Commission has to answer is whether two enterprises can, for the purposes of commerce and competition, be regarded as one.[8]

31. The Commission considered the details disclosed in the Application, met with the Applicant and other industry participants and reviewed the documentation disclosed and submissions made by the Applicant to form its view on the issue.

32. The Applicant does not consider the Trust and the Society to be associated. They submit that:

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[7] Commission Decision No. 388: New Zealand Seafood Investments Ltd / Basuto Investments Ltd, Para's 16 – 24.
[8] Commission Decision No. 278: Air New Zealand Ltd/Ansett Holdings Ltd/Bodas Pty Ltd, especially Para's 180 – 182.

- the Society is a separate legal entity from the Trust;
- there are no ownership links between the Society and the Trust;
- the organisations now operate from separate premises;
- the organisations' objects and their beneficiaries / members are distinct; and
- the Trustees of the trust are bound by their fiduciary duties when acting as such and the Directors of the Society are bound by their duties as directors when acting in that capacity.

33. The Commission's view is that the factors noted by the Applicant are not determinative. Physical and legal separation may be present in organisations which are clearly associated within the meaning of s 47. The Commission considers that the following additional matters are also relevant in determining whether the Trust and the Society are likely to be associated:
    - there is a close working relationship between the Trust and the Society. This has been previously noted by the Commission;[9]
    - there is evidence of strong links between the two organisations. For example, the Trust is licensed to use the "Southern Cross" brand by the Society;
    - the Trust and the Society have identical directorates, with the same 7 individuals who serve as the Trustees of the Trust also being the Directors of the Society;
    - the Society has the power under the Trust Deed to appoint (and remove) up to three persons as Trustees of the Trust;
    - over the past year the Chief Operating Officer at the Trust has also been the Chief Financial Officer at the Society; and
    - the Commission found a general perception among some of the industry participants interviewed that the Trust and Society act as one head in the market with Southern Cross being viewed as a vertically integrated organisation. [

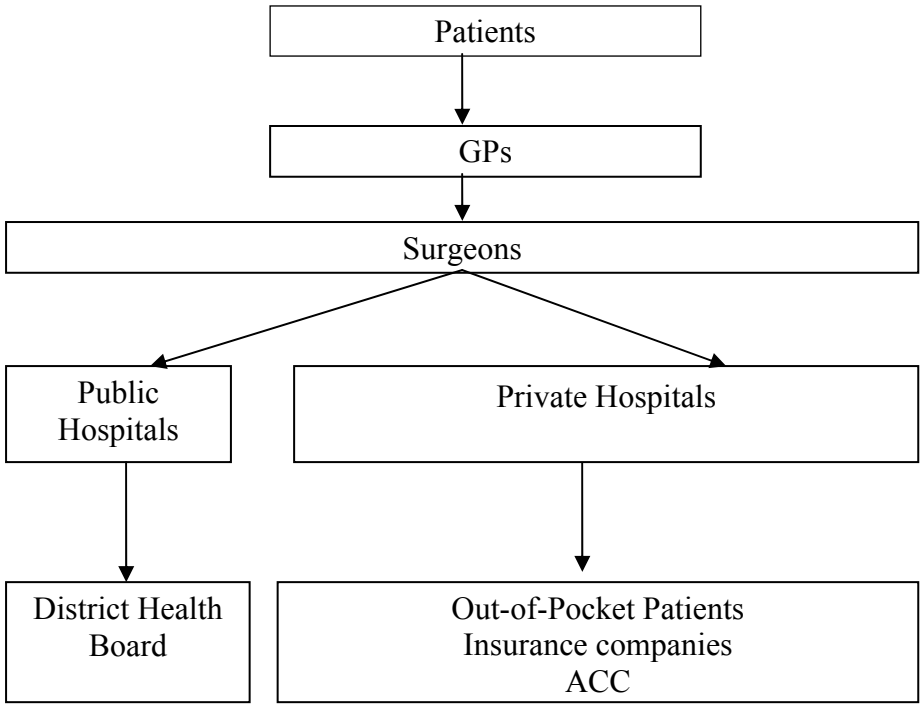
      ]
34. Having taken the relevant factors into account the Commission concludes that there is a community of interest between the Trust and the Society, which can, for the purposes of commerce and competition, be regarded as one.
35. Accordingly, for the purpose of considering whether the acquisition by Southern Cross of the Oxford Clinic in Christchurch would have, or would be likely to have, the effect of substantially lessening competition in any of the relevant markets the Commission will proceed on the basis that the parties are associated.

[9] Commerce Commission Termination Report: Southern Cross Healthcare/Aetna 18 December 1997, Para 6.

INDUSTRY BACKGROUND

36. This proposed acquisition affects the provision of healthcare services in New Zealand. Healthcare is provided by a range of different medical practioneers in public and private hospitals. The main industry participants considered in this proposed acquisition are shown in the diagram below.

Figure 2: Main Industry Participants in Healthcare



37. There is a relatively complex set of relationships leading to a particular patient being operated on by a particular surgeon in a particular hospital. As shown in Figure 2, patients are first seen by a *primary* healthcare provider (usually a GP). If surgery is warranted, or specialist consultation is required, the patient will be referred to a surgeon. Most GPs will have preferred surgeons they refer patients to.

38. If the surgeon decides that surgery is appropriate, a decision will be made as to the hospital (*secondary* healthcare provider) where the surgery will be undertaken, depending on the hospital (or hospitals) where that surgeon operates.

39. Often the choice of hospital is influenced by the surgeon. The factors taken into account are cost, location, timeliness or anticipated quality of care. Sometimes the patient's insurer will have an influence on the choice of hospital, in that patients might be encouraged to select a particular option.

Medical Procedures

40. Elective surgery is non-emergency treatments (including diagnostic services) where the condition is not life threatening and does not require immediate surgery. The types of elective surgery affected by this proposed joint venture are gynaecology and endoscopy procedures. A NZIER Private Hospitals' Survey

2003 found that 22.2% of endoscopy procedures carried out in New Zealand and 14.2% of general endoscopy procedures were performed at private hospitals.

Facilities and Services

41. Private hospitals provide facilities, namely, patient bedrooms and medical equipment, as well as related non–specialist services like administration staff and nursing staff. Specifically, they provide the operating theatres, equipment, surgical supplies, wards, and nursing and other staff. Private hospitals typically do not provide surgeons or the ancillary specialist skills such as the anaesthetists or physiotherapists. These medical professionals contract directly with the patient and therefore bill the patient separately.

42. The relationship between the surgeon and the private hospital involves quality control of the surgeon by the hospital (credentialing). Only credentialed surgeons may operate at the private hospitals. While surgeons book operating theatre time at the private hospitals, there is no formal employment contract between the surgeon and private hospitals relating to the use of the operating theatres or throughput of patients that the surgeon will provide.

Funding

43. Healthcare is financed by a mix of public and private funding, with the majority being funded from public sources (tax funded Vote Health and Accident Compensation Corporation (ACC)).

44. Public hospitals undertake the majority of surgical procedures, including almost all acute procedures – those services carried out to deal with an emergency. Those private hospitals that provide surgical services focus almost exclusively on elective (arranged or non-urgent) surgery.

45. Demand for the provision of elective surgery in the public system generally outstrips supply (or funding), so provision is rationed. The private system caters for those patients who would not otherwise receive treatment in the public system, or who prefer private treatment on timeliness or other grounds.

46. The patient finances most elective surgery in private hospitals, either directly or via insurance. A small amount of publicly funded elective services is provided by private hospitals on behalf of the public sector.

47. The main health insurance providers in New Zealand are:

- Southern Cross Medical Care Society (Society);
- Union Medical Benefits Society (UniMed);
- Tower Health and Life (Tower); and
- Sovereign Assurance Company (Sovereign).

PREVIOUS DECISIONS

48. The Commission has considered a number of cases in the provision of healthcare services. They are:

- Pacific Radiology Limited and Wakefield Radiology Limited *Decision 518;*
- Wakefield Hospital Limited and Bowen Hospital Limited *Decision 492;*

- The Ascot Hospital and Clinics Limited and Mercy Hospital Auckland Limited *Decision 449;* and
- Eastbay Health Limited and Western Bay Health Limited *Decision 331.*

49. All of the above acquisitions were cleared. In addition, in each of the above decisions apart from Decision 331, the Commission considered private hospitals to be in a separate market to public hospitals.

50. The most relevant previous decision is Decision 492. The Commission cleared the proposed acquisition and considered the relevant market to be the provision of hospital facilities and related non-specialist services for elective secondary surgery to private patients in the Wellington region (excluding the Wairarapa). The Commission concluded that the acquisition would not result in a substantial lessening of competition in this market, as it would be constrained from sufficient existing and potential competition, and countervailing power from private funders and insurance companies.

51. In Decision 449, the Commission cleared the acquisition of Mercy Hospital Limited by Ascot Hospital and Clinics Limited - two private hospitals operating in the Auckland region. The relevant markets considered were:

- hospital facilities and related non specialist services for elective secondary surgery to private patients in the Auckland region;
- hospital facilities and related non specialist services for elective tertiary[10] surgery to private patients in the Auckland region;
- elective secondary surgery for publicly funded patients in the Auckland region;
- angiography services to private patients in the Auckland region; and
- endoscopy services to private patients in the Auckland region.

52. In Decision 331, the Commission cleared the merger of Eastbay Health Limited and Western Bay Health Limited - two geographically separate public hospitals. The relevant markets were the provision of :

- primary healthcare services and/or facilities separately in the eastern and western Bay of Plenty regions;
- acute secondary healthcare services and/or facilities separately in the eastern and western Bay of Plenty regions;
- elective secondary healthcare services and/or facilities in the Bay of Plenty region; and
- tertiary healthcare services and/or facilities in the North Island.

53. The Applicant refers to the ophthalmologists case in relation to market definition, namely, *Commerce Commission v The Ophthalmological Society of New Zealand Incorporated*. In this case, Judge Gendall considered public and private hospitals to be in the same market. The Judge concluded the relevant market to be cataract surgery including pre-assessment and follow-up, provided to people in the Southland area. The Judge accepted the view of a particular economist because of his expertise and knowledge of the medical sector and because his views fitted a

[10] Tertiary surgery is specialised surgery involving specialised equipment, nursing or surgeons.

pragmatic analysis of the evidence and factual situation of patients with a common eye condition, wishing to have elective surgery to remedy that condition.

MARKET DEFINITION

54. The Act defines a market as:

> "… a market in New Zealand for goods or services as well as other goods or services that as a matter of fact and commercial common sense, are substitutable for them."[11]

55. For competition purposes, a market is defined to include all those suppliers, and all those buyers, between whom there is close competition, and to exclude all other suppliers and buyers. The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who produce, or could easily switch to produce, those goods or services. Within that broad approach, the Commission defines relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration, bearing in mind the need for a commonsense, pragmatic approach to market definition.[12]

56. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the five dimensions of a market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product Market

57. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. For each initial market so defined, the Commission considers whether the imposition of a SNNIP would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market.

58. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market. The degree of demand-side substitutability is influenced by the extent of product differentiation.

59. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

60. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.

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[11] s 3(1) of the Commerce Act 1986.

[12] Australian Trade Practices Tribunal, *Re Queensland Co-operative Milling Association*, above note 10; *Telecom Corporation of NZ Ltd v Commerce Commission & Ors* (1991) 3 NZBLC 102,340 (reversed on other grounds).

61. In the present Application, the Applicant considers that the relevant product market is the provision of hospital facilities and related non-specialist services for elective secondary services.

62. The Commission considered five possible dimensions of the relevant product market when defining the relevant market, for the purposes of the present Application:

- public versus private surgery;
- hospital facilities versus surgical services;
- elective versus acute surgery;
- secondary versus tertiary surgery; and
- day-patient versus in-patient surgical facilities.

Public vs. Private Elective Surgery

63. In Decisions 449 and 492 the Commission defined separate markets for private and publicly funded elective surgery. The Commission considered that both private and public hospitals operate in the publicly funded market, whereas only private hospitals operate in the privately funded market. Similarly, in Decision 518 separate markets were defined for private and publicly funded radiology work. In defining the market in this way, the Commission noted the following market characteristics:

- the bulk of work undertaken by private hospitals is privately funded. At present, approximately only 6% of funding received by private hospitals originates from DHBs;[13]
- publicly funded surgery is organised differently from privately funded surgery. Surgeons and related surgical staff are contracted employees of public hospitals, hence the product, with respect to publicly funded surgery, is the provision of the surgery and facilities. In the case of privately funded surgery, however, the relevant product is the provision of the facilities alone; and
- private hospitals are directly competing with public hospitals for publicly funded work, whereas only a small amount of privately funded work is undertaken in public hospitals. Therefore, for publicly funded operations, public and private institutions are in the same market, whereas, for privately funded operations that is not the case.

64. However, the Applicant considers that private and public hospitals are in the same market because:

- all the procedures carried out at St George, the Oxford Clinic, and Southern Cross are also conducted at the public hospitals;
- many surgeons operate at both public and private facilities;
- there is a chain of substitution (driven by the trade-off between timeliness and cost of surgical treatment) between those patients who prefer either the public or private system over the other; and

[13] New Zealand Private Hospital Association (2004) "The Role of New Zealand Private Hospital Association"

- nationally, DHBs frequently contract private facilities showing they regard the facilities as a substitute for their own.

65. In its investigations, all parties consulted by the Commission, with the exception of the Applicant [ ], considered it valid to distinguish between the private and public provision of secondary healthcare facilities and that separate market definitions were justified. Industry participants also advised the Commission that although Canterbury District Health Board (CDHB) has the technical capacity to perform private procedures, it was precluded from doing so by a shortage of funding.

66. On the supply-side, there is generally a clear distinction between public hospitals undertaking public work and private facilities undertaking private work (with ACC funded surgery being the exception). While there is potential for supply-side substitution, government policy actively discourages this.

67. In 2000, the Government introduced an initiative "Reduced Waiting Times for Public Hospital Elective Services" in an attempt to ensure that patients in the public sector wait no longer than six months for elective procedures. As such, public providers are obliged to reduce their waiting lists, rather than seek private business.

68. The Commission recognises that public surgical facilities may provide some degree of constraint on private surgical facilities in terms of two factors identified in Decisions 449 and 492, namely:

    - public hospitals have potential to carry out private work, even if this would require a change in government policy; and
    - public work can be contracted out to private providers to reduce waiting lists. Funding for public surgery is determined according to independently derived formulae, which tend to set the benchmark for how much public providers will pay private providers.

69. However, the Commission also considers that the key principle that guides market definition is the scope for substitution to occur between public and private surgical facilities.

70. The Commission recognises that on the demand-side, neither private nor public provision is costless for the patient. Public surgery is provided free of charge, but typically long waiting lists for procedures mean patients incur an opportunity cost for time. Patients who are unable to pay for their healthcare or who do not fall into ACC funding criteria, are limited to public health services. The opportunity cost of time is not a consideration for these individuals.

71. For those patients who can afford to pay for their healthcare, private facilities offer quick service, however, these patients pay a premium for timeliness. Therefore, in general, patients whose opportunity cost of time outweighs their willingness and ability to pay for surgery will choose private facilities. Those who are willing to accept long waiting periods in order to save on the cost of procedures will typically choose public facilities. Hence, timeliness and the cost associated with public and private procedures make these services differentiable and imperfect substitutes for patients.

72. The substitutability between public and private surgical facilities will depend greatly on who bears the cost of treatment. In public facilities, the time

opportunity costs associated with waiting lists are borne entirely by patients. However, for those patients who have a choice of public or private healthcare, the cost of treatment in private facilities is typically shared between those individuals who pay for services out-of-pocket, private insurers, and the Government via ACC.

73. In the face of a SSNIP imposed by a private provider of surgical facilities, it is highly likely that only those individuals who bear some of the incremental cost associated with the price rise (those who pay for treatment out-of-pocket and those whose cost of treatment prior to the price increase exceeded the payment cap set by their health insurer by a significant amount) would consider substituting away from a private facility in favour of a public facility. Given that the proportion of individuals who fall into this category is relatively small,[14] it is the Commission's view that the overall substitutability between private and public surgical facilities is also likely to be small.

74. Considering the scope for constraints on the supply-side, [ ] informed the Commission that [ ] does not take into consideration private hospital charges[15] when it allocates funding for public surgical procedures, so is not constrained by the pricing behaviour of private hospitals. Instead, the volume of procedures performed, and therefore the extent of public hospital waiting lists (the 'cost' borne by public patients) is directly determined by government funding policy initiatives.

75. In addition private hospitals do not actively respond to movements in public hospital waiting lists by adjusting their hospital charges. For example, a recent injection of funding into Burwood Hospital to reduce orthopaedic surgery waiting lists has not prompted any of the private hospitals to adjust their fee schedules. St George [

]. Southern Cross last adjusted prices in [

]. This suggests that private hospitals in Christchurch do not actively take into consideration the extent of public funding and the length of public waiting lists when setting prices.

76. [

]. Instead, factors of greater importance when setting private hospital charges are the cost of inputs such as the nursing wages, consumables and medical supplies, etc. For example, [

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77. Finally, during the course of its investigation, the Commission encountered the view from industry participants that private and public healthcare are complementary to one another, rather than substitutes in an economic sense. For instance, the Health Funds Association of New Zealand states:

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[14] Fewer than [ ] of all patients at Southern Cross, [ ] of all patients at St George, and [ ] of patients at Oxford Clinic are self-fund surgical procedures.

[15] Hospital charges, in this context, consist of a bed rate for overnight stays, consumables and surgical supplies, and operating theatre fees.

> "The New Zealand public and private health systems are complementary. The public health system is the provider of high level emergency or acute care and non-urgent elective surgery. The private sector provides access to semi-acute and non-urgent but necessary healthcare assessment and treatment".[16]

78. Giving full consideration to all these factors, the Commission concludes that, for the purposes of the present Application, public and private surgical facilities should be considered as being in separate product markets.

Facilities vs. Surgical Services

79. The Applicant has accepted the Commission's categorisation in Decisions 449 and 492 that the separate private hospital facilities and related non-specialist services (such as nursing) provided by the hospitals can be bundled together to form one aggregate market, rather than considering separate markets for nursing services, and surgical equipment.

80. Decisions 449 and 492 also considered that surgical facilities and services are fungible across medical specialities, so that general "surgical" markets can be defined rather than specific markets for each specialty or procedure. The Commission considered that an exception to the substitutability across medical specialities existed in the distinction between secondary and tertiary services. In this proposed joint venture, the Commission found that this still holds. The Commission therefore concludes that, for the purposes of the present Application:

- the separate facilities and non-specialist services that hospitals provide can be bundled together to form one aggregate market; and
- surgical facilities and non-specialist services are fungible across medical specialities, so that general "surgical" markets may be defined.

Acute vs. Elective and Secondary vs. Tertiary Surgery

81. Decisions 449 and 492 considered that acute and elective surgery are not part of the same market. The Commission considered that although there are aspects common to the provision of both services (e.g. clinical staff and facilities), there is a difference in the timeframes over which the services may be delivered. Acute services are required more urgently than elective surgery and there is little or no control over their volume. In general, only elective surgery is provided by private hospitals in Christchurch.

82. As in Decisions 449 and 492, parties spoken to by the Commission agreed that it was meaningful to distinguish between secondary and tertiary surgery because more specialised equipment, nursing staff and other staff are required for tertiary surgery (e.g. the need for intensive care units or coronary care units). From a supply perspective, facilities suitable for tertiary surgery can be used for secondary surgery, but not vice versa. The Applicant has accepted the Commission's categorisation of separate secondary and tertiary markets.

83. As Southern Cross and the Oxford Clinic only provide secondary elective surgery, the Commission considers that it is appropriate to limit the competition analysis to the consideration of aggregation in the market for secondary elective surgery only.

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[16] Health Funds Association of New Zealand Inc., (2004), "The Role of Health Insurance", *Fact File*: Health Insurance in New Zealand.

Day Patient vs. In-patient Surgical Facilities

84. Some industry participants have drawn a distinction between day-patient facilities and in-patient facilities, citing the high cost of gearing up a purpose-built day patient facility to accommodate more complex in-patient surgical procedures. Industry participants informed the Commission that a private hospital operating primarily as a day-patient facility would need the following additional resources in order to perform in-patient procedures:

    - overnight beds;
    - night staff;
    - evening meals; and
    - more spacious facilities to accommodate overnight beds.

85. For example, [

    ]. Hence, there is limited scope for substitution on the supply-side from day-patient facilities to in-patient facilities.

86. However, there is more scope for supply-side substitution from in-patient facilities to day patient facilities. For example, [

    ]. This indicates that the cost of switching from providing in-patient to day patient work is not prohibitive, given that much of the infrastructure common to the two types of surgical work is already in place.

87. The Commission considers that, on the demand-side, there are a number of technical and informational limitations that may override a patient's personal preferences for either in-patient or day patient surgery. The most significant of these is the medical opinion of the referring surgeon, whom the patient is likely to rely heavily upon. Given the strong asymmetry of information between surgeons and patients, it is highly likely that patients will accept the recommendation of the surgeon over whether an in-patient or day-patient procedure would be the most appropriate course of treatment. Hence, normal considerations of price and personal preferences rarely factor into the patient's decision between in-patient and day-patient surgery. As a result, the two cannot be thought of substitutes in the usual economic sense.

88. Furthermore, when patients choose either in-patient or day patient surgical work, they are selecting products with fundamentally different characteristics. In particular, when an in-patient procedure is opted for, the patient receives a bundle of services including an extended period of monitoring by medical staff, recovery time located within a medical facility where complications may be more readily addressed, a managed medication plan, etc.

89. When day surgery is selected, the patient receives the benefit of a shorter hospital stay and a less invasive treatment leading to a swifter recovery. These characteristic differences between in-patient and day patient surgery are quite significant, suggesting that the products themselves are different, so therefore should be defined in separate product markets.

90. Acknowledging that there are arguments in favour of both a narrow and broad product market, the Commission considers that for the purposes of the present Application, the relevant competition effects are best identified by defining separate product markets for in-patient and day patient surgical facilities, due to the limited demand-side and supply-side substitutability. The Commission recognises that if competition concerns are not identified within a narrowly defined market, they are unlikely to arise in a more broadly defined market.

Conclusion on Product Markets

91. For the purposes of the present Application, the Commission concludes the relevant product markets are the provision of private:

    - day patient hospital facilities and related non-specialist services for elective secondary surgery; and
    - in-patient hospital facilities and related non-specialist services for elective secondary surgery.

Geographic Markets

92. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

93. There are three private hospitals located in Christchurch. Industry participants have advised the Commission that due to this concentration of facilities and specialist skills, some patients do travel from all around the South Island to Christchurch to receive private surgical treatment. The willingness of patients to travel long distances to receive treatment typically arises for the following reasons:

    - general access to surgeons and facilities;
    - access to required subspecialty treatment;
    - reputation of the operating surgeon; and
    - timeliness of treatment.

94. For instance, Michael Laney, shareholding surgeon at the Oxford Clinic, apart from performing routine gynaecological and obstetric work, also has some specialised skills in gynaecological oncology and advanced endoscopic surgery. For these subspecialty skills, Michael Laney receives referrals from all over the South Island.

95. However, industry participants have also advised the Commission that the bulk of surgical work carried out at the three private hospitals originates from within the Canterbury region. For instance, [ ] come from within Canterbury. However, no hard data was available from the hospitals on the proportion of patients originating from the narrower catchment area of Christchurch itself. Nonetheless, Oxford Clinic estimated that approximately [ ] of patients came from Christchurch with the remaining coming from wider Canterbury. Southern Cross estimated [ ] of patients were from Christchurch, [ ] from the CDHB catchment area (excluding Christchurch) and [ ] from outside the CDHB catchment.

96. Based on the parties' estimates, the Commission considers it appropriate, for the purposes of the present Application, to adopt the conservative approach of defining the relevant geographic market to be Christchurch (as opposed to the broader market of the Canterbury region). The Commission recognises that if competition concerns are not identified within a narrowly defined market, they are unlikely to arise in a more broadly defined market.

Conclusion on Market Definition

97. For the purposes of the present Application, the Commission concludes that the relevant markets are the provision of private:

- day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch; and
- in-patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch.

COUNTERFACTUAL AND FACTUAL

98. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a "with" and "without" comparison rather than a "before" and "after" comparison. The comparison is between two hypothetical future situations, one with the acquisition (the factual) and one without (the counterfactual).[17] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

99. In the factual scenario, there would be two private hospital providers operating in Christchurch, Southern Cross and St George, in each of the relevant markets.

100. In particular, Southern Cross has stated [
]
gynaecological and colorectal/general surgery carried out at the Oxford Clinic facility. [

].

101. Post acquisition, five of the existing shareholders of Oxford Clinic would continue to have an interest in Oxford Clinic. The acquisition would dilute their respective equity stakes in Oxford Clinic from [ ] each to [ ]. The current sixth shareholder Suzanne Suckling is leaving the Oxford Clinic, regardless of the acquisition, to pursue personal interests. Suzanne Suckling was the business manager for the clinic and had no involvement in surgical procedures.

Counterfactual

102. The Oxford Clinic informed the Commission that [

]

[17] Commerce Commission, *Decision 410: Ruapehu Alpine Lifts/Turoa Ski Resorts Ltd (in receivership), 14 November 2000*, paragraph 240, p 44.

103. The Applicant stated that [

].

104. The Commission considers the relevant counterfactual to be that Oxford Clinic would continue to operate and Southern Cross [
].

COMPETITION ANALYSIS

Existing Competition

105. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors). Supply-side substitution by near competitors arises either from redeployment of existing capacity, or from expansion involving minimal investment, in both cases involving a delay of no more than one year.

106. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

107. The Commission identifies market shares for all significant participants in the relevant market. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used.

108. An aggregation that would result in a low concentration level is unlikely to be associated with a substantial lessening of competition in a market. On this basis, indicative safe harbours may be specified.

109. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of 40% share; or
- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

110. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market. Specifically, the Commission seeks to understand the dynamics of the competition that would exist between the

remaining firms in the market, compared to what would exist in the absence of the merger.

111. In each of the two relevant markets, the same private hospital providers are active in the provision of in-patient and day-patient facilities and related non-specialist services for elective secondary surgery in Christchurch. However, as shown in Table 2 the number of in-patients at Oxford Clinic and the revenue obtained from the provision of in-patient services is [ ] Southern Cross and St George. Therefore, given the [ ] in market share and competition from St George, the Commission considers the proposed joint venture is unlikely to lead to a substantial lessening of competition in the provision of private in-patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch. This market is not considered further.

Table 2: Market Shares by Revenue for Private Hospital Facilities for Elective Secondary Services for 2003

Private Hospital	In-patients		Day Patients		Total	
Oxford Clinic	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Southern Cross	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Combined	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
St George	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total	[ ]	100%	[ ]	100%	[ ]	100%

Table 3: Market Shares by Number of Patients for Private Hospital Facilities for Elective Secondary Services for 2003

Private Hospital	In-patients		Day Patients		Total	
Oxford Clinic	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Southern Cross	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Combined	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
St George	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total	[ ]	100%	[ ]	100%	[ ]	100%

112. Tables 2 and 3 show that in the provision of private day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch, the joint venture would have a market share of [ ] % by revenue and [ ] % by number of patients. This puts the acquisition outside the Commission's safe harbours.

113. Post joint venture, the only existing competitor to Southern Cross would be St George. Most of the industry participants contacted informed the Commission that the proposed joint venture would have little impact, given that the Oxford Clinic is currently such a small player and that there would continue to be competition between Southern Cross and St George.

114. [

].

115. Post joint venture, Southern Cross and St George would continue to compete by:
    - attracting surgeons to use their facilities;
    - offering state of the art equipment;
    - offering high quality nursing staff; and
    - offering competitive prices.

116. [

]

117. In addition the Commission found that hospitals attempt to attract surgeons through a numbers of measures. Surgeons perform complex and highly skilled procedures in the hospitals. As such they are very demanding in the resources that they use, whether in the equipment supplied by the hospital, or the nursing staff. Subsequently hospitals cater to the demand and needs of surgeons by providing the most up-to-date technology and the best available equipment.

118. Surgeon comfort is also critical. In private hospitals nurses assist the surgeons in the operating theatre and, because there are no house surgeons or registrars, provide all the pre- and post-operative care for the patient. By supplying the highest quality nursing care a hospital can attract a surgeon to use its facilities. Surgeons informed the Commission that the nursing standards also reflected on the performance of the surgeon and a surgeon had to be comfortable in leaving the patient in the care of the nurses.

119. The Commission considers that, post joint venture, surgeons would be able to switch between Southern Cross and St George's day facilities easily. For example, [

]

120. Another example is the switching of the cardiac units. In Christchurch, private cardiac surgery had been performed at Southern Cross by a specialist group of surgeons. However, a new cardiac group was formed [ ]. St George established purpose-built facilities required for the cardiac surgeons, such as the operating theatre and CATH laboratory, and the entire unit shifted to St George in April 2003. Whilst this example relates to surgeons choosing facilities for in-patient services it demonstrates that it would be easy for surgeons carrying out day surgery to switch hospitals.

121. Further, the Commission considers that St George is likely to remain a strong competitor, as it is a well established provider of private healthcare. For

example, it has recently completed the first stage of its three phased redevelopment following the decommissioning of the previous facilities. The concept of this redevelopment was to provide an upmarket, state-of-the-art hospital around which a number of associated services were integrated, creating a 'one-stop shop' approach to healthcare.

122. This initial stage was completed in 2002 when a new wing was opened with two new wards, four theatres, a new recovery unit as well as adjoining consulting rooms, pharmacy and medical laboratory. All industry participants described the facilities at St George as very high quality and reflected the public's demand for a hotel quality service from private hospitals.

123. St George also has [ ] capacity should surgeons prefer to carry out more surgery at that hospital. This is shown in Table 4 where capacity is measured by theatre availability.

Table 4: Spare Capacity at Private Hospital Facilities for Elective Secondary Services

Hospital	Total theatre procedures actually carried out	Total theatre procedures that could be carried out	Spare Capacity
Southern Cross	[ ]	[ ]	[ ]
Oxford Clinic	[ ]	[ ]	[ ]
St George	[ ]	[ ]	[ ]

124. Table 5 also shows that Southern Cross is currently operating at [ ] capacity. [

]. The Oxford Clinic informed the Commission that [

].

Conclusion on Existing Competition

125. The Commission concludes that in the provision of private day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch, post joint venture, Southern Cross is likely to continue to be constrained through existing competition from St George.

Potential Competition

126. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry.

127. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any barriers they might encounter should they try. Where barriers

to entry in a market are clearly low, it may be unnecessary for the Commission to identify specific businesses that might enter. In other markets, where barriers are higher, the Commission may seek to identify possible new entrants as a way of testing the assessed entry barriers.

Barriers to Entry

128. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of the aggregate barriers to entry into that market. The Commission is of the view that a barrier to entry is best defined as anything that amounts to a cost or disadvantage that a business has to face to enter a market that an established incumbent does not face.

129. A barrier to entry may exist due to the relatively small population base within a defined geographic market and the consequent potential growth in demand for hospital services to be static or low. Low growth in demand poses a barrier to entry when there are economies of scale and scope captured by incumbent operators, such that a new entrant may find it difficult to compete.

130. In the provision of private day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch, the Commission found the main barriers to entry to be:

- access to facilities and medical equipment;
- nursing staff; and
- attracting surgeons to use the new facilities.

131. In Decision 492 the Commission found that the capital costs of establishing a new hospital were not sufficiently high to constitute a material barrier to entry in the absence of other tangible barriers, and that the (suggested) low return on capital is correctly regarded as a sign of a competitive market where any market rents have been eroded by competitive forces.

132. In this proposed joint venture, industry participants estimated that the cost of a new theatre is approximately [ ] However, it was suggested that it was uneconomic to build a new clinic with only one theatre and the cost of a new facility, similar in size to the Oxford Clinic, would be [ ] Outfitting the theatre with the appropriate technology and equipment would increase cost by another [ ] stated that the biggest issue was not funding the initial investment, but finding a suitable location for a clinic. This was more of an issue for the Auckland market where land values are consistently higher than in Christchurch.

133. Alternatively, land, buildings and equipment can be leased, thus reducing the capital cost associated with them.

134. In this proposed joint venture, industry participants stated that the establishment cost of a day surgery hospital are significantly less than the cost of a full in-patient facility. Overall, the Commission considers the capital costs of setting up private day patient hospital facilities to be low.

135. Another key requirement for entry into a private day hospital is attracting surgeons. Surgeons are not contracted to any particular hospital and often operate across multiple hospitals, whether they are day, in-patient or public

hospitals. A new entrant would need to invest time in establishing relationships with surgeons and would need to market the new facilities. For instance, an Auckland day clinic advised the Commission that when it opened, it held an open day for surgeons to look at their facilities and invitations were sent to industry participants in the North Island. Oxford Clinic, when it opened in 1995, also held an open day.

136. The Commission investigated whether the proposed joint venture would foreclose access to surgeons to a potential new entrant. Most industry participants said that access to surgeons was not an issue and that new surgeons were continuously becoming qualified. Further in the last quarter for 2004, Oxford Clinic had [ ] surgeons use their facilities of which [ ] were gynaecologists, [ ] surgeons specialising in endoscopy and colorectal procedures, [ ].

137. Tables 5 and 6 show that there are currently three gynaecologists and six endoscopy surgeons that conduct surgery at Southern Cross, but not at the Oxford Clinic. However, just like any new entrant the joint venture would have to encourage those surgeons to use the facilities at Oxford Clinic.

138. In the event that these surgeons did use the Oxford Clinic facilities, a new entrant could attract them by offering better facilities and nursing staff. Further, the Commission found that there are currently 223 surgeons registered in New Zealand to carry out gynaecology procedures and 204 as general surgeons carrying out endoscopy procedures, should a new entrant wish to gain access to a wider pool of surgeons. Whilst not all of these surgeons would move to work in Christchurch, there is likely to be a sufficient number of surgeons that would move.

Table 5: Gynaecologists Working at the Private Hospitals in Christchurch

	Gynaecology	**Oxford Clinic**	**Southern Cross**	**St George**
1	East	X		X
2	Doig	X	X	X
3	Jones	X		X
4	Laney	X	X	X
5	Dover	X		X
6	Whineray		X	X
7	Conaghan		X	
8	Dixon		X	X
9	Bashford			X
10	Benny			X
11	Conaghan			X
12	Phillipson			X
13	Sissons			X
	Total number of surgeons	**5**	**5**	**12**

Table 6: Endoscopy Surgeons Working at the Private Hospitals in Christchurch

	Surgeon	Oxford Clinic	Southern Cross	St George
	Endoscopy			
1	Richard Perry	X	X**	X
2	Paul Fogarty	X*	X	X
3	Ding	X		
4	Barclay		X	
5	Chapman		X	
6	Burt		X	
7	Coulter		X	X
8	G Robertson		X	X
9	R Robertson		X	X
10	Frizelle	X	X	X
11	Renaut	X	X	X
12	Richardson	X		
13	Ross	X		X
14	Stubbs	X		
15	J Mercer			X
16	P Mercer			X
17	Ward			X
18	Gordon			X
19	Maoate			X
20	Ross	X		X
21	Utley			X
	Total number of surgeons	**9**	**10**	**15**

*[ ]

139. The Commission also found that most surgeons conduct surgery at more than one hospital and are not tied to any one facility. This is shown in the table below.

Table 7: Oxford Clinic Shareholders: Locations where Surgery Conducted

	Surgery Breakdown			
Surgeon	**Oxford**	**Southern Cross**	**St George**	**Public**
General				
Richard Perry	[ ]	[ ]	[ ]	[ ]
Paul Fogarty*	[ ]	[ ]	[ ]	[ ]
Gynaecology				
Michael Laney	[ ]	[ ]	[ ]	[ ]
Michael East	[ ]	[ ]	[ ]	[ ]
John Doig	[ ]	[ ]	[ ]	[ ]

140. Furthermore, as discussed earlier, private surgeons typically have sufficient freedom and flexibility so as not to be bound by individual employment contracts. Hence it is unlikely that the proposed joint venture would foreclose access to surgeons in Christchurch. The shareholding surgeons at the Oxford Clinic are likely to have an increased incentive to channel more patients towards

Southern Cross by virtue of their stake in the joint venture. However, in the event that the Oxford Clinic surgeons were to completely shift the procedures currently conducted at St George to either the Oxford Clinic or Southern Cross, this would represent only around [ ] worth of surgery per annum. Finally, the Commission found that surgeons are likely to be potential entrants into the provision of private day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch.

141. On the whole, the Commission does not consider attracting surgeons to be a significant barrier to entry.

Conclusion to Barriers to Entry

142. In conclusion, the Commission considers barriers to entry into in the provision of private day-patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch, to be low.

The "LET" Test

143. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be Likely, sufficient in Extent and Timely (the LET test).

144. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power, and would not alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational business would be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

145. If it is to constrain market participants, the threat of entry must be at a level and spread of services that is likely to cause market participants to react in a significant manner.

146. If it is to alleviate concerns about a substantial lessening of competition, entry must be feasible within a reasonably short timeframe, considered to be two years, from the point at which market power is first exercised.

The Likelihood of Entry

147. Some industry participants did not consider there was a high probability that, post joint venture, a de-novo private in-patient or day patient hospital facility would open in Christchurch, given the presence and competitiveness of the existing facilities at St George and Southern Cross.

148. However, industry participants did consider it possible that surgeons could open competing day surgery facilities should they become dissatisfied with the service at private hospitals, or if a venture of this type would be more profitable than their existing surgery at private hospitals.

149. The Commission was informed [

]

150. The Commission found differing opinions by industry participants as to the extent to which surgeon shareholders in private hospitals may influence the mobility of surgeons and patient referrals.

151. [ ] emphasised that it was very common for surgeons operating in New Zealand to also be shareholders in private facilities. Such a situation was deemed to be the norm rather than the exception. This was contrary to the experience of [ ]. The reason given for this was [ ].

152. Non-price factors such as reputation, quality, location or the presence of a leader in a given surgical field may also influence surgeon referral patterns.

153. It was also suggested to the Commission that GPs have, to a limited extent, the ability to enter the day surgery market in Christchurch and that some GPs already perform certain types of minor surgery. Pegasus Health, an Independent Practitioners Association of 243 GPs in Christchurch, [ ]. With advances in surgical techniques and technology it was anticipated that this will be a growth area for surgery. The Commission was also informed that a number of GP clinics in Auckland already perform some day procedures, such as hernia operations and vasectomies.

154. The Commission considers that while no new entrants were identified, entry is most likely from a group of surgeons or possibly from a group of GPs.

Extent of Entry

155. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

156. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that "toe-hold" position may be difficult because of the presence of mobility barriers, which may hinder firm's efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the 'extent' of entry.

157. Entry is more likely into specific secondary procedures rather than into the secondary market as a whole. Expansion by existing market participants into secondary procedures that they do not currently specialise in is also possible

158. A new day surgery is most likely to occur in the secondary market where the volume of operations is high and the degree of sophistication is low; such as for endoscopy, low complexity orthopaedic, general surgical and hernia procedures. In some cases procedures may be undertaken in a surgeon's consulting room. Entry of this sort may be categorised as niche, and therefore the extent to which a day surgery could constrain the merged entity would be limited to its area of specialisation and the potential for expansion into other secondary procedures, which is determined by the degree of sophistication of the day surgery's theatre. However, as technological advances increase the speed with which surgery can be performed and the post-operative recovery time, day surgeries are becoming

increasingly popular and the range of secondary procedures capable of being performed safely is increasing.

159. The Commission considers that the expansion of an existing hospital in Christchurch is limited. Southern Cross is [ ] capacity at its present location. St George has recently redeveloped and upgraded its facilities. Although further redevelopment is scheduled, this will concentrate on the hospital's infrastructure, such as refurbishing the heritage building and increasing car parking capacity, rather than core surgical services. [ ].

160. The Commission considers that entry, in the provision of private day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch would be sufficient in extent to constrain the joint venture should it attempt to exercise market power.

Timeliness of Entry

161. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

162. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

163. The Commission has previously found that a new day surgery could be operational within 6 – 12 months. The experience of Ascot in Auckland suggests that de novo entry of a significant scale can be accomplished within two years of planning being commenced. Furthermore, the recent experience in Auckland where a number of surgical centres have been established and the recent opening of the Bridgewater Day Surgery in Hamilton indicates that entry into the secondary surgical market is not slow.

164. The Commission considers that, in the event of the joint venture attempting to exercise market power, entry is likely to be within the necessary timeframe for it to constrain any exercise of market power.

Conclusion on Potential Competition

165. The Commission considers that in the provision of private day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch, barriers to entry are low and the prospect of entry in the event of the Southern Cross attempting to exercise market power is sufficiently tangible to be a constraint on the joint venture in the post-acquisition market.

Countervailing Power

166. The potential for a business to wield market power may be constrained by countervailing power in the hands of its customers, or when considering buyer market power (oligopsony or monopsony), its suppliers. In some circumstances,

this constraint may be sufficient to eliminate concerns that an acquisition would be likely to lead to a substantial lessening of competition.

167. In its previous decisions, particularly Decision 492, the Commission has considered the ACC, insurance companies and the surgeons to have strong countervailing power. In Decision 492, it was concluded that the constraints from surgeons, ACC and insurers were difficult to quantify in terms of their ability to constrain an increase in price but the cumulative impact of these funders would provide sufficient constraint to the private hospitals.

168. In this proposed joint venture, the Commission has considered the countervailing power of each of the funders of Southern Cross, Oxford Clinic and St George. The proportion of funding from each source for each hospital in Christchurch is shown in Table 8.

Table 8: The Proportion of Funding of Private Hospitals

Revenue Source	Southern Cross	Oxford Clinic	St George
Total Insurance Companies	**[ ]**	**[ ]**	**[ ]**
Southern Cross Medical Care Society	[ ]	[ ]	[ ]
Tower	[ ]	[ ]	[ ]
UniMed	[ ]	[ ]	[ ]
Other insurance companies	[ ]	[ ]	[ ]
Private Patients	**[ ]**	**[ ]**	**[ ]**
ACC	**[ ]**	**[ ]**	**[ ]**
District Health Boards	**[ ]**	**[ ]**	**[ ]**
Total	**100%**	**100%**	**100%**

[ ]

ACC

169. The Commission found that for some types of elective procedures, mainly orthopaedic procedures, the ACC contracts provide a significant source of funding for some private hospitals. However, [ ] of the procedures it funds are for gynaecology and endoscopy procedures.

170. The ACC informed the Commission that [ ]. It also stated that [

].

171. Even though the joint venture company may have a [ ] of its revenue from ACC, given that the ACC is a price maker the ACC is likely to provide a constraint if it increased its business with Southern Cross.

Health Insurance Companies

172. Like the ACC the health insurance companies are likely to provide some constraint on the proposed joint venture and this is unlikely to be affected by this

acquisition. For instance, insurers use a historical database of claims to establish the "usual and customary" cost of treatment. This average cost is used to benchmark payouts. Therefore, [ ] said that sometimes where it is asked for prior approval for the cost of surgery for a particular patient and found the cost to be out of line with its average price, it would go back to the surgeon. If it found the prices to be high it would negotiate and may even refuse to pay the whole claim.

173. St George stated that [

]

[

].

174. Further, Table 8 shows that at present [ ] of Southern Cross' revenue is obtained from insurance companies, although [ ] is from its associated company, the Society. Post joint venture, the revenue the new company would obtain from the Society would represent [ ] of its total revenue. While this represents a large amount it is not significantly different from the current proportion of revenue Southern Cross obtains from the Society. Therefore, post joint venture, given that the proportion of revenue from other funders would not alter significantly, the Commission considers that the proposed joint venture is unlikely to reduce any countervailing power the insurance companies currently have.

175. Table 9 shows that with the exception of the Society, the proportion of funding from each health insurance company for Southern Cross, Oxford Clinic and St George mirrors their national market share.

Table 9: Market Shares by Insurance Company

Insurance Company	Total of Earned Premiums	Total of Lives Covered
Southern Cross	[ ]	[ ]
Tower Health and Life	[ ]	[ ]
Sovereign Assurance	[ ]	[ ]
UniMed	[ ]	[ ]
Other	[ ]	[ ]
Total	100%	100%

176. [

].

177. On the whole the Commission considers that the health insurance companies provide an important source of revenue and are likely to provide some constraint on the proposed joint venture and this is unlikely to be affected by the proposed joint venture.

Surgeons

178. In Decision 492, it was noted that "the degree to which surgeons are price sensitive for their patients is difficult to quantify", but that there was "some suggestion that surgeons have incentives to keep hospital prices down, especially if patients are price sensitive, are funding the surgery themselves and opt not to have the surgery."

179. In this proposed joint venture it appears that surgeons take a range of factors into account when considering which hospital to carry out the patients' surgery. If the patient is paying for it themselves then they will try and choose the cheaper hospital. Other factors that are taken into account are urgency of surgery, personal preference, theatre availability. Further, as highlighted in paragraphs 119 and 120, surgeons can and do switch between the private hospitals in Christchurch. In the event that the joint venture increased hospital charges or reduced the quality of its service, this reflects poorly on the surgeon. Consequently, the threat of surgeons switching is credible and is likely to constrain the joint venture.

Conclusion on Countervailing Power

180. In conclusion, the Commission considers that the surgeons, insurance companies and the ACC are likely to constrain the joint venture and that the constraint currently provided by these funders is unlikely to be reduced significantly as a result of the proposed joint venture.

Co-ordinating Market Power

181. An acquisition may lead to a change in market circumstances such that either co-ordination between the remaining businesses is make more likely, or the effectiveness or pre-acquisition co-ordination is enhanced. The Commission is of the view that where an acquisition materially enhances the prospects for any form of co-ordination between businesses in the market, the result is likely to be a substantial lessening of competition.

182. The Commission evaluates the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for co-ordination would be materially enhanced by the acquisition. In broad terms, effective co-ordination can be thought of as requiring three ingredients: collusion, detection and retaliation.

183. Collusion involves businesses in a market either each individually coming to a mutually profitable expectation as to co-ordination (tacit collusion), or together reaching agreement over co-ordination (explicit collusion).

184. Detection requires that businesses that would deviate from the likely co-ordination are able to be swiftly detected by the other market participants involved.[18]

185. Deviations from the terms of co-ordination need to be not only quickly detected by the other suppliers, but also the deviating firm needs to be faced with a credible threat of swiftly being punished. The threat of retaliation increases the cost of deviating, thereby reducing the short-term profit to be gained by the business from deviating, and helping to preserve the co-ordination.

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[18] Stephen Martin, Industrial Economics: Economic Analysis and Public Policy (2nd edition), New York: Macmillan, 1994, ch 6.

186. In the provision of private day patient hospital facilities and related non-specialist services for elective secondary surgery, there are some structural and behavioural characteristics that may facilitate collusion. For instance, the proposed joint venture is likely to reduce the number of players from three to two, namely Southern Cross and St George. In addition, prices are transparent as the hospital providers publish price lists for their facilities and services and the service offered is comparable despite the fact that private hospitals will try to differentiate themselves by the quality of the services and facilities provided. Consequently, the two hospitals could collude on the price of their facilities and related non-specialist services for elective secondary surgery in Christchurch.

187. However, any collusion between the hospital providers would be easily detected by patients, surgeons, insurance companies and the ACC. Therefore, any attempt to collude on prices would be undermined by the countervailing power and threat of potential competition identified above. Therefore, the Commission is of the view that the proposed joint venture is unlikely to increase the likelihood of co-ordinated market power in the provision of private day patient hospital facilities.

OVERALL CONCLUSION

188. The Commission has considered the probable nature and extent of competition that would exist in the provision of private:

- day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch; and
- in-patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch.

189. In the provision of private in-patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch, the proposed joint venture would increase Southern Cross's market share by [ ]. Oxford Clinic is not a facility designed for in-patients and Southern Cross' main competitor is St George's Hospital. Consequently, the Commission considers that the proposed joint venture is unlikely to lead to a substantial lessening of competition in the in-patient market.

190. The Commission has mainly focussed on the provision of day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch. In this market, post joint venture, the Commission considers that there would be sufficient existing competition from St George's Hospital and countervailing power from surgeons and health insurance companies.

191. The Commission also considered whether the acquisition would foreclose access to surgeons to a potential new entrant. The Commission found that this was unlikely to be the case, as surgeons have no formal contracts with private hospital providers, most surgeons performed surgery at more than one private hospital and in New Zealand there is a wide of pool of gynaecology and endoscopy surgeons that new entrants could source from.

192. A final key consideration was the impact of the proposed acquisition on the health insurance market. The Commission found that while the Trust and Southern Medical Care Society, which provides health insurance, are associated, the proposed acquisition is unlikely to have a significant impact as, post joint venture,

the proportion of funding Southern Cross would obtain from the Society would increase by [ ].

193. On balance, the Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the provision of private:

- day patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch; and
- in-patient hospital facilities and related non-specialist services for elective secondary surgery in Christchurch.

DETERMINATION ON NOTICE OF CLEARANCE

194. Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Southern Cross Oxford Hospital Limited of the assets of the Oxford Clinic business in Christchurch.

Dated this 11th day of November 2004

Paula Rebstock
Chair
Commerce Commission