

COMMERCE ACT 1986: BUSINESS ACQUISITION**SECTION 66: NOTICE SEEKING CLEARANCE**

Wednesday 27 August

The Registrar
Mergers and Authorisations
Commerce Commission
PO Box 2351
WELLINGTON

Pursuant to section 66(1) of the Commerce Act 1986, notice is hereby given seeking clearance of a proposed business acquisition.

EXECUTIVE SUMMARY

- 1 The Applicant, Connor Healthcare Limited (*Connor*) has made a takeover offer to purchase all of the shares in Acurity Health Group Limited (*Acurity*) it does not already own (the *Acquisition*). If the Acquisition settles, Acurity will be wholly owned by Connor, and Connor will be 75% owned by Austron Limited (*Austron*) and 25% owned by Evolution Healthcare (NZ) Pty Ltd (*Evolution*), which is in turn 100% owned by Evolution Healthcare Partners Pty Ltd as trustee for the EHPO Trust.
- 2 Evolution and Acurity are each members of a group of companies (referred to as the *Evolution Group* and the *Acurity Group* respectively) which own private hospitals that provide private hospital facilities and related non-specialist services in the greater Wellington region.
- 3 The Applicant's view is that the competitive environment will remain robust following the transaction with:
 - 3.1 the continuing presence of Southern Cross Hospital as a formidable competitor able to leverage a unique advantage through its vertical integration into health insurance and its not-for-profit status;
 - 3.2 strong countervailing market power from private insurers and Accident Compensation Corporation (*ACC*) which is intensifying as these parties strive to reduce costs as a means of maintaining affordable premiums;
 - 3.3 low barriers to entry and likely entry if the merged entity attempted to exercise market power;
 - 3.4 an overall market context of excess capacity meaning there will continue to be a strong incentive to price (low) to increase utilisation of facilities;
 - 3.5 the absence of mechanisms to "lock in" specialists and the ability of specialists to be mobile and make their services available at any venue combined with the referral discretion vesting in GPs who have the ability to direct patients to a preferred specialist operating out of the hospital of their choice; and
 - 3.6 the high and ever increasing quality baseline service available in public hospitals, as well as reduced wait times for elective surgery.

- 4 The Acquisition will not result in a substantial lessening of competition. This conclusion is supported by NERA in a supplementary report which we have submitted together with this application.

PART 1: TRANSACTION DETAILS

The person giving notice

- 1 This notice is given by Connor Healthcare Limited.

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151 Queen Street
Auckland 1010
New Zealand

Postal address: Connor Healthcare Limited
C/- Mayne Wetherell
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- 2 All correspondence and notices in respect of this application should be directed in the first instance to:

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Phone: (04) 498 6313

Laura Ashworth, Solicitor, Chapman Tripp
Email: laura.ashworth@chapmantripp.com
Phone: (04) 498 6338

Other merger party

- 3 The other merger party is Acurity Health Group Limited.

Registered office: 30 Florence Street, Newtown
Wellington 6021
New Zealand

Postal address: Private Bag 7909
Wellington 6242
New Zealand

Physical address: 30 Florence Street, Newtown
Wellington 6021
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Telephone: (04) 920 0131

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Website: www.acurity.co.nz

- 4 All correspondence and notices in respect of this application should be directed in the first instance to:

Ian England, Chief Executive Officer
 Email: ian.England@acurity.co.nz
 Phone: (04) 920 0131

The merger parties

- 5 We have provided organisational structure diagrams in **Appendix A**.

Connor

- 6 Connor Healthcare Limited (*Connor*), which has an 11.7% shareholding in Acurity, is presently wholly owned by Evolution Healthcare (NZ) Pty Ltd. Connor is the offeror under the takeover offer for all of the shares in Acurity. If that takeover offer is successful, Evolution will own 25% of the shares in Connor.

- 7 Evolution is part of the Evolution Group, which has a 100% shareholding in **Boulcott Hospital Limited** (Hutt Valley) — through a limited partnership (Evolution Healthcare (NZ) LP).

Acurity

- 8 Acurity is one of New Zealand's largest providers of private surgical healthcare services, with the following interests:

- 8.1 Wholly owns, and operates the following private hospitals:

- (a) **Wakefield Hospital** (Wellington);
- (b) **Bowen Hospital** (Wellington); and
- (c) Royston Hospital (Hastings).

- 8.2 Is an investor in part-owned private hospitals:

- (d) 60% shareholding in Grace Hospital (Tauranga);
- (e) 30% shareholding in Endoscopy Auckland (Auckland); and
- (f) 30% shareholding in Laparoscopy Auckland (Auckland).¹

- 9 Acurity is listed on the Main Board operated by NZX Limited.

- 10 Acurity has approximately 800 shareholders, however the main shareholders in Acurity are as follows:

- 10.1 "Austron" holdings:

- (a) Austron Limited (*Austron*): 50.01%. Austron is owned 41.23% by Royston Hospital Trust Board and 58.77% by Medusa Limited.

¹ Note that Acurity's shareholdings in Endoscopy Auckland and Laparoscopy Auckland will increase to 40% in September 2014, via the exercise of a call option.

- (b) Royston Hospital Trust Board (*Royston*): 4.48% (separately from its holding through Austron).
- (c) Medusa Limited (*Medusa*): 4.48% (separately from its holding through Austron).

10.2 Connor Healthcare Limited (currently wholly owned by Evolution Healthcare (NZ) Pty Ltd): 11.70%.

10.3 AMP Capital Investors (New Zealand) Limited: 5.87%

The Acquisition

- 11 Connor seeks clearance to acquire all of the shares in Acurity it does not already own (including those held by Austron, Royston and Medusa). Connor is seeking to acquire those shares through a takeover offer regulated by the Takeovers Code. If that offer is successful, contemporaneously with settlement of the takeover offer, Austron will subscribe for 75% of the shares in Connor.
- 12 The takeover offer is conditional on the Commission having given clearance under the Commerce Act 1986 to the Acquisition (the *Clearance Condition*).
- 13 As a takeover of a publicly-listed company, the latest date by which Connor can declare its takeover offer unconditional (including as to receiving clearance under the Commerce Act) is regulated by the Takeovers Code. That latest date is 21 December 2014. However, in accordance with the rules of the Takeovers Code, current shareholders of Acurity only have until 21 November 2014 (the *Closing Date*) to decide whether or not to accept the takeover offer.
- 14 Against that background, Connor requests that the Commission endeavours to make its decision on this application on or before 5 November 2014 to give shareholders certainty as to whether or not the Clearance Condition is satisfied and to give shareholders time (two weeks) to decide whether or they wish to accept the offer. If the transaction settles:
- 14.1 Acurity will be wholly owned by Connor, and Connor will be 75% owned by Austron and 25% owned by Evolution; and
 - 14.2 neither Austron nor Acurity will have any ownership interest in Evolution or Boulcott.
- 15 Following the Acquisition, Evolution will be entitled to appoint two out of six directors to the board of Connor. Austron will be entitled to appoint the balance (four out of six). A majority of directors will be able to pass resolutions of the Connor board, except if the decision involves a "Restricted Action" (as defined the draft constitution for Connor, provided to the Commission on 12 August 2014), in which case both Evolution and Austron must consent to the action.
- 16 We have provided organisational charts showing the structure of the ownership and control of Acurity and Boulcott both pre-offer and post-offer in **Appendix B**.

Commercial rationale

- 17 The Acquisition provides an opportunity for both Evolution and Austron to:
- 17.1 privatise the Acurity Group, which has the benefits of:

- (a) eliminating public company listing costs;
- (b) [

]; and

- (c) increasing their ability to raise sufficient capital in the event of a catastrophic event so as to meet the first 5% of an asset value insurance claim (a new requirement in relation to catastrophic event insurance cover). Acurity has a high value asset portfolio across the North Island, creating a potentially significant self-insurance obligation;

17.2 utilise Evolution's private hospital management expertise and experience to benefit the New Zealand private healthcare market, [

];

17.3 leverage Evolution's buyer power to achieve cost efficiencies from third party suppliers, [

]; and

17.4 increase their existing stake in the Acurity business, [

].

18 From Evolution's unique perspective, as a specialist investor in the private hospital sector, the Acquisition provides an opportunity to grow its exposure to the New Zealand market. Acurity's portfolio includes a range of assets, only two of which (Bowen Hospital and Wakefield Hospital) are relevant to the issues canvassed in this application. Put another way, Bowen Hospital and Wakefield Hospital together represent [] of the total value of the Acurity business based on earnings. The fact that Evolution already owns Boulcott Hospital is incidental and not a driver of the transaction.

Takeover notice

19 A copy of the takeover offer is provided at **Appendix C**.

PART 2: THE INDUSTRY**Goods or services supplied by the merger parties*****Evolution***

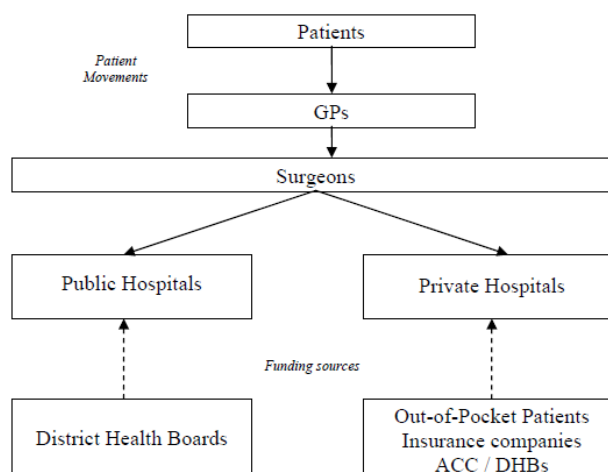
- 20 Boulcott Hospital (owned by the Evolution Group) is located in the Hutt Valley and provides private hospital facilities and related non-specialist services.
- 21 Boulcott Hospital's facilities include:
- 21.1 three operating theatres;
 - 21.2 a fully equipped endoscopy suite, with its own recovery area;
 - 21.3 a 29 bed inpatient suite;
 - 21.4 a 7 bed day surgery suite; and
 - 21.5 a Specialist Centre accommodating over 40 consultants and visiting specialists.
- 22 Boulcott Hospital provides related non-specialist services, including
- 22.1 nursing;
 - 22.2 physiotherapy;
 - 22.3 access to radiological services;
 - 22.4 catering;
 - 22.5 administration; and
 - 22.6 cleaning.
- 23 A number of specialist services are currently undertaken at Boulcott Hospital. These are set out in **Appendix D**.

Acurity

- 24 Wakefield Hospital and Bowen Hospital (both owned by the Acurity Group) are both located in central Wellington and provide private hospital facilities and related non-specialist services.
- 25 Wakefield Hospital's facilities include:
- 25.1 Intensive Care Unit and High Dependency Unit;
 - 25.2 Wakefield Specialist Medical Centre;
 - 25.3 Apartments (accommodation for family and visitors);
 - 25.4 Cafeteria;
 - 25.5 Outpatient clinics;

- 25.6 Diagnostic facilities;
 - 25.7 Cardiac catheterisation laboratory;
 - 25.8 seven operating theatres;
 - 25.9 68 patient beds, including five intensive care beds and three endoscopy beds.
- 26 Bowen Hospital's facilities include:
- 26.1 Bowen Specialist Centre;
 - 26.2 Gastroenterology Unit;
 - 26.3 three operating theatres;
 - 26.4 seven-bed recovery unit;
 - 26.5 30 patient beds; and
 - 26.6 12 bed day stay unit.
- 27 A number of specialist services are currently undertaken at Wakefield Hospital. These are set out in **Appendix E**.
- 28 A number of specialist services are currently undertaken at Bowen Hospital. These are set out in **Appendix F**.
- 29 Wakefield Hospital and Bowen Hospital both provide related non-specialist services, including:
- 29.1 nursing;
 - 29.2 physiotherapy;
 - 29.3 access to radiological services;
 - 29.4 catering;
 - 29.5 administration; and
 - 29.6 cleaning.
- Industry affected by the Acquisition**
- 30 The industry affected by the Acquisition is the private healthcare industry (including hospitals, surgeons and healthcare insurance providers) in the greater Wellington region.
- 31 The Commission has, in the past, illustrated the main industry participants in healthcare as follows:²

² Commerce Commission Decision No. 729, page 4.



- 32 We note that GPs also refer patients directly to public hospitals, rather than to specific surgeons.
- 33 As the Commission pointed out in Decision No. 729, the industry is characterised by:³

... a relatively complex set of relationships leading to a particular patient being operated on by a particular surgeon at a particular hospital.

- 34 The Commission explained a number of the dynamics:⁴

... 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.

20. When a surgeon recommends private elective surgery, the decision as to which private hospital will be used will be heavily influenced by the hospital (or hospitals) where that surgeon normally operates. Typically, patients will follow their surgeon's recommendation about where the surgery is to be performed.

21. Factors that influence surgeons' choice of hospital include:

- whether or not they have a shareholding in a facility (as is the case with Aorangi);
- the ability to schedule surgery at a time convenient to the surgeon at a particular private hospital; and
- the particular private hospital's charges for the provision of the necessary facilities.

22. Private hospitals provide facilities, namely, patient rooms and medical equipment, as well as the related services such as administrative 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 rationing is imposed. 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.

³ Commerce Commission Decision No. 729, page 4.

⁴ Commerce Commission Decision No. 729, pages 4–5.

- 35 An important new layer to add to those dynamics is the significant and increasing effect of Southern Cross' Affiliated Provider Scheme (APS), membership of which in many cases determines whether a hospital can viably offer a particular procedure in the first instance.
- 36 Many factors can affect the aggregate demand for private surgical healthcare services, including:
- 36.1 the wider demand for surgical healthcare services (which can be heavily influenced by public policy and the population makeup);
 - 36.2 the performance of the public healthcare system; and
 - 36.3 economic conditions which influence demand for elective surgery.
- 37 The key factors which influence demand at any individual hospital include:
- 37.1 surgeons — attracting and retaining the most sought after specialists with large and growing practices – relative to patient catchment and specialist residential address and public hospital appointments;
 - 37.2 location;
 - 37.3 membership (or lack thereof) in Southern Cross' APS for a particular procedure; and
 - 37.4 quality of facilities and service, including post-operative care.

Industry trends

- 38 Recent trends in the healthcare industry include:
- 38.1 intense focus from insurers on seeking a reduction in procedure pricing – this is exemplified by the rapid escalation of Southern Cross' APS. Southern Cross is a powerful player through its APS, under which it fixes a procedure price with a lead provider (usually the private hospital). That price covers the cost of hospital services as well as the surgeon and anaesthetist fees and there is very little scope for private hospitals to negotiate procedure prices with Southern Cross under the APS. Membership in the APS in many cases determines the viability of a hospital offering a particular procedure. Southern Cross also has the ability to bypass private hospitals by entering into contracts with surgeons at its own hospitals;
 - 38.2 an ageing population, resulting in increasing aggregate demand for healthcare services; and
 - 38.3 technological change impacting positively on the ease and costs of secondary procedures, resulting in increasing aggregate demand for healthcare services.

Recent mergers

- 39 There has been one private hospital merger in New Zealand notified to Commission in the last three years. The joint venture between Southern Cross Hospitals Limited and Aorangi Hospital Limited was authorised by the Commission in 2011. The Commission's reasons are set out in Decision No. 729.

- 40 In addition, the Commission directly considered the markets affected by this application in Decision No. 492. That 2003 decision granted clearance to Wakefield Hospital Limited to acquire Bowen Hospital Limited.

Acquisitions of the merger parties

- 41 The Evolution Group acquired the land and assets of Boulcott Hospital in December 2012. At that time, Acurity was a 12% shareholder of the company that owned and operated Boulcott Hospital.

PART 3: MARKET DEFINITION

- 42 For practical purposes, in this application we propose to work with the market definition approach taken by the Commission in past clearance and authorisation decisions regarding arrangements in the private healthcare industry.⁵ We broadly accept that the approach taken by the Commission to market definition in those decisions is an appropriate method for assessing competitive effects. However, it is important to note that all aspects of market definition in the context of these markets are “blurry” to the extent that constraint in adjacent markets is often significant and, arguably, sufficient to be considered within the relevant market.
- 43 Nonetheless, for analytical purposes, the relevant markets can be considered as follows:
- 43.1 the provision of short-stay⁶ hospital facilities and related non-specialist services for elective secondary surgery to private patients in the Wellington region (excluding the Wairarapa);
 - 43.2 the provision of in-patient hospital facilities and related non-specialist services for elective secondary surgery to private patients in the Wellington region (excluding the Wairarapa);
 - 43.3 the provision of short-stay hospital facilities and related non-specialist services for elective tertiary surgery to private patients in the Wellington region (excluding the Wairarapa); and
 - 43.4 the provision of in-patient hospital facilities and related non-specialist services for elective tertiary surgery to private patients in the Wellington region (excluding the Wairarapa).
- 44 This approach to market definition reflects the Commission’s past findings – all of which remain broadly relevant to this application. In particular, the Commission found that:
- 44.1 public hospitals are in a separate market from private hospitals for private patients, yet public hospitals still pose a constraint on the private funded elective surgery market.⁷ Public hospitals exercise significant constraint on private hospitals and more recently the extent of that constraint has been growing, with an overall reduction in waiting times for elective surgical procedures;
 - 44.2 there are separate markets for secondary surgery and tertiary surgery (the latter requiring highly specialised equipment and expertise);⁸
 - 44.3 there are separate markets for short-stay (less than 24 hours) and in-patient surgery;⁹

⁵ Commerce Commission Decision No. 449; Commerce Commission Decision No. 492; Commerce Commission Decision No. 729.

⁶ Consistent with the Commission’s analysis in Decision No. 729, “short stay” refers to surgery with less than 24 hours spend in a hospital or clinic.

⁷ Commerce Commission Decision No. 449, [40] – [52]; Reinforced in Commerce Commission Decision No. 492, [55] – [59].

⁸ Commerce Commission Decision No. 449, [53] – [56].

- 44.4 there is an aggregate market for surgical services and facilities;¹⁰
- 44.5 general 'surgical' markets can be defined (because surgical facilities and services are "fungible" across specialties);¹¹ and
- 44.6 the market for surgical facilities and services (provided by the hospital) must be distinguished from the market for the provision of surgery itself.¹² An exception to this is in relation to surgical contracts with ACC and other public providers, and with Southern Cross through its APS, which are generally held by the hospital as lead provider. The hospital then negotiates the allocation of the bundled price with surgeons and anaesthetists, through its own separate contracts.¹³
- 45 Consistent with the Decision No. 492, we have assumed that the relevant geographic market is the Wellington region, including Porirua and Lower Hutt, but excluding the Wairarapa.¹⁴ This is because the significant majority of patients referred to Boulcott, Wakefield and Bowen are from that geographic region.
- 46 However we note that actual historic data shows the Wellington and Hutt Valley geographic markets operate in a largely distinct manner, with a modest level of overlap in terms of patient and surgeon flows. This geographic distinction is reflected in the fact that:
- 46.1 between 1 June 2013 – 25 June 2014 only [] of Boulcott Hospital's patients were referred from Wellington and [] from Porirua – compared to [] from the Hutt Valley. This is illustrated in the following graph, which shows Boulcott Hospital's referrals by geographic source between those dates:¹⁵

⁹ Commerce Commission Decision No. 729, [25].

¹⁰ Commerce Commission Decision No. 449, [36]; Reinforced in Commerce Commission Decision No. 492, [43].

¹¹ Commerce Commission Decision No. 449, [37]; Reinforced in Commerce Commission Decision No. 492, [43].

¹² Commerce Commission Decision No. 449, [35]; Reinforced in Commerce Commission Decision No. 492, [47].

¹³ Commerce Commission Decision No. 449, [38].

¹⁴ Commerce Commission Decision No. 492, [71] – [79].

¹⁵ Source: Boulcott Hospital.

- 46.2 the Wellington and Hutt Valley regions each have separate District Health Boards, offering almost all of the same services; and
 - 46.3 Boulcott Hospital recruits most of its surgeons from Hutt Valley Public Hospital appointments. Similarly, the private hospitals in Wellington recruit most of their surgeons from Wellington Public Hospital appointments.
- 47 Such geographic distinctions show that the competitive constraint lost in the factual is relatively marginal, compared (for example) to the more direct competition between Wakefield / Bowen Hospitals and Southern Cross Hospital.

PART 4: COUNTERFACTUAL

48 There are two possible counterfactual scenarios:

48.1 continuation of the status quo; or

48.2 sale of Acurity to a third party.

Continuation of the status quo

49 These two scenarios are similar in competition terms, but we are not aware of any other third party buyer of Acurity. Accordingly, we consider continuation of the status quo the correct basis on which to undertake a competition analysis and we have prepared our application accordingly.

50 Continuation of the status quo involves Boulcott only having an ownership link with Wakefield/Bowen via the Evolution Group's 11.7% shareholding in Acurity.

51 A residual question – which is relevant to the factual as well – is what will happen to Wakefield Hospital, given that the building is in need of earthquake strengthening. In that regard, Wakefield Hospital would continue operating in both the factual and the counterfactual, but it is currently unclear whether this operation would continue:

51.1 on the current site, with seismically stable structures retained and the remaining structures rebuilt; or

51.2 on the current site, with the hospital entirely rebuilt; or

51.3 on another site, with the hospital entirely rebuilt.

52 Estimated cost under all scenarios is in the range of \$40m - \$60m.

53 We note that, in the factual, Evolution would be more likely to invest in improving Wakefield Hospital's facilities than its current owners who have proven to be relatively conservative in this respect.

Sale of Acurity to a third party

54 We are not aware of any other third party buyer of Acurity.

PART 5: COMPETITION ANALYSIS**Existing competitors**

- 55 Southern Cross (owner of Southern Cross Hospital, Newtown) is the main competitor of each of the Acurity and Evolution Groups. Southern Cross is in a unique position to compete vigorously with the merged entity due to a combination of its:
- 55.1 national coverage (enabling it to, amongst other things, assess the reasonableness of hospital fees¹⁶);
 - 55.2 depth of experience across the entire spectrum of services being provided;
 - 55.3 greater commercial scale giving rise to additional efficiencies and superior buying power, and greater negotiating leverage with major funders;
 - 55.4 not-for-profit model (and lower cost base given its tax free status); and
 - 55.5 vertical integration (described further below).
- 56 Southern Cross Hospital is owned by the Southern Cross Health Trust, meaning that any financial surpluses are reinvested into upgrading and expanding medical facilities and patient services, and the development of its employees. This dynamic means that Southern Cross' presence in the market is assured to continue and grow as any profits are reinvested into the business.
- 57 In Decision No. 729, the Commission accepted that Southern Cross does not have profit maximisation as its primary driver and may take other factors into account when determining its behaviour.¹⁷

Market share

- 58 The table below sets out the market share estimates relevant to the Acquisition:

Participants	# Inpatient Beds	% Beds	# Theatres	% Theatres	# Theatres Used	% Theatres Used
Boulcott (Evolution)	29	18%	3	16%	3	19%
Wakefield	68	41%	7	37%	5	31%
Bowen	30	18%	3	16%	3	19%
Acurity	98	59%	10	53%	8	50%
Southern Cross	37	23%	6	32%	5	31%

Source: Evolution

¹⁶ The Commission acknowledged this in Decisions 448 (at para [180]) and 492 (at para [186]).

¹⁷ Commerce Commission Decision No. 729, page 17.

Potential competition***Conditions of entry***

- 59 There are low barriers to establishing a small short-stay facility, primarily due to lower cost of initial capital investment and ongoing staffing overheads. Indeed, if a surgeon felt that hospital facilities were inadequate or the prices were too high, that surgeon is well positioned to establish a short stay facility (individually or together with other surgeons).
- 60 In Decision No. 492, the Commission found that while the threat of de novo entry of a hospital is low, the merged entity was likely to be constrained by the threat of expansion by an existing competitor and by the potential entry of day surgeries.¹⁸ We agree with this assessment. Indeed, the strong position of Southern Cross, with particular regard to its not-for-profit nature, means that the threat of expansion is ever-present. In 2011 Southern Cross completed a large redevelopment of its Wellington hospital facilities, which included an expansion and update of its theatre complex, a new six bed intensive care unit and a new specialist centre for consultations. And, despite current excess capacity, Southern Cross is considering further expansion subject the acquisition of neighbouring land.
- 61 Significantly, de novo entry of a short stay private hospital has occurred in Christchurch. A group of surgeons have opened a new four theatre private hospital called Forté Health.¹⁹

Likelihood, extent and timeliness of entry

- 62 We are not anticipating new entrants in either the factual or the counterfactual because we expect existing players will be providing competitive services. However, if that were to change (i.e. a new hospital were to enter the market), surgeons would be well placed to act on the opportunity.

Countervailing power of buyers

- 63 There are a number of market participants which have strong countervailing power. These include:
- 63.1 private health insurance providers (in particular, Southern Cross Insurance); and
- 63.2 ACC.

Private health insurance providers

- 64 Private health insurance providers obviously have an incentive to keep procedure prices at a level which generates an efficient level of demand having regard to the given capacity. Procedure price is important to health insurers because it affects their costs and, accordingly, the price of their premiums, which in turn dictates demand for their products.
- 65 Private health insurers are sophisticated commercial operators and, for them, hospital charges are the key cost component. Private health insurers generally operate nationally, allowing them to benchmark prices against other hospitals providing equivalent services.

¹⁸ Commerce Commission Decision No. 492, page 28.

¹⁹ Information on Forté Health can be found at <http://www.fortehealth.co.nz/>.

Southern Cross health insurance

66 Southern Cross is the leading provider of health insurance in New Zealand, holding a market share in excess of 61%.²⁰ Southern Cross accounted for approximately [] of total admissions, and [] of insured patient admissions, to Boulcott Hospital in 2013. The graph below shows the 2013 Boulcott Hospital admissions by source of funding:

67 Southern Cross is a powerful player through its APS and the potential for it to use its countervailing market power through the APS is becoming increasingly evident.

68 Under the APS, Southern Cross fixes a procedure price lead provider (usually the private hospital). That price covers the cost of hospital services as well as the surgeon and anaesthetist fees. There is very little scope for private hospitals to negotiate the procedure prices set by Southern Cross under the APS. Hospitals that do not have APSs in place for procedures that fall under the scheme cannot accept Southern Cross Insurance patients for those procedures. As seen in the graph above, the majority of Southern Cross funded admissions are pursuant to an APS. Furthermore, the percentage of APS admissions is increasing significantly. This is an area of rapid change in the market. During 2013 and 2014, Southern Cross Insurance has made a major push to bring more procedures under the APS. For example, from 21 July 2014, ten further procedures can only be covered by Southern Cross Insurance if an APS in place, including extraction of teeth, carpal tunnel release and tonsillectomy.

69 Membership in the APS in many cases determines the viability of a hospital offering a particular procedure and Southern Cross has the ability to bypass private hospitals in a range of ways. These include Southern Cross entering into contracts with surgeons at its own hospitals, or by entering into exclusivity arrangements with particular private hospitals for certain procedures (Southern Cross recently entered into an exclusivity arrangement for the provision of cataract procedures with a hospital in Christchurch).

²⁰ Southern Cross Health Society *Non-Executive Director Information Memorandum 2014* at pg 1 (available here: <https://www.southerncross.co.nz/Portals/0/Group/Corporate/SCMCS%20Background%202014.pdf>)

- 70 It is notable that Southern Cross Hospital provides virtually all of the services that are provided at Boulcott, Wakefield and Bowen Hospitals. The only exceptions are certain specialised tertiary procedures (being interventional cardiology, cardiac surgery and neurosurgery) - which are provided only at Wakefield Hospital due to its specialist equipment, catheterisation lab and intensive care unit - but not any of the other private hospitals.²¹ This means that, post-acquisition, Southern Cross Insurance will always have choice between Southern Cross Hospital and the other three (if considered together). The only exception would be for those specialised tertiary procedures (interventional cardiology, cardiac surgery and neurosurgery), in respect of which Wakefield Hospital alone provides services – which is currently the case - meaning the fact of there only being one option is unaffected.
- 71 As a provider of health insurance under a not-for-profit model, Southern Cross has the ability to leverage its vertical integration to defeat price rises by the other hospitals in the Wellington region essentially by in-sourcing procedures within its own hospitals. Whether any of this happens or not is less important here than the fact that Southern Cross clearly has the ability to use these kinds of strategies in response to any market gains made by the Acurity Group or the Evolution Group. In any event, we understand that such in-sourcing currently occurs, which demonstrates Southern Cross’s willingness to use this power.

Uninsured patients

- 72 For Boulcott Hospital, procedure prices for uninsured patients are the same as for privately insured patients (where no fixed price arrangement is in place with the insurance provider). Evolution has reason to believe that this is also the case at other private hospitals.

ACC

- 73 ACC operates a national fixed pricing regime whereby it sets standard prices for procedures. Hospitals are price takers. As shown in the graph above, ACC funded patients accounted for approximately 15% of the admissions to Boulcott Hospital in 2013. ACC has significant countervailing power.
- 74 ACC will often contract with the hospital for surgical procedures and, in turn, the hospital negotiates with the surgeon and anaesthetist to allocate the bundled price between themselves. Hospitals must negotiate contracts with individual surgeons who hold significant bargaining power in this respect.
- 75 Public hospitals (via DHBs) also compete for ACC funding. We provide more detail on constraints posed by public hospitals below.

Coordinated market power

- 76 There will be no prospect that the merger will give rise to risk of coordinated market power. Taking in turn the criteria specified in the Commission’s Guidelines:
- 76.1 There is a particularly vigorous competitor in the form of Southern Cross Hospitals, which is not only a sophisticated and well-resourced competitor on a national scale, but also, through its vertical integration and not-for-profit model, operates an entirely different business model than the merged entity. The presence of a strong vertically integrated hospital tells against coordination.

²¹ Evolution’s understanding is that Southern Cross has plans to install their own catheterisation lab in Southern Cross Hospital in Wellington.

- 76.2 Southern Cross Insurance has countervailing purchasing power through its APS and nationally benchmarked prices. Southern Cross Insurance controls 60-70% of the private health insurance market in New Zealand.
- 76.3 Interaction between hospitals is modest. One area of interaction is via the New Zealand Private Surgical Hospitals Association Inc, of which Boulcott, Wakefield, Bowen and Southern Cross Hospitals are all members.
- 76.4 Private hospitals do not generally publish their full price list, so hospitals cannot readily observe each other's prices. Volumes are also difficult to discern. Given that, there is no specific data on the number of operations being performed at specific hospitals.

Efficiencies

- 77 The Acquisition will not result in the consolidation of the operations of the Acurity Group and the Evolution Group, but Connor anticipates that:
- 77.1 efficiencies will be able to be made by leveraging off Evolution's existing relationships with suppliers, specialists, funding bodies and professional associations in both New Zealand and Australia to increase efficiency and enhance the services that Acurity's hospitals are able to provide to New Zealand consumers; and
- 77.2 Evolution will bring to the Acurity Group new and enhanced technologies, abilities, expertise and specialised knowledge [

]

Other factors

Surgeons

- 78 Demand for the facilities and services provided at any particular hospital is reliant upon surgeons making the choice to complete procedures at that hospital. In Decision No. 492, the Commission pointed out that:
- 78.1 the key requirement for a successful hospital is attracting surgeons; and
- 78.2 surgeons are not contracted to any particular hospital and often operate across two or more different hospitals.²²
- 79 We agree with these statements. Hospitals and surgeons are co-suppliers and, from a surgeon's perspective, lower hospital fees are preferred because that relieves fee pressure for the surgeon. The same is true for private hospitals and surgeons' fees. However, surgeons are in a strong bargaining position due to the fact that:

²² Commerce Commission Decision No. 492 at para [154].

- 79.1 the location of a patient's surgery is largely determined by that patient's surgeon — typically, patients will follow their surgeon's recommendation; and
- 79.2 surgeons are able to perform procedures at their choice of venue — many surgeons in New Zealand work in both the public and private systems (and, as noted above, within the private system at multiple private hospitals).

GPs

- 80 GPs also have a large degree of influence in the sense that they are typically the initial point of referral. GPs have the ability to direct patients to a preferred specialist operating out of the hospital of their choice.

Patients and public hospitals

- 81 Public hospitals pose a significant and growing competitive constraint on private hospitals, especially following recent Government and DHB initiatives aimed at improving access to, and the quality of, public elective surgeries. For example:
- 81.1 in May this year the Government announced an extra \$110m in funding towards public elective surgery;²³
- 81.2 in July this year Taranaki DHB opened a new state of the art public elective surgery facility which includes six new operating theatres;²⁴
- 81.3 in July 2013 Waitemata DHB opened its new Elective Surgery Centre, also considered to be state of the art, and which includes 4 operating theatres;²⁵
- 81.4 in September 2012 Wellington Hospital opened a new vascular lab, allowing it to avoid outsourcing scans to Wakefield Hospital and Southern Cross Hospitals;²⁶
- 81.5 in March 2011 the Government identified improving access to public elective surgery as a priority health target, requiring DHBs to increase the number of elective surgeries they perform by an average of 4,000 per year (compared to the previous increase of 1,400 per year);²⁷ and
- 81.6 in 2011 Hutt Hospital's new Emergency Department, including 8 new operating theatres, became operational,²⁸ and the hospital began performing weekend surgeries to meet elective targets.²⁹
- 82 Public hospitals have a high quality baseline service (surgeons generally operate in both private and public hospitals), encouraging private hospitals to maintain high quality, innovative service offerings. Improvements in waitlists and the quality of

²³ See here: <https://www.national.org.nz/news/news/media-releases/detail/2014/05/15/more-new-zealanders-to-get-elective-surgery>

²⁴ See here: <http://www.nbr.co.nz/article/80-million-hospital-facility-taranaki-jw-158511>

²⁵ See here: <http://www.waitematadhb.govt.nz/AboutUs/ElectiveSurgeryCentre.aspx>

²⁶ See here: <http://www.ccdhb.org.nz/news/2011/11-09-12.html>

²⁷ See here: <http://www.health.govt.nz/publication/targeting-more-elective-operations-improved-access-elective-surgery>

²⁸ See here: <http://www.stuff.co.nz/dominion-post/news/local-papers/hutt-news/10037282/Providing-hospital-care-for-growing-regionand>

²⁹ Hutt Valley District Health Board Annual Report (2012) at page 2.

service at public hospitals, as a result of initiatives like those detailed above, make public elective surgeries more substitutable for private elective surgeries.

- 83 Patients have a fundamental choice between the public healthcare system and the private healthcare system, and will be driven to the public system if the price of the private offering is too high. As the Commission pointed out in Decision No. 729, the improving efficiency of the public health system may impact on a patient's willingness to switch from privately funded elective surgery and enter the public waiting list for elective surgery.³⁰
- 84 As discussed above, public hospitals also compete directly with private hospitals for ACC funding.

Other healthcare providers

- 85 For short stay procedures, clinics also provide a competitive constraint. As the Commission pointed out in Decision No. 492, due to technological advances increasing the speed with which surgery can be performed and the post-operative recovery time, day surgeries are becoming increasingly popular.³¹

Spare capacity in private hospitals

- 86 The practical reality is that there are 3 theatres in the Wellington market not being used. This means there is excess supply which places a downward pressure on price - a scenario that is expected to continue in both the factual and counterfactual scenarios.
- 87 Note that between FY10 and FY13 Bowen Hospital made a \$34m investment in rebuilding its entire theatre complex and increased its capacity from 3 to 5 theatres, but only 3 of those are commissioned. Further, that capacity investment by Bowen did not negatively affect either Boulcott's or Wakefield's operations.

Partial acquisition

- 88 It is worth remembering that the Acquisition would not result in a full merger between the Acurity Group (as the owner of the Bowen and Wakefield hospitals) and the Evolution Group (as the owner of the Boulcott Hospital). In effect, Evolution is retaining ownership of Boulcott Hospital, while increasing its stake in Acurity from 11.7% to 25%. Neither Austron nor Acurity will have any ownership interest in Evolution or Boulcott. Accordingly, post-acquisition, competitive tension will remain between the Evolution Group and the Acurity Group in the provision of private hospital facilities and related services in the Wellington region.
- 89 Nevertheless, Connor expects that the Commission will adopt a conservative approach to its assessment of the competitive effects of this application, as it did in *USG Corporation and Boral Limited* [2014] NZCC 4. In *Boral* the merger parties sought clearance to form a 50/50 joint venture and, rather than assess the degree to which the joint venture may have enabled one joint venture party to influence the other, the Commission assumed that the proposed joint venture may change the incentives of the parties to vigorously compete with each other.³²
- 90 Connor is broadly supportive of this analytical approach in the context of this application and, in that regard, believes that the overall merits of the application

³⁰ Commerce Commission Decision No. 729, page 18.

³¹ Commerce Commission Decision No. 492, Page 29.

³² *USG Corporation and Boral Limited* [2014] NZCC 4 at para [27].

mean that the Acquisition would not substantially lessen competition even under a full merger analysis.

91 [

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PART 6: FURTHER INFORMATION AND SUPPORTING DOCUMENTATION

92 Please find below the contact details of relevant market participants:

	Name of company	Company Contact details	Relevant contact person
Competitors	Southern Cross Hospital	[]	[]
Customers	Southern Cross Medical Care Society	[]	[]
	Accident Compensation Commission	[]	[]
Suppliers	Surgeons	[]	[]
		[]	[]
Sector Associations	NZPSHA	[]	[]
Other market participants / interested parties	Capital & Coast District Health Board	[]	[]
	Wairarapa and Hutt Valley District Health Boards	[]	[]
		[]	

- 93 Please find below information about the revenue Evolution earned from its key customers in the last financial year (1 July 2013 – 30 June 2014):

Customer	Revenue Earned (excl. GST)
[]	[]
[]	[]
[]	[]
[]	[]
TOTAL	[]

[

]

- 94 The most recent audited financial statements for the Evolution Group are provided at **Appendix G.**
- 95 The Evolution Group's confidential, unaudited financial statements for the year ended 30 June 2014 are provided at **Appendix H.**
- 96 The most recent annual report for Acurity is available at:
<http://www.acurity.co.nz/investor-centre/financial-information/annualinterim-reports>

PART 7: CONFIDENTIALITY

Specific information contained in or attached to the notice

- 97 Confidentiality is requested for all the information contained in this version of the notice. A "public version" of this notice will be provided subsequently that will specifically identify all information that is commercially sensitive to the Applicant.
- 98 The parties request that they be notified if a request is made to the Commission for release of the information under the Official Information Act 1982.

PART 8: DECLARATION

THIS NOTICE is given by Connor Healthcare Limited.

I, BEN THYNNE, have prepared, or supervised the preparation, of this notice seeking clearance.

To the best of my knowledge, I confirm that:

- all information specified by the Commission has been supplied;
- if information has not been supplied, reasons have been included as to why the information has not been supplied;
- all information known to me that is relevant to the consideration this notice has been supplied; and
- all information supplied is correct as at the date of this notice.


I undertake to advise the Commission immediately of any material change in circumstances relating to the notice.

I understand that it is an offence under the Commerce Act to attempt to deceive or knowingly mislead the Commission in respect of any matter before the Commission, including in these documents.

I am a director of the company and am duly authorised to submit this notice.

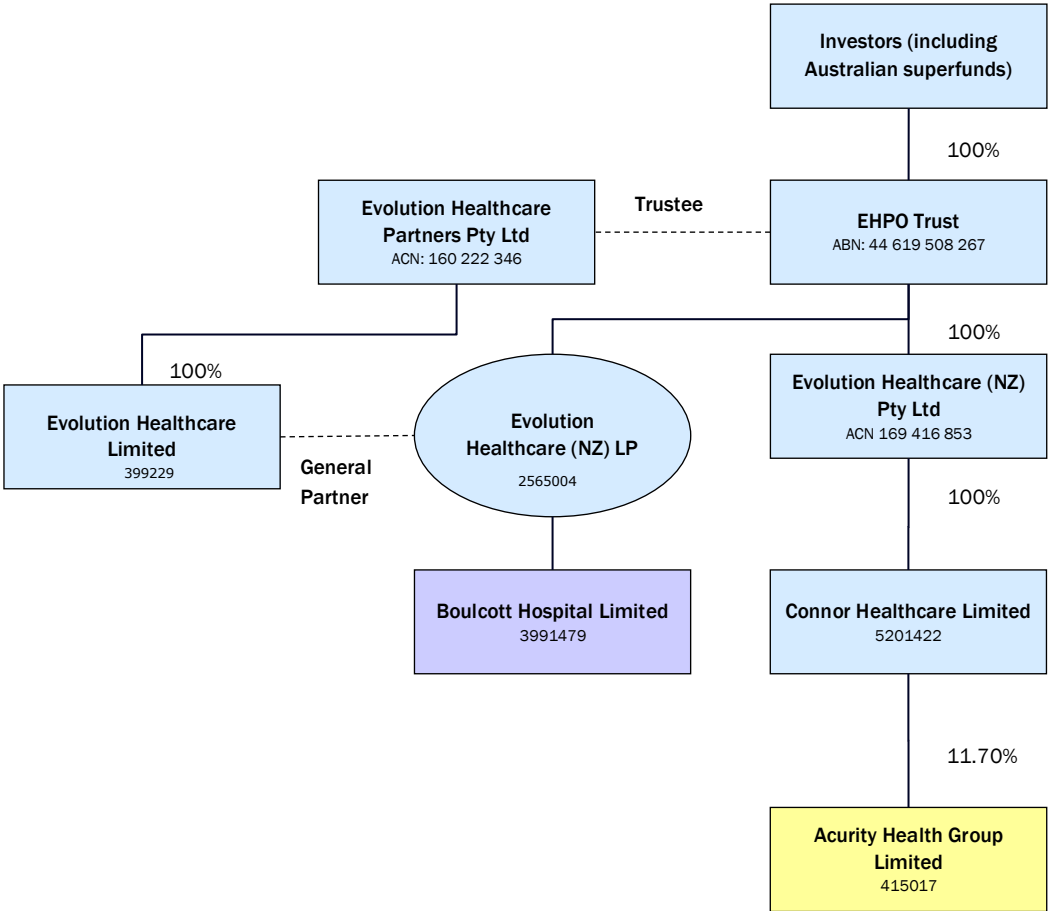
Name and title of person authorised to sign

BEN THYNNE DIRECTOR

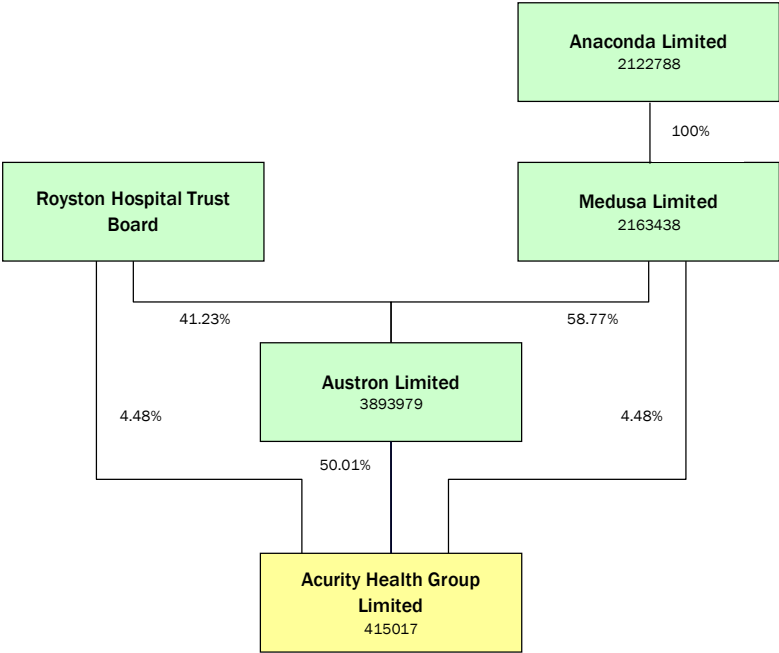
Sign:  Date: 27/8/14

APPENDIX A: CORPORATE STRUCTURE DIAGRAMS

Corporate structure diagram for Evolution

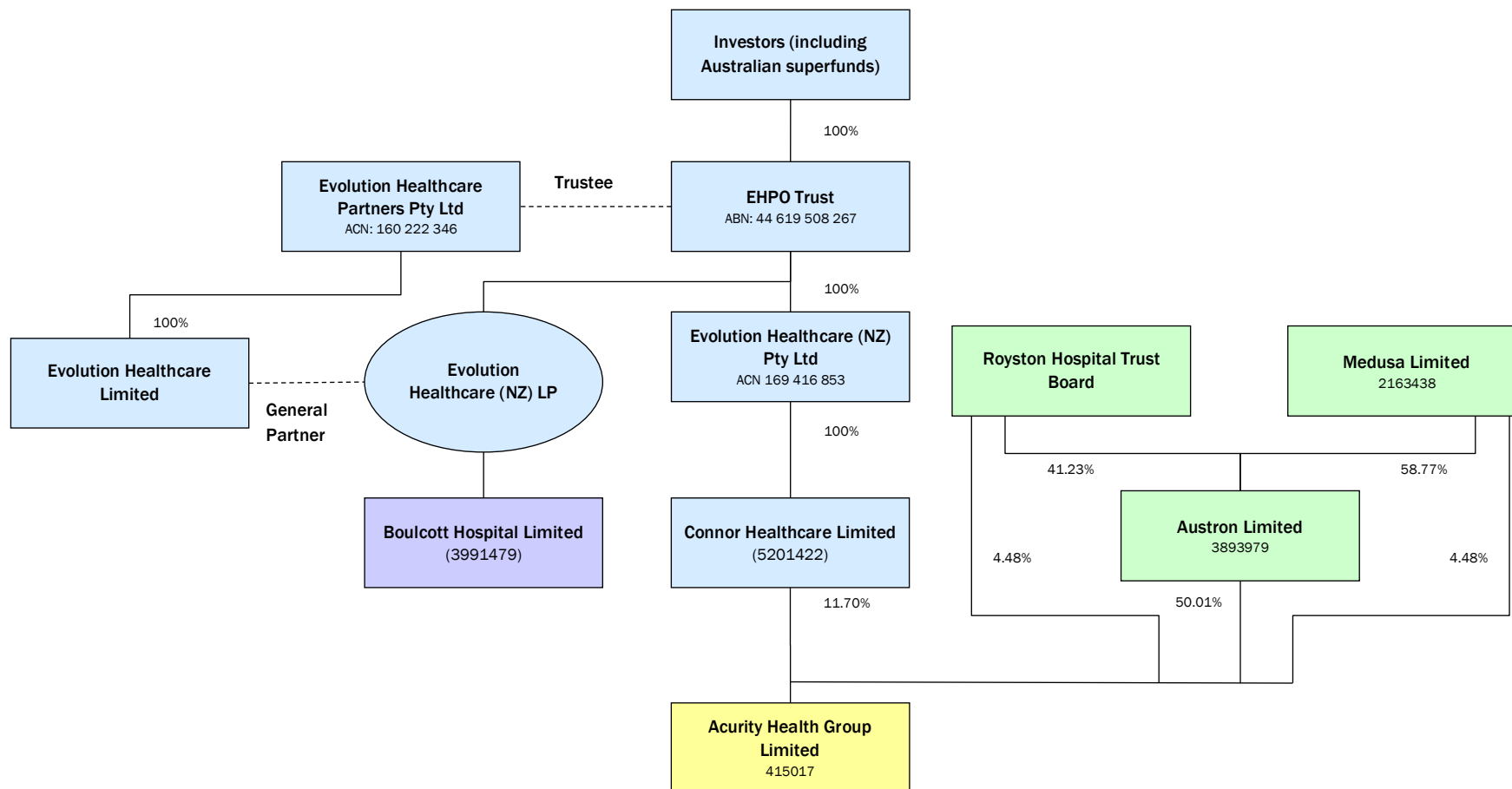


Corporate structure diagram for Austron

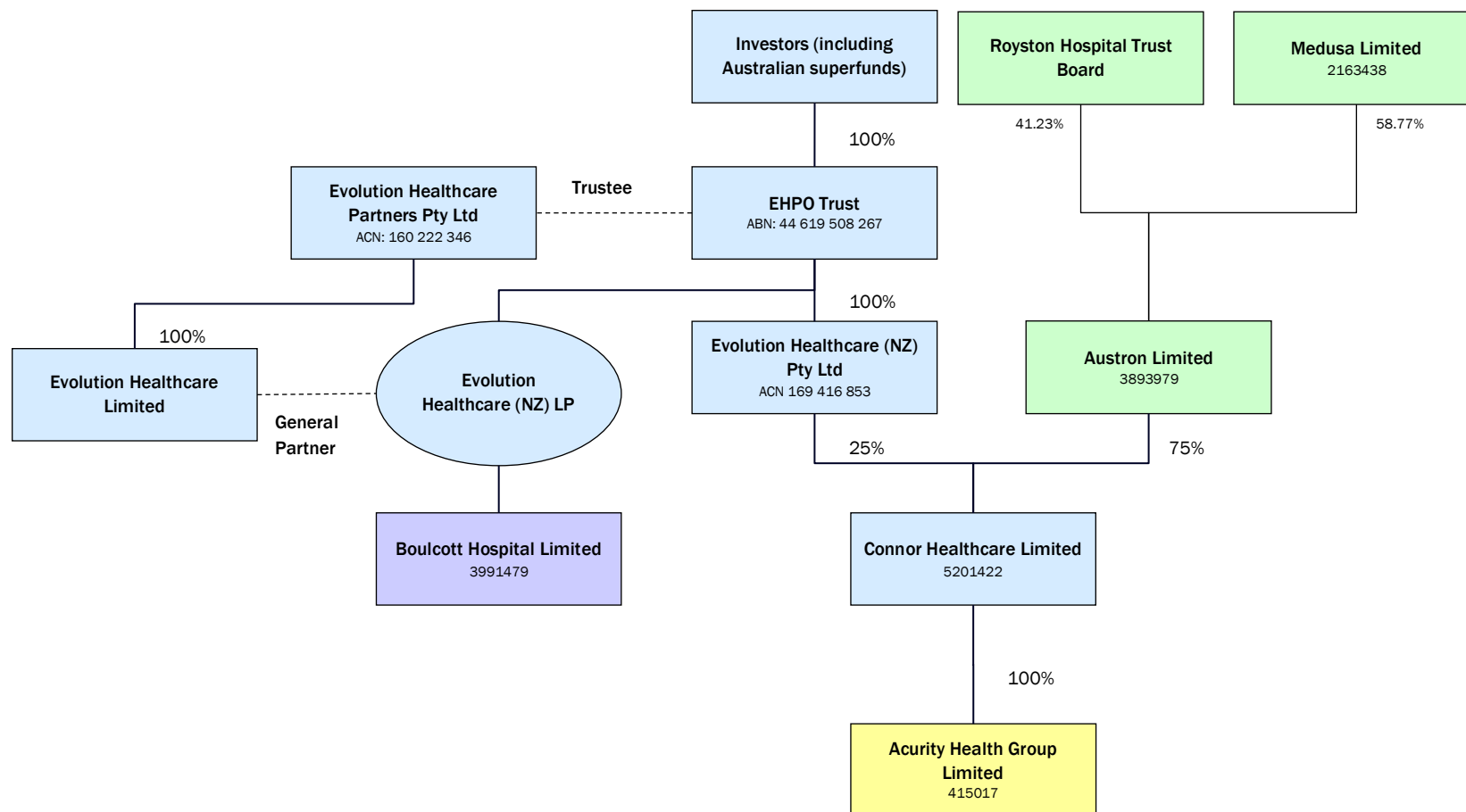


APPENDIX B: CORPORATE STRUCTURE DIAGRAMS (PRE- AND POST-OFFER)

Corporate structure diagram – pre-offer position



Corporate structure diagram – post-offer position



APPENDIX C: CONNOR TAKEOVER OFFER

APPENDIX D: SPECIALIST SERVICES PROVIDED BY BOULCOTT HOSPITAL

99 Boulcott Hospital provides the following specialist services:

99.1 Boulcott Joint Replacement Centre

99.2 Orthopaedic

99.3 Plastic and Reconstructive Surgery

99.4 Gynaecology

99.5 General Surgery

99.6 Cardiology

99.7 Gastroenterology

99.8 Ophthalmology

99.9 Otolaryngology

99.10 Rheumatology

99.11 Urology

99.12 Oral and Maxillofacial

99.13 Fertility Services

99.14 Vascular

APPENDIX E: SPECIALIST SERVICES PROVIDED BY WAKEFIELD HOSPITAL

100 Wakefield Hospital provides the following specialist services:

100.1 Anaesthesia

100.2 Physiotherapy
(TBI Health)

100.3 Bariatric Surgery

100.4 Cardiac
(Wakefield Heart Centre [WHC])

100.5 Ear Nose and Throat

100.6 Gastroenterology

100.7 General Surgery

100.8 Gynaecology

100.9 Hepato-biliary

100.10 Intensive Care

100.11 Neurosurgery

100.12 Orthopaedics

100.13 Paediatrics

100.14 Plastic Surgery

100.15 Radiology

100.16 Skin Cancer Clinic

100.17 Sports Medicine

100.18 Urology

APPENDIX F: SPECIALIST SERVICES PROVIDED BY BOWEN HOSPITAL

101 Bowen Hospital provides the following specialist services:

101.1 Anaesthesia

101.2 Audiology

101.3 Cosmetic, Plastic and Reconstructive

101.4 Dermatology

101.5 Ear Nose & Throat (ENT)

101.6 Gastroenterology

101.7 General

101.8 Gynaecology

101.9 Ophthalmology

101.10 Oral and Maxillofacial

101.11 Orthopaedics

101.12 Radiology

101.13 Respiratory Medicine

101.14 Rheumatology

101.15 Urology

101.16 Vascular Surgery

**APPENDIX G: EVOLUTION GROUP'S AUDITED FINANCIAL STATEMENTS (YE
JUNE 2013)**

[Confidential]

**APPENDIX H: EVOLUTION GROUP'S UNAUDITED FINANCIAL STATEMENTS
(YE JUNE 2014)**

[Confidential]