

COMMERCE COMMISSION

Decision No. 620

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

THE SOUTHERN CROSS HEALTH TRUST

and

QE HOSPITAL LIMITED

The Commission: Peter JM Taylor
Donal Curtin
Denese Bates QC

Summary of Application: The acquisition by Southern Cross Health Trust and QE Hospital Limited, or companies owned by them respectively, of shares in JV Co (a new company to be formed) and for the acquisition by JV Co of the private surgical hospital businesses of Southern Cross Hospital Rotorua and QE Health Rotorua (including shares held in QE Orthopaedics Limited by QE Hospital Limited).

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: 28 September 2007

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SQUARE BRACKETS**

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EXECUTIVE SUMMARY

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 3 August 2007. The Notice sought clearance by Southern Cross Health Trust and QE Hospital Limited, or companies owned by them, to acquire shares in JV Co (a new company to be formed) and for the acquisition by JV Co of the private surgical hospital businesses of Southern Cross Hospital Rotorua and QE Health Rotorua (including shares held in QE Orthopaedics Limited by QE Hospital Limited).
2. In the factual scenario, the combined entity would be the only private hospital in the Rotorua region. The Commission considers that in the counterfactual, while neither QE Health nor Southern Cross Rotorua are failing firms, it is likely that one of these hospitals would not continue to operate in the short term. The likely exit of one of these hospitals would mean that there would be little difference in the level of competition between the factual and counterfactual scenarios.
3. For completeness, the Commission considers that, even if both private hospitals in Rotorua continued to be in existence within the Commission's timeframe for analysis, they exert only a limited competitive constraint on each other, both in respect of the current level of competition between them and in their potential to compete, in all the relevant markets.
4. Therefore, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the affected markets.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 3 August 2007. The Notice sought clearance by Southern Cross Health Trust and QE Hospital Limited, or companies owned by them respectively, to acquire shares in JV Co (a new company to be formed) and for the acquisition by JV Co of the private surgical hospital businesses of Southern Cross Hospital Rotorua and QE Health Rotorua (including shares held in QE Orthopaedics Limited by QE Hospital Limited).

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice 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 Applicants. Accordingly, a decision on the Application was required by 28 September 2007.
3. The Applicants 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.
4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.¹

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal is, or is likely to have the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal would not be likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied it must decline the application. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.²
6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held:

We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgment is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.³

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

² *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.

³ *Air New Zealand & Qantas Airways Ltd v Commerce Commission*, (2004) 11 TCLR 347 Para 47.

7. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is more than nominal and not minimal.⁴ 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.
8. 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 ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any given case.
9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate in any given case.

ANALYTICAL FRAMEWORK

10. 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).
11. 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.

⁴ *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.

THE PARTIES

Southern Cross Health Trust

12. Southern Cross Health Trust (Southern Cross) is a not-for-profit charitable trust established for the purposes of providing hospital care to the general public.⁵ Southern Cross is the largest private hospital operator in the country and currently owns ten private surgical hospitals,⁶ and has partnerships in another four.⁷
13. The Southern Cross Rotorua hospital (Southern Cross Rotorua) was originally built in 1968 and it currently has two theatres and 26 in-patients beds, with services divided between day patients [] and in-patients [].⁸ A range of surgery including gynaecology, general, ophthalmology and endoscopy, as well as some orthopaedic surgery, is performed at the Southern Cross Rotorua hospital.

QE Hospital Limited

14. QE Hospital Limited (QE Health) is operated by the Queen Elizabeth Hospital Community Trust. QE Health provides a range of surgical services as well as health spa and rehabilitation services.
15. QE Health surgical facilities comprise one operating theatre and 21 in-patient beds, with services divided between day patients [] and in-patients []. QE Health predominantly performs orthopaedic surgery. QE Health's spa and rehabilitation business does not form part of the proposed joint venture.⁹
16. The current QE facility was built in 1942 for returning servicemen and developed into a treatment facility for rheumatology and arthritis sufferers. The QE hospital remained as part of the public sector until the early 1990s when it was not seen as suitable and was scheduled to be closed.
17. QE Health advised that widespread local dissatisfaction with this decision sparked community interest in the facility. Ultimately this led to the hospital being purchased from the Government in 1993 by a 50/50 joint venture between a local community trust and private investors. In 2005 the private investors exited the joint venture and the QE facility became 100% owned by the Queen Elizabeth Hospital Community Trust.

OTHER RELEVANT PARTIES

The Pukeroa Oruawhata Trust

18. The Pukeroa Oruawhata Trust is responsible for administering various sections of land in Rotorua on behalf of the beneficial owners of Ngati Whakaue. In

⁵ The Commission has proceeded on the basis that Southern Cross and the health insurer, the Southern Cross Medical Care Society, are "associated persons" pursuant to s47(3) of the Commerce Act. This is consistent with previous Commission determinations.

⁶ Auckland Surgical Centre, Brightside, Christchurch, Hamilton, Invercargill, New Plymouth, North Harbour, Palmerston North, Rotorua and Wellington

⁷ Gillies Hospital (Auckland), Mercy Angiography Unit (Auckland), Norfolk Southern Cross Hospital (Tauranga) and Southern Cross Oxford Hospital (Christchurch).

⁸ Southern Cross acquired the hospital in 1986.

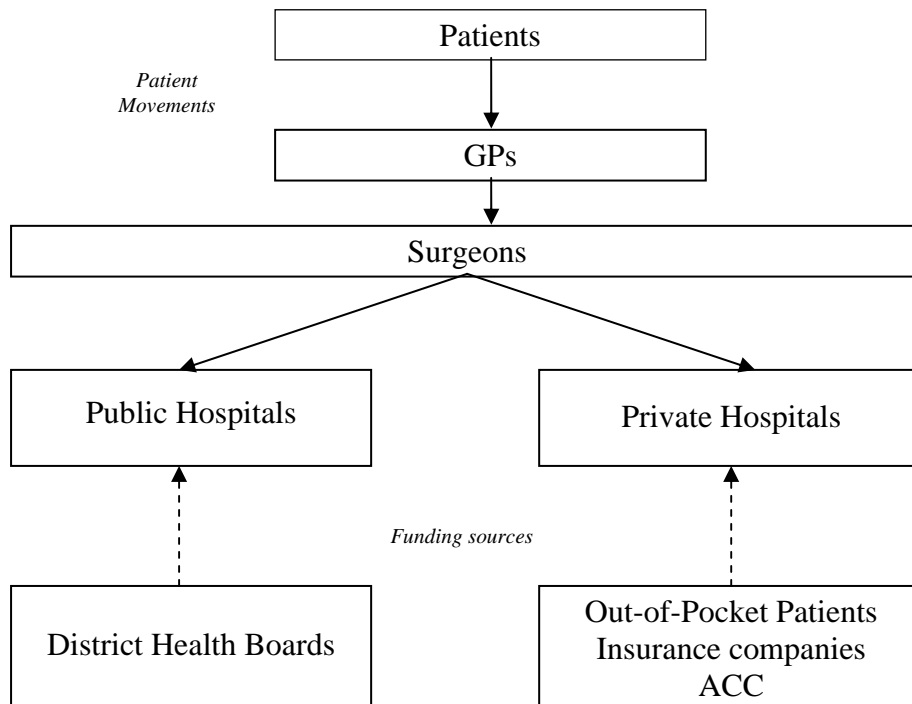
⁹ Accordingly, for the purposes of this report, the term QE Health refers to the surgical facilities of QE Hospital Limited.

particular, Pukeroa Oruawhata Trust's subsidiary Pukeroa Lakefront Holdings Limited (PLHL) holds the lease with QE Health.

INDUSTRY BACKGROUND

19. In New Zealand, healthcare is provided by a range of medical practitioners and facilities. The main industry participants considered in this proposed acquisition are shown in the diagram below.

Figure 1: Main Industry Participants in Healthcare



20. 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 1, 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.
21. 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. Typically, patients will follow a surgeon's recommendation about when and where the surgery is to be performed.
22. Private hospitals provide facilities, namely, patient rooms and medical equipment, as well as the related non-specialist services like administration staff and nursing 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.

23. Private hospitals focus almost exclusively on providing elective surgery. Elective surgery is defined as non-emergency treatments (including diagnostic services) where the condition is not life threatening and does not require immediate surgery.
24. Demand for the provision of elective surgery in the public system generally outstrips supply so provision is rationed. The private system caters for those patients who would not otherwise receive treatment in the public system, or who want to receive private treatment for reasons such as timeliness.

PREVIOUS DECISIONS

25. The Commission has recently considered a number of applications in respect of the private hospital industry, namely:
 - *Decision 537: Southern Cross Oxford Hospital Limited / The Oxford Clinic*, 11 November 2004 (the Oxford Decision); and
 - *Decision 546: The Southern Cross Health Trust / Auckland Surgical Centre Limited*, 17 February 2005 (the Auckland Surgical Decision).
26. The Commission granted clearance in both the Oxford and Auckland Surgical Decisions as it considered that the proposed acquisitions would be unlikely to lead to a substantial lessening of competition, primarily due to the strength of existing competition and sufficient excess capacity in the relevant markets.

MARKET DEFINITION

27. 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.”¹⁰
28. 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 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.
29. QE Health and Southern Cross Rotorua both provide private elective surgery on a day-patient and short-stay basis.¹¹ In addition, QE Health and Southern Cross (through its various regional hospitals) both provide public elective surgery on a contractual basis to District Health Boards (DHBs) in the central North Island.

¹⁰ s 3(1A) of the Commerce Act 1986.

¹¹ Short-stay patients are those patients that stay less than 23 hours in the hospital. See the Auckland Surgical Decision.

Private elective surgery

Product Market

30. 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.
31. 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.
32. Close substitute products on the supply-side are those between which suppliers can easily shift production easily and in the short run, using largely unchanged production facilities and little or no additional investment, when they are given a profit incentive to do so by a small change to their relative prices.
33. In previous decisions, the Commission considered that, since private hospitals only offer facilities and non-specialist support, and since these appear largely fungible across specialties, private hospitals tend to compete across all surgical specialties. In other words, the Commission has tended to define general, as opposed to specialty-specific, surgical markets. Short-stay (less than 23 hours) services were distinguished from in-patient services, primarily because in-patient services are more complex and need additional resources.
34. Therefore, the product market definitions previously adopted by the Commission were the provision of:
 - private short-stay hospital facilities and related non-specialist services for elective secondary surgery; and, separately
 - private in-patient hospital facilities and related non-specialist services for elective secondary surgery.¹²
35. However, the Applicants and industry participants advised that the provision of orthopaedic surgery, which comprises a large element of the work at QE Health, requires more specialised instrumentation than do other surgical specialities. The cost of equipping a standard theatre to perform orthopaedic surgery can be significant, depending on the types of orthopaedics procedures to be performed. Further, given the specialised nature of the equipment, any investment in equipping a theatre for complex orthopaedic work would be largely sunk.
36. In the Auckland Surgical Decision, the Commission specifically examined whether orthopaedics fell into a discrete product market. In that case, the Commission did not consider the cost of equipping a theatre for orthopaedic procedures (estimated to be in the order of \$400,000) was prohibitive and, as such, general surgical markets were appropriate.
37. In this case, Southern Cross advised that, at present, it can only perform a small volume of minor orthopaedic surgery at its Rotorua facility. This is because it does not have the necessary instruments and facilities and because all but one of the orthopaedic surgeons in Rotorua are extremely reluctant to switch any of their existing surgical 'lists' from QE Health to Southern Cross Rotorua.¹³ It estimated that it would cost approximately \$[] to equip its Rotorua hospital

¹² For example, see the Oxford and Auckland Surgical Decisions.

¹³ Dr Ross Bohm is the one orthopaedic surgeon who routinely operates at Southern Cross Rotorua.

with the necessary instruments to perform a full range of orthopaedic surgery. In addition, Southern Cross Rotorua would also need to upgrade its existing sterilisation facilities, as well as carry out further building work, which, it estimated, would cost an additional \$[].

38. Southern Cross advised that it has on several occasions approached Rotorua's other orthopaedic surgeons and inquired as to whether they would consider working at Southern Cross Rotorua. On each occasion its invitations have been declined. This claim was verified by all the orthopaedic surgeons canvassed by the Commission. Southern Cross submitted that it cannot offer the facilities for major orthopaedic work without a commitment from local orthopaedic surgeons.
39. While this evidence could be consistent with a speciality-specific product market, it is also consistent with the existence of differentiated general surgical product markets in which Southern Cross Rotorua and QE Health both compete. This would accommodate the apparent fungibility of facilities and services across some specialties, while recognising the unique requirements and characteristics of other specialties. Nevertheless, the exact boundaries of differentiated product markets are often difficult to delineate precisely. For instance, it could be argued that QE Health tends to specialise in orthopaedic work while Southern Cross Rotorua offers the majority of other surgical services.
40. Overall, given the facts of this case, the Commission considers that an appropriate starting point for its analysis of the competitive effects of the proposed joint venture is the provision of:
 - private short-stay hospital facilities and related non-specialist services for elective secondary surgery; and, separately
 - private in-patient hospital facilities and related non-specialist services for elective secondary surgery.

Geographic Market

41. 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.
42. In other relevant Decisions, geographic markets have been based on local regions because of a reluctance for short-stay patients to travel great distances for routine elective surgery. However, the geographic boundaries of the market may expand with the complexity of the procedure.
43. Southern Cross Rotorua and QE Health operate hospitals in Rotorua and the majority of patients (and associated staff) reside in the Rotorua region. The Applicants submitted that the geographic dimension of the relevant market(s) should be wider than Rotorua because of the existence of significant inter-regional patients flows and out-of town referrals between Rotorua and Hamilton and, separately, between Rotorua and Tauranga.
44. The Applicants submitted that, at present, referrals out of Rotorua are primarily for complex procedures that Southern Cross Rotorua and QE Health do not currently perform. The Applicants consider that these movements indicate that there are no barriers to out-of-region referrals and such referrals would be possible for every type of procedure. The Commission notes that it is likely that

some of these complex procedures (such as cardiac surgery) could be considered secondary elective procedures.

45. Southern Cross and QE Health maintain it is difficult to accurately identify the origins of their patients. QE Health estimated that approximately []% of its privately-funded patients originate from beyond Rotorua City, although the Commission notes that some of these patients would be considered to be from the wider Rotorua hinterland. Southern Cross estimated that between []% of its patients originated from beyond Rotorua City.
46. Most industry participants, for example QE Health's Patient Association, advised the Commission that the majority of surgical patients treated at either Southern Cross Rotorua or QE Health reside in the Rotorua region although there are some patients that come from further afield. Dr Preston Moorcroft, orthopaedic surgeon, advised that most of his patients come from Rotorua but that he has a clinic in Kawarau, and this results in patients coming from a wider area.
47. The Commission also sought information about which hospitals the Applicants have regard to when setting their fees. Southern Cross and QE Health noted that it is common to benchmark their fees against other 'provincial' hospitals rather than the hospitals in the neighbouring cities of Hamilton and Tauranga. However, a Southern Cross internal document notes that [

] ¹⁴ The Commission notes that the new hospital in Tauranga is a Southern Cross joint venture.

48. Overall, the Commission considers that there may be some constraint offered by hospitals outside the Rotorua region but it is likely that this occurs only at the margins. Accordingly, the Commission considers the relevant geographic market to be the Rotorua region.

Public elective surgery and DHB contracts

Product market

49. District Health Boards (DHBs) are responsible for the provision of public elective surgery in New Zealand. The relevant DHB for the Rotorua region is the Lakes DHB.
50. The Commission previously considered that private elective surgery is distinct from public elective surgery.¹⁵ In this particular case, the Commission notes that a high percentage of all the services provided by QE Health, approximately [], is contractual work on behalf of the surrounding DHBs and in particular the Waikato DHB.¹⁶ These contracts are for procedures that would ordinarily be performed in public hospitals but, for various reasons, the DHBs do not have the necessary resources at the present time to provide them. Contracts from the Waikato DHB account for the majority of DHB contracts concerning Southern Cross Rotorua and QE Health.

¹⁴ [

¹⁵ For example, see the Oxford and Auckland Surgical Decisions.

¹⁶ [

51. For example, the Waikato DHB currently contracts QE Health to perform a specific number of orthopaedic operations on patients from its region. The primary reason for this is that the Waikato DHB is in the process of redeveloping its main hospital in Hamilton and it does not have the physical space to undertake these procedures. It advised that it will no longer need to contract these operations to an external party once these redevelopments have been completed. QE Health, Southern Cross and Braemar Hospital Limited (in Hamilton) have all recently tendered for these contracts.¹⁷ However, the Commission notes that Southern Cross tendered on behalf of its Hamilton hospital and not its Rotorua hospital.
52. Southern Cross also has an existing contract with the Waikato DHB. This contract is for cataract surgery, and it performs this work at both its Hamilton and Rotorua hospitals.
53. The nature of these DHB contracts would suggest they are in a distinct product market. These contracts include the provision of both short-stay and in-patient procedures. Accordingly, it is appropriate for the Commission to consider DHB contracts separately in its competition analysis.

Geographic market

54. Patients appear willing to travel further for public elective surgery if doing so will reduce the waiting times. Hence, unlike private surgery, the geographic market for DHB contracts is likely to be much wider than the Rotorua region (or even the local Lakes DHB catchment area) and would include the neighbouring Waikato DHB catchment area. For example, QE Health only competes with private hospitals in Hamilton for contracts from the Waikato DHB. QE Health then performs the specified surgery on patients residing in the Waikato DHB catchment area.
55. Accordingly, in this particular case, the relevant geographic market in respect of DHB contracts should include the Waikato and Lakes DHB catchment areas.

Conclusions on Market Definition

56. As a starting point for its competition analysis, the Commission in this case will consider the markets for:
 - the provision of private short-stay hospital facilities and related non-specialist services for non-DHB elective secondary surgery in the Rotorua region (the short-stay market);
 - the provision of private in-patient hospital facilities and related non-specialist services for non-DHB elective secondary surgery in the Rotorua region (the in-patient market); and
 - the provision of hospital facilities and related non-specialist services for DHB contracts in the Waikato and Lakes DHB catchment areas (the DHB contracts market).

¹⁷ Since 2003, all three parties have been awarded contracts by the Waikato DHB, although the size of these contracts has varied between the parties.

COUNTERFACTUAL AND FACTUAL

57. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgment considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (the counterfactual).¹⁸ The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

58. The Applicants submitted that the proposed joint venture would enable them to combine their resources so that they can refurbish and upgrade the Southern Cross Rotorua hospital.
59. Currently, QE Health leases theatre space with a local GP clinic, Lakes Primecare Limited, where local surgeons perform a small number of short-stay operations for QE Health. QE Health advised the Commission that under the proposed joint venture it will terminate the lease as it would be surplus to requirements.
60. In this scenario, the combined entity would be the only private surgical facility operating in the Rotorua region.

Counterfactual

Southern Cross' view on the counterfactual

61. Southern Cross submitted that its Rotorua hospital is currently loss-making, underutilised, and requires significant refurbishment and upgrading. Further, it stated that it has long been accepted that the status quo in Rotorua is unsustainable and that it, QE Health, or both, will exit the relevant markets if there is no change to the current situation. Nevertheless, it did not formally submit a failing firm argument to the Commission.
62. Southern Cross advised that, in its view, both private hospitals in Rotorua are only marginally economic and both are in need of significant upgrade. Further, given the small population base in the Rotorua area, Southern Cross considers that there is only demand for one surgical facility in Rotorua in the medium-to-long-term.
63. [
-].¹⁹
64. In addition, Southern Cross stated that if it did not have the ability to cross-subsidise with its other hospitals, it would have closed its Rotorua hospital some time ago. It has previously closed several of its provincial hospitals when they have failed to make reasonable economic returns. These hospitals were Southern Cross Wanganui, in July 2000, and Southern Cross Napier, in April 2001. Southern Cross noted that, [

¹⁸ *Air New Zealand & Qantas Airways Ltd v Commerce Commission (No 6)*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.

¹⁹ []

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65. Nevertheless, Southern Cross advised that it has not determined what it will do if the proposed joint venture does not proceed, but considered that, absent the proposed joint venture, its possible options could include:[

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QE Health's view on the counterfactual

66. As with Southern Cross, QE Health did not submit a failing firm argument to the Commission. However, QE Health noted that there has not been any significant investment in its facilities since the early 1980s and that its hospital facilities require upgrading but that the current building is not suitable for an extensive refurbishment. For example, an internal board report notes that:[

] ²⁰

67. Further, QE Health advised that, [

]. In this respect, it can not justify the significant capital cost of a new facility on its own.

68. QE Health currently has a [] lease for its existing site with PLHL. This lease commenced in 1993 [

]

69. The lease made provisions for [

] Continued disagreement between QE Health and PLHL resulted in an external arbitration in late 2005. [

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70. [

] ²¹

[_____]

71. [

²⁰ []
²¹ []

]. []

-]
72. [
-]
73. [
-].²²
- [
-]
74. QE Health considers its time on the present site is limited [

]

Industry participants' views of the Counterfactual

75. Several industry participants canvassed by the Commission considered that Rotorua was not large enough to support two private hospital facilities and that it was likely in the counterfactual that there would only be one private hospital in Rotorua. For example, [] advised that things have reached a point where the two hospitals have no choice but to merge, due to the increasing cost of delivering healthcare and the small number of patients in Rotorua. [] stated that the Commission's determination would not actually matter because, one way or the other, in three years' time there would only be one private hospital in Rotorua. This is because if the Commission granted clearance, the rationalisation of private hospitals would happen by design and planning, and if it declined to grant clearance then QE Health would simply close its doors.

The Commission's assessment of the Counterfactual

76. Southern Cross and QE Health have both submitted that the status quo is not feasible and both require significant investment in facilities to continue to provide the existing levels of service. In this respect, each has investigated a number of different development options for their respective surgical businesses but neither has considered it economic to undertake the necessary investment.
77. Although Southern Cross and QE Health consider that their businesses are unsustainable in the long run, based on their present form, neither has submitted

²² [

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that their existing operations are not currently viable. While both Southern Cross and QE Health have, in the past, been operating with []

- 78. However, the Commission considers that without any investment, it is likely that the existing levels of service and the competitive constraint offered by either Southern Cross or by QE Health would not continue in the counterfactual.
- 79. QE Health provided the Commission with its financial accounts for the past five years. The Commission analysed these accounts with consideration to both the spa and rehabilitation facilities and to the surgical facilities.²³ Both businesses operate from the same facility, although only the surgical business forms part of the proposed joint venture.
- 80. The Commission has made the following observations []

]

- 81. []

]

- 82. []

]

- 83. Taking all these factors into account, the Commission considers that, while neither private hospital in Rotorua is a failing firm, it is likely that that one of these hospitals [] would not continue to operate in the short term. The likely exit of one hospital, possibly in the next 12 months, would allow the other hospital to absorb its customers, staff and surgeons.

²³ QE Health advised the Commission that it does not split out its overheads between the two different operations. The Commission therefore estimated overheads for the surgical and for the spa and rehabilitation businesses based on their proportion of total revenue.

Therefore, the Commission considers that, either with or without the proposed acquisition, there would likely be little difference in the level of competition in the relevant markets.

84. Nevertheless, the Commission acknowledges there is a possibility that both private hospitals in Rotorua will still be in existence within the Commission's two year timeframe for analysis. For completeness, the Commission has gone on to consider whether the present level of competition would be substantially lessened (or likely lessened) by the proposed acquisition.

COMPETITION ANALYSIS

Private elective surgery in the Short-Stay and In-patient Markets

Extent of actual competition between Southern Cross Rotorua and QE Health

85. Tables 1 and 2 indicate Southern Cross Rotorua's and QE Health's respective numbers for private short-stay patients and in-patients for the past two years.

Table 1: Patient Numbers in the Short-stay Market

Facility	2005-2006 year		2006-2007 year	
	Patients	Market Share	Patients	Market Share
Southern Cross	[]	[]	[]	[]
QE Health	[]	[]	[]	[]
Total	[]	100%	[]	100%

Source: Southern Cross, QE Health. Excludes DHB patients

Table 2: Patient Numbers in the In-Patient Market

Facility	2005-2006 year		2006-2007 year	
	Patients	Market Share	Patients	Market Share
Southern Cross	[]	[]	[]	[]
QE Health	[]	[]	[]	[]
Total	[]	100%	[]	100%

Source: Southern Cross, QE Health. Excludes DHB patients.

86. The proposed joint venture would result in the Applicants being the sole suppliers of private elective surgical facilities in Rotorua. However, there is not, and has not been for a considerable period of time, a great deal of overlap between the surgical specialities performed at Southern Cross Rotorua and at QE Health.
87. Table 3 shows the degree of existing overlap between the surgical specialties offered by Southern Cross Rotorua and QE Health for both short-stay patients and in-patients. There is minimal overlap in the provision of orthopaedic surgery and urological surgery.²⁴ The Applicants argued that the small overlap

²⁴ Given the minimal number of urology procedures performed in both the short-stay and in-patient markets, the effect on urology procedures is likely to be *de minimis*. In this respect, the Commission does not intend to specifically consider this type of surgery further.

between specialties demonstrates that Southern Cross Rotorua and QE Health do not directly compete.

Table 3: Services by Speciality at Southern Cross Rotorua and QE Health for the 2006/2007 year

Facility	Southern Cross				QE Health			
	Short	In	Total	Total %	Short	In	Total	Total %
Orthopaedic	[]	[]	[]	[]	[]	[]	[]	[]
Urology	[]	[]	[]	[]	[]	[]	[]	[]
Endoscopy	[]	[]	[]	[]	-	-	-	-
General	[]	[]	[]	[]	-	-	-	-
Gynaecology	[]	[]	[]	[]	-	-	-	-
Ophthalmology	[]	[]	[]	[]	-	-	-	-
Otolaryngology	[]	[]	[]	[]	-	-	-	-
All other surgery	[]	[]	[]	[]	[]	-	[]	[]
Total at each facility	[]	[]	[]	100%	[]	[]	[]	100%

Source: Southern Cross, QE Health []

88. The Commission assessed the extent to which Southern Cross Rotorua could expand its current operations to perform a greater range of orthopaedic procedures.
89. Southern Cross advised that its facilities in Rotorua have been significantly underutilised for some time. Table 5 shows the available and utilised capacity for Southern Cross Rotorua's two theatres. These figures suggest that it has the capacity to perform more operations.

Table 5: Available and Utilised Capacity at Southern Cross Rotorua

Southern Cross	2003	2004	2005	2006
Theatre hours used	[]	[]	[]	[]
Theatre hours available	[]	[]	[]	[]
Utilised capacity	[]	[]	[]	[]

Source: Southern Cross. Includes DHB procedures.

90. Southern Cross advised that it performs [] different orthopaedic procedures across all its hospitals around New Zealand but, at present, it can only perform [] of these procedures in Rotorua.
- []
91. Dr Ross Bohm performs most of these more routine orthopaedic procedures. He advised that the primary reason why he uses Southern Cross is []

] He now shares his availability between QE Health and Southern Cross.

92. [] advised that Southern Cross Rotorua does not have the staffing expertise in orthopaedics and he noted that, in many respects, it was because the surgeons have only used QE Health for this type of surgery for a considerable period of time. As a result, Southern Cross Rotorua has not been able to build up the necessary expertise to attract the surgeons.
93. Overall, it appears that at present patients have no choice for the majority of orthopaedic surgery as all but one of the five local orthopaedic surgeons only use QE Health.
94. The Commission also assessed the extent to which QE Health could expand its current operations to perform types of surgery other than orthopaedics or urology.
95. QE Health advised that it is currently operating at close to full capacity. Table 6 shows the available and utilised capacity for QE Health's single operating theatre.

Table 6: Available and Utilised Capacity at QE Health

QE Health	2003	2004	2005	2006
Theatre hours used	[]	[]	[]	[]
Theatre hours available	[]	[]	[]	[]
Utilised capacity	[]	[]	[]	[]

Source: QE Health. Includes DHB procedures.

96. QE Health noted that 80-85% utilisation is considered to be full capacity because the 'downtime' from different patients being moved in and out of the operating theatre is not charged to a particular patient. While its average capacity figures suggest that there is some spare capacity, the Commission notes that QE Health currently only has [

] QE Health advised that, due to its capacity constraints, it does not have the ability to attract surgeons operating at Southern Cross to use its facilities.

Extent of potential competition between the Applicants

97. Southern Cross advised that its main barrier to expanding in such a way that it constrains QE Health, either in the short-stay or in-patient markets, is its inability to attract surgeons, particularly to perform orthopaedic surgery.
98. Southern Cross considers that it has little chance of attracting surgeons or the patient referrals to its Rotorua facility due to the apparent strong preference for local orthopaedic surgeons to work at QE Health. Southern Cross advised that, in its view, orthopaedic surgeons in Rotorua were completely loyal to QE Health as QE hospital has historically been considered a centre of excellence for orthopaedic surgery. Southern Cross has approached local orthopaedic surgeons on several occasions with a view to enticing them away from QE Health, but all such attempts have proved unsuccessful. This suggests fairly high reputational barriers to Southern Cross' expansion.

99. As noted above in the market definition section, Southern Cross submitted it could not justify making the necessary investment in its facilities to attract the local orthopaedic surgeons, without the certainty of surgeon referrals, []].
100. QE Health advised that Southern Cross has not been able to secure orthopaedic work because it provides superior rehabilitation facilities for orthopaedic patients. For example, it considers that its patients recover better following orthopaedic surgery than anywhere else. This in turn directly enhances the reputation of the surgeon, which strengthens surgeons' loyalty to QE Health.
101. The orthopaedic surgeons canvassed by the Commission all confirmed the views expressed by the Applicants. For example, [] described patient care at QE Health as "second to none." Other orthopaedic surgeons in Rotorua spoken to by the Commission endorsed this view.

Conclusion on Extent of Actual and Potential Competition between the Applicants

102. The proposed joint venture would reduce the number of private hospitals in both the short-stay and in-patient markets from two to one, assuming that both hospitals continue to operate in the counterfactual. However, the Commission notes that there is only a limited amount of overlap between the procedures that can be performed using the facilities currently offered by QE Health and those offered by Southern Cross Rotorua.
103. Further, QE Health is currently operating close to full capacity and has had to resort to using other surgical facilities in Rotorua when it can. Southern Cross has excess capacity but does not have all the facilities in place to perform the more complex orthopaedic surgery that is performed at QE Health. Further, the likelihood of Southern Cross Rotorua acquiring the necessary facilities and associated personal to carry out this type of work is minimal. The Commission notes that the local orthopaedic surgeons in Rotorua have, for some considerable period of time, shown a strong preference to use QE Health's facilities over those of Southern Cross Rotorua. The Commission considers that Southern Cross, on its own, would be unlikely to change this situation.²⁵
104. Overall, the Commission considers that the evidence suggests that the Applicants exert only a limited competitive constraint on each other, either through the actual level of competition between them or through their potential to compete.

Barriers to entry

105. The Applicants recognised that there are significant barriers to entry in these types of markets, particularly in respect to in-patient facilities. This is consistent with other investigations conducted by the Commission.²⁶ In this particular case, the Applicants as well as the Commission were not able to identify any potential new entrants.

²⁵ Several of the orthopaedic surgeons are approaching retirement age []].

²⁶ For example, see the Oxford Decision.

Countervailing Buyer Power

106. There are four main providers of funding for the private hospitals in Rotorua: insurance companies, the Accident Compensation Corporation (ACC), DHBs and private patients. Table 7 shows the proportion of revenue that each hospital receives from each ‘customer’ for the 2006/2007 year.

Table 7: Funding provided to Rotorua hospitals by various funders

Revenue Source	Insurance	ACC	DHB	Private Patients	Total
Southern Cross	[]	[]	[]	[]	100%
QE Health	[]	[]	[]	[]	100%
Combined Entity	[]	[]	[]	[]	100%

Source: Applicants

107. The Commission’s previous Decisions in respect of private hospitals have noted that the ACC and insurance companies have a degree of countervailing buyer power (although the degree varies between each insurance provider). Both these types of customer are national purchasers and, with this, they have an ability to influence prices. For example, ACC has a set national price for each elective surgical procedure it funds and it does not allow a private hospital to charge an ACC patient any additional fee for the specified procedure. All industry participants advised the Commission that the ACC has a strong degree of countervailing power in respect of private elective surgery. However, such countervailing power is unlikely to exist for private patients.

108. Table 7 indicates that only a small proportion of each hospital’s revenue is from private patients. For example, [

]

109. Overall, the Commission considers that in this case the ACC and insurance providers do have a degree of countervailing buyer power in the counterfactual and will continue to possess this in the factual, primarily due to ability to coordinate prices at a national level.²⁷ However, private patients are unlikely to possess any countervailing buyer power, either in the factual or the counterfactual.

Conclusions on the Short-Stay and In-Patient Markets

110. The Commission considers that the evidence above suggests that:

- while neither of the private hospitals in Rotorua is a failing firm, one hospital, [] may exit the market [], possibly in the next 12 months;
- QE Health and Southern Cross Rotorua exert only a limited competitive constraint on each other of the relevant markets, both in respect to the current level of competition between them and in their potential to compete; and

²⁷ As noted previously, Southern Cross is associated with largest health insurance provider in the country, Southern Cross Medical Care Society. See Footnote 5.

- the main customers of the combined entity, notably the ACC and insurance companies, are likely to have a degree of countervailing power.
111. Therefore, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in either the short-stay market or the in-patient market.

The DHB Contracts Market

112. The market for DHB contracts has a wider geographic scope than that for private elective surgery. For example, QE Health and Southern Cross' hospital in Hamilton compete for DHB contracts with other private hospitals, such as Braemar Hospital Limited in Hamilton, in the Waikato and Lakes DHB catchment areas. Waikato DHB did not have any concerns that the proposed joint venture would substantially lessen competition because it would still have a choice of provider and, due to budgetary constraints, it considered that it has a degree of countervailing buyer power.
113. Further, the Commission considers that the same conclusions in respect to the short-stay and in-patients markets also apply to the DHB Contracts market. Accordingly, the Commission is satisfied that the proposed joint venture will not have, or would not be likely to have, the effect of substantially lessening competition for DHB contracts in the Waikato and Lakes DHB catchment areas.

OVERALL CONCLUSION

114. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the markets for:
- the provision of private short-stay hospital facilities and related non-specialist services for non-DHB elective secondary surgery in the Rotorua region (the short-stay market);
 - the provision of private in-patient hospital facilities and related non-specialist services for non-DHB elective secondary surgery in the Rotorua region (the in-patient market); and
 - the provision of hospital facilities and related non-specialist services for DHB contracts in the Waikato and Lakes DHB catchment areas (the DHB contracts market).
115. In the factual scenario, the combined entity would be the only private hospital in the Rotorua region. The Commission considers that in the counterfactual, while neither QE Health nor Southern Cross Rotorua are failing firms, it is likely that one of these hospitals would not continue to operate in the short term. The likely exit of one of these hospitals would mean that there would be little difference in the level of competition between the factual and counterfactual scenarios.
116. For completeness, the Commission considers that, even if both private hospitals in Rotorua continued to be in existence within the Commission's timeframe for analysis, they exert only a limited competitive constraint on each other, both in respect of the current level of competition between them and in their potential to compete, in all the relevant markets.

117. Therefore, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the affected markets.

DETERMINATION ON NOTICE OF CLEARANCE

118. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Southern Cross Health Trust and QE Hospital Limited, or companies owned by them, of shares in JV Co (a new company to be formed) and for the acquisition by JV Co of the private surgical hospital businesses of Southern Cross Hospital Rotorua and QE Health Rotorua (including shares held in QE Orthopaedics Limited by QE Hospital Limited).

Dated this 28th day of September 2007

Peter JM Taylor
Division Chair
Commerce Commission