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Statement of Preliminary Issues

Connor Healthcare Limited / Acurity Health Group Limited

29 September 2014

Introduction

1. On 27 August 2014, the Commerce Commission received an application from Connor Healthcare Limited (Connor), seeking clearance to acquire all of the shares that it does not presently own in Acurity Health Group Limited (Acurity). At present, Connor has an 11.7% shareholding in Acurity.

2. The public version of the application is available on our website at:

   http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/835

3. This Statement of Preliminary Issues outlines the key competition issues we currently consider will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as our assessment of the application for clearance progresses. Therefore, the issues highlighted in this statement are not binding on us.

4. We invite interested parties to make comment on the likely competitive effects of the proposed acquisition and request that parties who wish to make a submission do so by **Friday 10 October 2014**.

The transaction and the parties

5. Connor is 100% owned by Evolution Healthcare (Evolution), which owns and operates the Boulcott private hospital in Lower Hutt.

6. Acurity is publicly listed on the New Zealand Stock Exchange. Acurity owns and operates the Wakefield and Bowen private hospitals in Wellington and the Royston private hospital in Hastings. Currently, the largest shareholder in Acurity is Austron Limited, which in turn is owned by Royston Hospital Trust Board and Medusa Limited.

7. The acquisition would involve a partial merger between Acurity as owner of the Bowen and Wakefield hospitals and Evolution as owner of Boulcott Hospital. If the transaction proceeds:

   7.1 Acurity will be 100% owned by Connor;

   7.2 Connor will be 75% owned by Austron Limited and 25% by Evolution;

   7.3 Evolution will be entitled to appoint two out of six directors to the Connor board and Austron would be entitled to appoint the remaining four directors;

7.4 Evolution will own 25% of the company that owns 100% of each of the Wakefield and Bowen Hospitals; and

7.5 Evolution will retain full ownership of Boulcott Hospital so neither Austron nor Acurity will have any ownership interest in Evolution or Boulcott Hospital.

Our framework

8. As required by the Commerce Act 1986, we assess whether an acquisition of shares is likely to result in a substantial lessening of competition. How we assess this is set out in our Mergers and Acquisitions Guidelines.[1]

9. We ask whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[2]

10. A tool often used to assess competitive effects is market definition. Market definition provides a framework to help identify and assess the close competitive constraints the merged firm would likely face.[3] A market is defined in the Commerce Act as a market in New Zealand for goods or services as well as other goods or services that are substitutable for them as a matter of "fact and commercial common sense".[4]

11. We define markets in the way that we consider best isolates the key competitive constraints on the merging parties. In many cases this may not require us to precisely define the boundaries of a market.

12. We analyse the extent of competition in each relevant market both with and without the acquisition to determine whether the acquisition would be likely to substantially lessen competition.

13. We assess the following three factors when considering whether this is likely to be the case.

13.1 Existing competition – the degree to which existing competitors compete.

13.2 Potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased.

1 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

2 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

3 *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 (HC), at [123]. *Brambles New Zealand Ltd v Commerce Commission* (2003) TCLR 868 (HC) at [137].

4 Similarly, the courts have said that "[t]he boundaries of the market are defined by substitution between one product and another and between one source of supply and another, in response to changing prices". See *Commerce Commission v New Zealand Bus Limited* (HC), above n 3 at [123] citing *Re Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,247.

13.3 The countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser's ability to exert substantial influence on negotiations.

14. A comparison of the extent of competition both with and without the acquisition enables us to assess the degree by which the proposed acquisition might lessen competition. If the lessening is likely to be substantial, we may not give clearance to the proposed acquisition.

Preliminary issues

15. We will investigate the prospect of the proposed acquisition to substantially lessen competition in the relevant markets.

Market definition

16. This acquisition involves parties that run private hospitals in the greater Wellington region. As such the acquisition has the potential to affect competition in the provision of services at private hospitals.

17. For the purposes of considering this acquisition, we will initially consider the relevant markets to be:

17.1 the provision of short-stay hospital facilities and related non-specialist services for elective secondary surgery to private patients in the greater Wellington region; and

17.2 the provision of in-patient hospital facilities and related non-specialist services for elective secondary surgery to private patients in the greater Wellington region.

18. However, given that the acquisition involves markets that are differentiated in terms of the services provided and geography, our investigation will focus on the closeness of competition between the merging parties and the closeness of competition between the merged firm and remaining competitors. We will also consider the extent to which the closeness of competition between the merging parties and remaining competitors varies depending on the type of surgery or specialist service.

Existing competition

Closeness of competition

19. Connor submitted that the location of Boulcott Hospital in Lower Hutt means that it does not compete closely with the private hospitals in Wellington city with only a limited overlap in terms of patient and surgeon flows.

20. However, we will consider whether the merging parties are close competitors in the affected markets by :

20.1 identifying the geographic location of the patients for each of the merging parties' private hospitals that are referred for short-stay[5] and in-patient surgery;

20.2 whether there is a significant number of patients who would consider the other hospital(s) for their needs (and whether this differs by type of surgery or patient), or, alternatively, the extent to which factors other than location, such as a surgeon's recommendation, plays a primary role in hospital choice; and

20.3 assessing the number and type of surgeons that carry out surgery and specialist services at each of Evolution's and Acurity's hospitals and whether such surgeons would consider using the other hospital(s) for their needs.[6]

21. Connor considers that Southern Cross Hospitals, Evolution's and Acurity's main competitor in the Wellington region, will continue to provide vigorous competition to the merged firm.

22. We will consider the extent to which the merged firm would be effectively constrained by Southern Cross Hospitals, in the event that the merged firm raised its prices above the competitive level, or reduced the quality of its services.

23. We will do this by assessing the ability of Southern Cross Hospitals to expand its presence in Wellington, taking into account whether it has sufficient excess capacity (or whether it could add capacity) and, if necessary, whether it could attract additional surgeons.

Potential competition

24. Connor considers that there are low barriers to entry to establishing a small short-stay facility and refers to the recent opening of a short stay facility in Christchurch by Forte Health Limited as evidence of such entry.

25. We will assess whether entry by new competitors or expansion by existing competitors is likely, of sufficient extent and occurs in a timely fashion to prevent a substantial lessening of competition.

Countervailing power

26. Connor submitted there are a number of existing parties with strong countervailing power, including:

26.1 private health insurance providers (and particularly Southern Cross Health through its Affiliated Provider Scheme (APS)); and

26.2 The Accident Compensation Corporation (ACC).

27. We will consider whether the countervailing power of Southern Cross Health, (including through its APS), other private health insurance providers, and ACC, would

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[5] Procedures that require a patient to stay less than 24 hours in a hospital.

[6] In this context, we will also consider each hospital's reliance on ACC contracts as a means of attracting and retaining surgeons.

be sufficient to constrain the merged firm from profitably increasing prices, including for instance by disciplining the merged firm in other geographic markets.

28. Further, we will consider whether the ACC would have the incentive to purchase hospital services from a wider geographic area, given their national pricing structure, in order to mitigate against an attempted price increase for these services. This is because a price increase in the Wellington area would increase the ACC's costs across the country under this pricing structure and so moving patients outside of the Wellington area in order to avoid this increase in costs may be a cost effective strategy. We will also consider the extent to which Connor is likely to exercise market power by substantially raising prices to private self-funded patients. Previously we have considered that such patients lack any degree of countervailing power.

Next steps

29. Our final decision is due by **Wednesday 5 November 2014**, which is the revised deadline agreed with Connor. However, this date may change as the investigation progresses.

30. To keep up to date with any changes to our deadline and to find relevant documents, visit our clearance register on our website at http://www.comcom.govt.nz/clearances-register/

31. As part of our investigation, we will identify the parties we believe will provide the best information to help us assess the preliminary issues identified above. We will be contacting those parties over the next few weeks.

32. We also invite submissions from any other parties who consider they have information relevant to our consideration of this matter. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Connor/Acurity in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by close of business **Friday 10 October 2014**. Please clearly identify any confidential information contained in the submission and provide contact details.