

Statement of Preliminary Issues

SCL / Medlab South

9 March 2012

Introduction

1. On 1 March 2011, the Commerce Commission (Commission) received an application from Southern Community Laboratories Limited (SCL or the Applicant), through its wholly owned subsidiary Canterbury SCL Limited, seeking clearance to acquire 100% of the shares in Medlab South Limited (Medlab South). The public version of the application can be accessed on the Commission's website at:

<http://www.comcom.govt.nz/clearances-register/detail/756>
2. This Statement of Preliminary Issues outlines the key competition issues the Commission currently considers 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 the Commission's assessment of the application for clearance progresses. Therefore, the issues highlighted in this Statement of Preliminary Issues are in no way binding on the Commission.
3. The Commission invites interested parties to make comment on the likely competitive effects of the proposed merger.

Relevant Parties

The Acquirer – Southern Community Laboratories Limited (IAG)

4. SCL forms part of the Healthscope group of companies, which is a provider of pathology services in Australia. In New Zealand, Healthscope, through SCL and various other subsidiaries, contracts to provide community, and in some instances, hospital pathology services to six District Health Boards (DHBs), including the Southern and Canterbury DHBs. Healthscope also provides cervical screening tests to the National Screening Unit (NSU), the sole purchaser of such tests in New Zealand.

The Target – Medlab South Limited (Medlab South)

5. Medlab South is ultimately owned by Sonic Healthcare Limited, an Australian-listed group of companies, which provides pathology and radiology services in Australia, New Zealand and various other countries. In New Zealand, Sonic through Medlab South and various subsidiaries, contracts to provide community, and in most instances, hospital pathology services to eight DHBs, including the South Canterbury and Nelson/Marlborough DHBs. Sonic also provides cervical screening tests to the NSU.

Analytical Framework

6. In the context of an application for clearance, the Commission must consider whether or not an acquisition substantially lessens competition. An important step in the Commission's analytical framework¹ is to determine the relevant market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target where aggregation of market share may arise from the acquisition. The Commission then considers the relevant products and geographic regions that may be close substitutes from both a customer's and a supplier's point of view.
7. The Commission uses a forward-looking type of analysis to assess the degree of any potential lessening of competition in the relevant market or markets arising from a proposed acquisition. Therefore, the next step is to establish the two hypothetical future scenarios:
 - with the acquisition in question
 - without the acquisition.
8. The impact of the acquisition on competition is then viewed as the difference between those two scenarios.
9. The Commission analyses the extent of competition in each relevant market for both the with and without scenarios, in terms of:
 - Existing competition – the degree to which existing competitors compete and their ability to expand production in the event that the combined entity raises prices.
 - Potential competition – the ability of businesses to readily enter the market and thereafter expand, given an inducement to do so.
 - The countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser's ability to exert an influence on price, quality and/or terms of supply.
 - Coordinated behaviour – whether the acquisition would enhance the ability of market participants to collude either tacitly or explicitly.
10. A comparison of the extent of competition in the relevant markets both with and without the acquisition enables the Commission to assess the degree by which the proposed acquisition might lessen competition. If the lessening is substantial the Commission may not give clearance to the proposed acquisition.

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

Preliminary Issues

11. The Applicant submits that the proposed acquisition would not result in any aggregation of market share between the parties in the pathology markets. Rather, the effects of the acquisition will arise in the future when the South Canterbury and Nelson/Marlborough DHB contracts are next tendered. Accordingly, the Commission intends to focus on the impact of the acquisition in the South Canterbury and the Nelson/Marlborough regions in 2016 when the respective DHB contracts fall due.
12. In regard to cervical screening tests, the acquisition may result in a small aggregation of market share, but the market situation is unlikely to change significantly.
13. The Commission considers that its consideration of the proposed acquisition will focus on the following areas:

Market Definition

14. In respect of market definition, the Commission intends to define the markets in a similar way to that adopted in *New Zealand Diagnostic Group Ltd/Sonic Healthcare (New Zealand) Limited*.² Consequently the Commission is of the view that the relevant markets are likely to be:
 - 14.1 The markets in the South Canterbury region for the provision of community and hospital testing pathology services;
 - 14.2 The markets in the Nelson/Marlborough region for the provision of community and hospital testing pathology services; and
 - 14.3 The national market for the provision of cervical screening tests.

Existing Competition

15. The Applicant submits that the degree of competition in the affected markets when the contracts are due for renewal in 2016 would be the same in the factual and the counterfactual. Whether the acquisition occurs or not, it considers that Sonic, along with other existing providers of pathology services, are likely to tender for these contracts. In addition, the Applicant submits that there will be no change to the competitive situation in the provision of cervical screening tests.
16. The Commission will assess the nature of competition in the pathology markets by identifying the likely potential bidders for contracts in 2016, and the extent of competition these bidders are likely to provide under the factual and counterfactual. The competitive impact of the proposed acquisition on the provision of cervical screening tests will be considered also.

² *New Zealand Diagnostic Group Limited/Sonic Healthcare (New Zealand) Limited*, Decision 559, 29 September 2005.

Potential Competition

17. The Applicant submits that there are no material factors impeding entry or expansion by Sonic, or any of the other existing providers, into the provision of pathology services as a result of the proposed acquisition.
18. The Commission intends to assess the entry conditions that potential providers are likely to face in the factual and counterfactual to determine whether these might hinder or constrain entry into the affected markets.

Countervailing Power

19. The Applicant considers that the proposed acquisition does not lessen the buying power of the DHBs, which are the sole purchasers of pathology services in their regions, because the DHBs will be able to continue to play off providers against each other.
20. The Commission proposes to consider whether the countervailing power of the DHBs is likely to be sufficient to constrain the merged entity from exercising market power in the factual.

Coordinated Market Power

21. The Applicant submits that the risk of co-ordinated effects is low and that the pathology markets are characterised by a number of features that are not conducive to the exercise of coordinated market power.
22. The Commission will consider the factors listed in the Commission Mergers and Acquisitions Guidelines³ to assess whether the proposed acquisition would be likely to increase the prospect of coordinated behaviour in the factual compared to the counterfactual.

Next Steps

23. In line with the Commission's Merger and Acquisitions Clearance Process Guidelines (available on the Commission's website at www.comcom.govt.nz), the Commission has established a draft timeframe for consideration of the issues and SCL's application for clearance. An extension of time has been agreed to by the Applicant such that the Commission should make its final decision by **30 March 2012**. However, this timeframe could change. To keep abreast of possible changes to timing and to find relevant documents, visit the Clearance Public Register on the Commission's website at:

<http://www.comcom.govt.nz/clearances-register/>
24. As part of its investigation, the Commission will identify the parties it believes will provide the best information to help it assess the preliminary issues identified above. The Commission will be contacting those parties over the next few weeks.

³ Commerce Commission, *Mergers and Acquisitions Guidelines*, p 33-35.

25. The Commission invites submissions from any other parties who consider they have information relevant to the Commission's consideration of this matter. If you wish to make a submission, please send it to the Registrar, at registrar@comcom.govt.nz with the reference SCL/Medlab South in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by **4pm on Tuesday 20 March 2012**. Please clearly identify any confidential information contained in the submission and provide contact details.