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Commerce Commission

Decision No. 331

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

EASTBAY HEALTH LIMITED

and

WESTERN BAY HEALTH LIMITED

The Commission:	P C Allport E C A Harrison P Rebstock
Summary of Proposed Acquisition:	The amalgamation of Western Bay Health Limited with Eastbay Health Limited.
Determination:	Pursuant to s 66(3)(a) of the Act, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	19 November 1998

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS.

CONTENTS

THE PROPOSAL

1. On 2 November 1998, the Commission registered a notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) seeking clearance for the amalgamation of Western Bay Health Limited (WBHL) with Eastbay Health Limited (EHL).

2. The proposed acquisition is to be effected pursuant to ss 219 and 222 of the Companies Act 1993, with the shares in EHL being cancelled, and the amalgamating companies continuing in operation as a single successor company, WBHL, which is then to be renamed.

3. This report concludes that Commission staff are satisfied that implementation of the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market. It is recommended that, in terms of s 66(3)(a) of the Act, the Commission gives clearance for the proposed acquisition.

THE PROCEDURES

4. Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under s 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. By agreement between the Commission and the applicant, the date for the Commission's determination on the application was extended to Friday 20 November 1998.

5. The applicant has not requested confidentiality relating to any matters concerning the application.

THE INVESTIGATION

6. Staff contacted the following parties during the investigation of the proposed acquisition:

   - Accident Rehabilitation Compensation and Insurance Corporation;
   - Good Health Wanganui Limited;
   - Health Waikato Limited;
   - Lakeland Health Limited;
   - Norfolk Hospital, Tauranga;
   - Prime Health Limited, Tauranga;
   - Southern Cross Hospitals, Tauranga and Rotorua;
   - the Health Funding Authority; and
   - GPs in the Bay of Plenty.

7. The parties to the proposed acquisition also provided additional information and comment.

THE PARTICIPANTS

Western Bay Health Limited (WBHL)

8. WBHL provides a range of predominantly secondary healthcare services, and some primary care services, for residents domiciled mainly in the Western Bay of Plenty region (see Appendix One for details of the services provided by WBHL). The main facility operated by WBHL is the Tauranga Hospital, which is a 322-bed facility with five operating theatres.

9. WBHL owns 50% of the shares in Western Orthopaedics Limited (WOL), with Bay Orthopaedic Services Ltd (BOSL) holding the balance of shares. BOSL is owned by a group of surgeons. WOL provides orthopaedic services in the Bay of Plenty region. WBHL also owns 50% of the shares in Venturo Limited along with Urology Bay of Plenty Ltd (UBOP), a company which is owned by urologists. Venturo provides urology services in the Bay of Plenty and Taupo/Turangi regions.

Eastbay Health Limited (EHL)

10. EHL provides a range of primary and secondary care services for residents domiciled mainly in the eastern Bay of Plenty region. The company operates three facilities: Whakatane Hospital, a 151 bed facility with two operating theatres, Opotiki Hospital, an 11 bed facility, and a maternity unit at Murupara with four beds (see Appendix One for further details of the services provided by EHL).

11. WBHL and EHL are members of the group of New Zealand Hospital and Health Services (HHSs). Each HHS is wholly owned by the Crown, but operates independently from the others. The Ministers of Health and Finance hold the shares in HHSs on behalf of the Crown.

12. WBHL and EHL have common Boards of Directors.

OTHER RELEVANT PARTIES

Lakeland Health Limited (Lakeland Health)

13. Lakeland Health is an HHS, and provides a range of primary and secondary healthcare services for people in the Lakes district region (including Taupo/Turangi regions). The company operates two facilities: a Taupo hospital, with 36 beds and one operating theatre, and Rotorua Hospital, a 189 bed facility with five operating theatres. Lakeland Health, along with EHL and WBHL, formed part of Bay of Plenty Area Health Board prior to the 1993 health reforms.

Health Waikato Limited (Health Waikato)

14. Health Waikato is the second largest HHS in New Zealand. It is based in Hamilton and provides a range of primary, secondary and tertiary healthcare services. Health Waikato operates the Hamilton hospital, which has approximately 700 beds and 12 operating theatres. The company receives referrals for tertiary care services mainly from the Waikato, Bay of Plenty and Taranaki regions.

Private Providers

15. There are a number of private providers of healthcare services in the Bay of Plenty region. In Rotorua, these include Southern Cross Hospital, Lakes Care Surgical, and Queen Elizabeth Hospital. The private providers in Tauranga include Southern Cross Hospital, Norfolk Hospital, Park Street Day Clinic and a day care facility called Promed. These providers compete with the HSSs for ACC funding for elective surgical work. Private providers in the main do not compete with HHSs for the provision of publicly funded secondary healthcare services.

The Health Funding Authority (HFA)

16. The HFA is a Crown entity which is responsible for purchasing and funding nearly all publicly funded health services, disability support and public health services throughout the country. The HFA's activities include:

- investigating the health and disability support needs of the population;
- consulting with communities and other interest groups on needs and priorities for service;
- deciding the range and mix of services it will purchase in order to meet the needs of the population within the budget it has available;
- purchasing services from appropriate providers through contracts and other arrangements; and
- monitoring to ensure that service providers perform the services and meet the standards in their contracts.

17. The HFA is a national organisation with five locality offices. Of relevance to this proposal is the HFA's Hamilton office, which is responsible for managing the purchase of publicly funded healthcare and disability services in the Midland region.[1] On the basis of 1996 Census data, the total population of the Midland region is around 724,000, of which approximately 163,000 reside in the Bay of Plenty region.

Accident Rehabilitation and Compensation Insurance Corporation (ACC)

18. ACC is the Crown agency responsible for the administration of the statutory insurance scheme for accident-related injuries and disabilities. The scheme was originally created by legislation in 1974. ACC's objective is to reduce the social, economic and physical impact of personal injury by:

- implementing effective injury prevention programmes;
- ensuring effective intervention when injury occurs; and

[1] The Midland region comprises Taranaki, King Country, Waikato, Coromandel, Lakes District and Bay of Plenty.

- working with claimants to help them, where practical, return to independent living and employment as soon as possible.

BACKGROUND TO THE HEALTH SECTOR

Overview

19. Prior to the 1993 health reforms, most hospital-based secondary and tertiary healthcare services were administered by 14 Area Health Boards (AHBs). These had been formed gradually from the amalgamation of the Hospital Boards during the 1980s. The AHBs were responsible for purchasing and providing healthcare and disability services for the population in their catchment areas.

20. In 1993, the Government introduced a programme of major healthcare reforms. The main feature of the reforms was the splitting of the funding of services and their provision. Four Regional Health Authorities (RHAs)were established to purchase personal health, disability support and public health services competitively, and 23 Crown Health Enterprises (CHEs) based around major hospitals were established to provide healthcare and disability services.

21. In 1996, the Coalition Government announced that it was "...committed to publicly funded health care that encourages cooperation and collaboration rather than competition between health and disability services".[2] To this end, the four RHAs were replaced by the Transitional Health Authority (THA) in April 1997.[3] The THA became the Health Funding Authority (HFA) in January 1998.

22. Instead of purchasing healthcare services on a competitive basis, the HFA is now required to contract with providers for the supply of a range of services with the objective of maximising the health status of the local populations within available funding.

23. From 1 July 1998 the CHEs were renamed Hospitals and Health Services (HHSs). The requirement that they earn a profit was removed.

24. The Minister of Health has overall responsibility for the public health system. The Ministry of Health provides policy advice to the Minister of Health, decides on health priorities and funding levels, monitors the HFA's performance, administers regulations, and provides the link between the Minister and the HFA. The National Health Committee (NHC) advises the Minister on the types and relative priorities of services that should be publicly funded. (See Appendix Two for details of the structure of the New Zealand health sector.)

25. The Policy Guidelines published by the Ministry of Health for the 1996/97 year outlined six principles of purchasing that the Government decided should underlie purchasing activity. These principles give direction to, and provide a framework for, the HFA's decision-making, resource allocation and purchase arrangements for health and disability support services. They also provide a framework for monitoring purchase activity. The purchasing principles are, in brief:

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[2] The Coalition Agreement, 1996, p.34.

[3] The amalgamation of the RHA's into a single agency was effected by an Order in Council.

- equity of access;
- efficiency;
- effectiveness;
- safety;
- acceptability; and
- risk management.

HFA Purchasing Strategy

26. The HFA's purchasing methods act as a strong constraint on the ability of the HHSs to set prices, and determine volumes and service requirements for publicly funded healthcare services.

27. One of the objectives of the HFA is to achieve a standardised pricing policy for health and disability services throughout New Zealand. To this end the HFA has been comparing prices for services delivered by HHSs and developing a national price for each of these services. The 1998/99 year is the first year in which prices have been paid by the HFA to all HHSs for each of a range of services they provide. The HFA has developed a national price for most of the services it purchases. The ability of HHSs to negotiate on price is constrained by this national pricing policy.

28. There are additional payments available to HHSs from the HFA in the form of rural and tertiary adjusters. These take into account the higher costs associated with providing secondary healthcare services in rural areas, and with providing tertiary level services.

29. The HFA, in its contracts with HSSs, specifies the sites at which services will be provided. For example, in terms of its contract with the HFA, Lakeland Health is required to provide services at Taupo Hospital in addition to it's main site at Rotorua. The HFA's contract with EHL includes the delivery of services at Murupara and Opotiki in addition to EHL's main site at Whakatane.

30. The HFA has stated that the proposal will not affect its requirement for services at their current locations. The HFA also determines, in conjunction with HSSs, the volume of services to be delivered at each site.

The Booking System

31. On 1 July 1998, a new booking system was introduced by the HFA. This system is currently being implemented. The new system, which is intended to replace waiting lists, covers outpatient assessments and all elective surgical and medical services. The purpose is to introduce explicit criteria to ensure that access to such services is available to those who need them most and when they need them most.

32. Under the new system, at the time of seeing a hospital specialist, a person is either booked for treatment or told their present condition does not meet the criteria for treatment in the public health system. Those whose need and capacity to benefit meet the criteria, as assessed by their specialist, will be booked. The HFA decides what level of resource is available for treatments after reviewing the overall requirements

of the health sector. The volume of services covered by the booking system is thus affected by other priorities within the public health system.

JURISDICTION

33. In the notice, the applicant states that the proposed acquisition will be implemented by a short form amalgamation in accordance with s 222 of the Companies Act. As a consequence, the applicant submits that no assets or shares will be acquired in the conventional sense. Rather, the amalgamating companies will merge into a successor company (WBHL), and the shares of EHL will be cancelled.

34. Section 47 of the Act applies to acquisitions of the assets of a business, or shares. Its ambit extends to all share and asset acquisitions.

35. Section 2 of the Act defines "acquire" to include:

> "... obtain by way of gift, purchase, or exchange; and also includes take on lease, hire or hire purchase."

36. Section 2 of the Act also defines assets to include "intangible assets", and the term share to include "the share capital of a company or other body corporate ..."

37. Staff consider that the term "acquire" is defined inclusively, and not exclusively. Staff also note that the ordinary meaning of "acquire" is to gain by or for oneself, or come into possession of, and that "acquisition" means the act of acquiring, or the thing acquired.

38. It is the view of staff that because implementation of the amalgamation between WBHL and EHL under the Companies Act would produce a successor company to the amalgamating companies' property and other assets and liabilities, that company acquires the assets of the amalgamating or amalgamated companies for the purpose of s 47 of the Act.

Conclusion on Jurisdiction

39. Given the ordinary meaning of the word "acquire", and the inclusive nature of the definition, it is concluded that the amalgamation of WBHL and EHL constitutes an acquisition in terms of s 47 of the Act, of shares or assets of a business.

THE RELEVANT MARKETS

Introduction

40. The purpose of defining markets is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition under consideration. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in terms of s 47(1) of the Act in any of those markets.

41. Section 3(1A) of the Act provides that:

> ... the term 'market' is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.

42. The Commission's *Business Acquisition Guidelines* outline the Commission's approach to market definition.[4] A brief discussion of this approach follows.

43. Markets are defined in relation to product type, geographical extent, and functional level. With the first two dimensions, market boundaries are determined by testing for substitutability in terms of the response to a change in relative prices of the good or service in question, and possible substitute goods or services. A properly defined market will include products which are regarded by buyers as being not too different ('product' dimension), and not too far away ('geographical' dimension), and are thus products to which they could switch if a *s*mall yet *s*ignificant and *n*on-transitory *i*ncrease in *p*rice *("ssnip")* of the product in question was to occur. It will also include those suppliers currently in production who are likely, in the event of such a *ssnip*, to shift promptly to offer a suitable alternative product, even though they do not do so currently.

44. In practice, the process of defining markets is unlikely to be as precise and as scientific as suggested by the *ssnip* test. However, in the Commission's view, the *ssnip* approach provides a useful framework for assessing the question of what other products, or products from other areas, are substitutable for the product in question as a matter of fact and commercial common sense.

45. Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products proceeds through a series of vertical functional levels, so the functional levels affected by the application have to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the "manufacturing market", while that between wholesalers and retailers is usually known as the "wholesaling market".

Market Definition and the Healthcare Sector

46. In the healthcare sector, there are difficulties in applying the *ssnip* test. This arises because of the characteristics of healthcare services, which include the following factors:

- healthcare services provide a complex and diverse array of services;
- there is often no 'price' for healthcare services apparent to the consumer, and therefore they cannot experience the likely impact of price variations on demand and service substitutability;
- consumers sometimes lack the necessary information on which to base their 'purchasing' decisions, and in some instances, they may not be in a position to make rational choices (eg major road accidents or mental health);

[4] Commerce Commission, *Business Acquisition Guidelines 1996,* pp 11-16.

- in some circumstances, consumers are unlikely to be in a position to reach an independent decision in respect of the cost of medical intervention, or on the likely quality, or effectiveness of any intervention. This in turn results in consumers delegating to GPs and other clinicians, their healthcare purchasing decisions, who then assume a major influence as gate-keepers on the supply- and demand sides;

- most healthcare services in New Zealand are subsidised, in whole, or in part, by the Government, or by private insurers. As a consequence, the consumer's demand for healthcare services is constrained by supply restrictions as well as what is described as moral hazard issues;[5]

- there are economies of scale associated with the provision of some aspects of healthcare services.

47. Taking into account the above factors, the interaction of the purchasing and provision patterns of healthcare services provides the most appropriate framework to analyse the relevant markets. Further there are strong complementarities between the provision of many healthcare services which means that there are economies of scale and scope in providing them through a single organisation such as a hospital. This also makes it difficult to define narrower markets for specific procedures. Hence it is considered appropriate to group a range of services within a broad market. It is likely that the competitive impact of the proposal would be similar in each of the numerous hypothetical "procedures" markets.

48. Staff consider that for the purpose of analysing the competition issues in this report, a useful starting point is the conventional separation of services into three broad groups, as follows:

- primary care services, which represent the first level of contact patients experience in the health system, and typically cover GP services, pharmaceuticals and laboratory services, dentistry and public health programmes;

- secondary care services, which are generally available on referral from a primary care provider, but include some self-referrals, and generally covers acute and elective hospital services; and

- tertiary care services, which refers to highly specialised surgical and medical services (eg cardio-thoracic surgery), and which are delivered at a hospital with the necessary specialist equipment and personnel to provide comprehensive services.

49. It must be noted, however, that there is no precise boundary between secondary and tertiary services (eg. cardiac services may move from secondary to tertiary as the clinical condition requires). Likewise, the division between secondary and primary

[5] Examples of moral hazard in the healthcare sector include where a patient may not take the necessary precautions to reduce healthcare requirements, or where a GP may overprescribe pharmaceuticals.

services is not exact (eg. some maternity services may move from primary to secondary services). Nevertheless, we consider that the three broadly defined categories of healthcare services provide a convenient framework within which to analyse the competition issues arising from the proposal. This is a dynamic area and factors such as technology and pharmaceutical developments may impact on these definitions.

Product and Function Markets Affected By The Proposal

50. WBHL and EHL both carry out a range of general secondary healthcare services. In addition, the parties to the acquisition are both involved to a varying extent in the provision of primary healthcare services. EHL has an involvement in the provision of community health services in the Bay of Plenty. Tertiary healthcare services are provided by Health Waikato. However, some associated care, such as follow up or clinic assessment, is provided at EHL's and WBHL's facilities.

51. Staff have also considered whether or not primary, secondary and tertiary healthcare services can be broken down into additional categories. This is discussed below.

Public/Private

52. In New Zealand, GPs and other primary care providers derive a proportion of their revenue from government subsidies, while publicly funded secondary and tertiary care providers generate nearly all their revenue from government sources. The major proportion of the secondary care undertaken by private hospitals is related to private insurance and ACC work, and is confined in most cases to elective procedures.

53. WBHL has stated that there are no restrictions on HHSs performing private healthcare work, while private hospitals can, and do, compete for some funding from ACC. However, as the HFA requires that publicly funded procedures receive first priority, and due to the capacity constraints faced by some HHSs, the provision of publicly funded secondary care services is the major activity of HHSs. Due to the evolving nature of health service funding and delivery there is the potential for blurring of the boundaries between public and private services and facilities.

54. It is proposed to consider the combined private and publicly funded secondary healthcare services market when examining the competition issues raised by this proposal.

Acute/Elective

55. It is possible to make a distinction between acute (ie urgent cases which require immediate treatment) and elective procedures (ie non-urgent conditions which do not require immediate attention). Although there are aspects common to the provision of both services (eg. clinical staff and facilities), there is a difference in the timeframes over which the services may be delivered. Acute services are required more urgently than elective services and there is little or no control over their volume. Both elective and acute services are undertaken at most HHSs, including EHL and WBHL.

56. When examining the competition issues raised by the proposal it is proposed to consider the markets for elective and acute services separately.

Services/Facilities

57. When examining the competitive impact of the proposed acquisition, it might be possible to distinguish between the provision of healthcare services, and the provision of facilities at which those services can be carried out. This was an important distinction in the Health Waikato Determination 1995.[6]

58. For example, HHSs enter into contracts with the HFA and/or ACC to provide specific services, and then carry out these services at their own facilities. However, it is possible for other secondary or primary care providers, to contract for the provision of services, and then to sub-contract with a third party for the use of its facilities. Indeed, Good Health Wanganui Ltd (GHWL) has contracted with the HFA to provide ophthalmology services in Tauranga, and has sub-contracted the work to Park Street Eye Clinic, which is owned and operated by private specialists in Tauranga.

59. In this report staff have considered the services and facilities market together.

Conclusion on Product/Functional Markets

60. Having regard to the factors outlined above, and for the purposes of analysing the competition issues in this report, it is proposed to define the relevant product and function markets as:

- the provision of primary healthcare services and/or facilities;
- the provision of acute secondary care services and/or facilities;
- the provision of elective secondary care services and/or facilities; and
- the provision of tertiary healthcare services and/or facilities.

Geographic Markets Affected by the Proposal

61. The geographic dimensions of the healthcare services and facilities markets identified above are, to a large extent, determined by the following factors:

- the costs incurred by patients for transport, and the convenience of travelling to a local facility to receive treatment. The costs may cover travelling costs and the costs in terms of time off work, and also the costs incurred by the families and relatives of patients in visiting patients;

- the availability of the necessary services, facilities and specialists. For example, for general surgical and medical procedures, a patient may be able to have the procedure undertaken at the nearest hospital. For some complex procedures, the patient may be required to travel to a hospital outside his or her immediate locality. For instance, a patient in Whakatane must travel to Tauranga hospital, or elsewhere, for a cataract operation, as such services are not available at the local hospital;

- as noted above, the patient's GP has a major influence in determining what specialist and facility the patient is referred to, and this extends to the

[6] Commerce Commission *Decision 275 Health Waikato/Midland Health*, 1995.

geographic locality in which the treatment is carried out. In most instances, a GP or specialist is likely to refer the patient to the nearest hospital, but in some instances, a GP might refer a patient to a facility outside the immediate locality (eg GPs refer patients to Tauranga for some private insurance funded work as the surgeon uses the Southern Cross facility there). However, the HFA does produce documents which *inter alia* set out the criteria limiting the extent to which a GP can refer a patient outside of the local region;

- the HFA exercises a major role in influencing the geographic location and facility in which a patient will receive treatment. This is a consequence of the HFA's responsibility for purchasing the specific healthcare requirement's for the population of a specific region, and contracting with the HHSs and/or other parties to fulfil those requirements;

- the extent to which a patient may travel may also be influenced by other factors including historical, ethnic and cultural factors. For example, because of the tribal affiliations of Maori in the Murupara district of the south-eastern Bay of Plenty, and also because of its close proximity to Rotorua, the local Maori population is generally referred to Lakeland Health for the provision of secondary healthcare services; and

- whether the services provided are elective or acute.

62. Having regard to the above factors, staff conclude that for primary and acute secondary healthcare services, the geographic scope of the market is limited to a relatively confined area which is generally based on the catchment area of the respective parties, that is the western and eastern Bay of Plenty regions. The geographic market for elective secondary healthcare services is considered to be a wider Bay of Plenty one.

63. Tertiary level services cover a much wider geographic area. For the purposes of the analysis of the proposal the relevant geographic market has been defined as a North Island market.

Conclusion on Geographic Markets

64. For the purposes of assessing the competitive impact of the acquisition, the relevant geographic markets in relation to primary and acute secondary healthcare services have been defined separately as those for the eastern and western Bay of Plenty regions. The relevant geographic market for elective secondary services is Bay of Plenty wide, while the tertiary healthcare services market is to be treated as a North Island one.

Conclusion on Market Definition

65. For the purpose of examining the competition implications of this proposal, staff intend to define the relevant markets as those for:

- the provision of primary healthcare services and/or facilities separately in the eastern and western Bay of Plenty regions;

- the provision of acute secondary healthcare services and/or facilities separately in the eastern and western Bay of Plenty regions;

- the provision of elective secondary healthcare services and/or facilities in the Bay of Plenty region; and

- the provision of tertiary healthcare services and/or facilitiesin the North Island.

ASSESSMENT OF DOMINANCE

66. Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to give clearance for a proposed acquisition if it is satisfied that the proposed acquisition would not result, and would not be likely to result, in a person acquiring or strengthening a dominant position in a market. If the Commission is not so satisfied, clearance must be declined.

67. Section 3(9) of the Act states that a person is in a "dominant position" if:

> ... a person as a supplier or an acquirer of goods or services either alone or together with an interconnected or associated person is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market ...

68. That section also states that a determination of dominance shall have regard to:

- market share, technical knowledge and access to materials or capital;
- the constraint exercised by competitors or potential competitors; and
- the constraint exercised by suppliers or acquirers.

69. In reaching a conclusion on whether a person is in a position to exercise a dominant influence in a market, the Commission considers the foregoing non-exhaustive factors and any other relevant matters that may be found in a particular case. Important factors to consider in this case are the constraint exercised by existing competitors and the constraint exercised by customers.

70. In *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554, the Court of Appeal approved the following dominance standard, adopted by McGechan J in the High Court:

> ... dominance involves more than "high" market power; more than mere ability to behave "largely" independently of competitors; and more than power to effect "appreciable" changes in terms of trading. It involves a high degree of market *control*.

Application of the Commerce Act to the Health Sector

71. The health reforms of 1993 were intended to create a quasi-competitive environment for healthcare services, where previously the markets were not competitive.

Subsequently, however, the Government has made policy changes which have altered the focus of publicly funded healthcare services towards a collaborative and co-operative approach rather than a competitive one. As noted in para 23, hospitals are not required to earn a profit. In addition, the HFA is required to purchase healthcare services to meet the health needs and to improve the health status of the population.

72. Current policies toward the provision of healthcare have to be incorporated into the dominance assessment for each relevant market. Having regard to the above factors, a dominance assessment for each market follows.

The Markets for the Provision of Primary Healthcare Services and/or Facilities in the Western and Eastern Bay of Plenty Regions

73. The proposed acquisition would result in only a limited degree of aggregation in the markets for the provision of primary healthcare services and/or facilities in the eastern and western Bay of Plenty regions respectively. EHL provides a range of primary healthcare services and WBHL provides some primary health services.

74. However, these markets would remain highly competitive post-acquisition with numerous GPs, and other primary care providers, operating in each of the affected geographic markets. Further, there do not appear to be any significant barriers to prevent new entrants from providing primary healthcare services, or limiting existing participants from expanding in the relevant markets. These constraints are unlikely to change to any significant extent as a result of the implementation of the proposed acquisition.

75. It is concluded, therefore, that the proposed acquisition would not result in any person acquiring or strengthening a dominant position in the markets for the provision of primary healthcare services and/or facilities in either the eastern or western Bay of Plenty regions.

The Markets for the Provision of Acute Secondary Healthcare Services and/or Facilities in the Western and Eastern Bay of Plenty Regions

76. The parties to the proposal are the sole providers of acute secondary healthcare services under contract to the HFA in their respective geographic markets. They are required to provide these services on a 24-hour basis for the population in their local catchment areas. In those circumstances, where the patient cannot be treated at a local hospital, that patient is required to be transferred to another secondary or tertiary facility.

77. Because of the high capital cost of acute facilities, the requirement to have access to staff with a range of clinical and technical expertise, and the costs associated with maintaining a 24 hour service, staff consider that it is highly unlikely that any new entrant would commence providing acute services, particularly in smaller population centres such as the eastern and western Bay of Plenty.

78. Irrespective of the high barriers to entry, staff consider that the proposed acquisition is unlikely to have any material impact on the market post-acquisition. The HFA currently purchases all of the requirements for acute healthcare from the HHSs,

including the parties to the acquisition. This situation is unlikely to change as a result of the acquisition.

79. A Ministerial directive prevents ACC from purchasing acute care services. It does however receive bulk funding from the Crown for acute services which it then disburses to the HFA. The acquisition would result in no material change to this situation.

80. Having regard to these factors, staff consider that, because of the constraint provided by the HFA, neither WBHL nor EHL is dominant in its relevant markets.

The Markets for the Provision of Elective Secondary Healthcare Services and/or Facilities in the Bay of Plenty

81. In assessing whether the proposal would result in any person acquiring or strengthening a dominant position in these markets, the following factors have been analysed.

- the constraint provided by existing market participants;
- the constraint provided by market entrants; and
- the constraint from purchasers of elective secondary healthcare services.

Constraint by Existing Market Participants

82. EHL and WBHL are the principal providers of elective secondary healthcare services in the Bay of Plenty region.

83. Estimated market shares for elective secondary healthcare services by revenue are provided in Appendix Three. The combined entity would account for approximately 62% of total revenue for elective secondary services in the Bay of Plenty. However, staff consider that this is largely due to the historical purchasing policies of the HFA (eg site-specific contracts) as previously described rather than any competition factors.

84. While the acquisition would result in what may appear to be a high market share, this tends to exaggerate the actual level of current competition between EHL and WBHL. For example, the HFA has previously, and will continue to require, provision of services at EHL's and WBHL's facilities (see paras 97-101 for further details on the countervailing power of the HFA). In light of these factors, staff conclude that market circumstances are unlikely to change as a result of the acquisition.

85. Other secondary healthcare service providers would continue to supply services for residents in the affected geographic market. Lakeland Health would continue to provide a range of elective services, including for some residents in the southern Bay of Plenty, while various private providers located at Rotorua and Tauranga are also likely to provide an alternative for some patients requiring elective services.

86. Staff consider that implementation of the proposed acquisition would not alter to any significant extent the level of constraint provided by any of these providers. Further, it is considered that GPs, and other primary referrers, would continue to influence the referral patterns for patients in the affected geographic market post-acquisition.

Constraint Provided by Market Entrants

87. In considering the extent to which potential providers of elective healthcare services are likely to constrain the enlarged EHL/WBHL, staff have considered the following barriers to entry and expansion as being potentially important:

Economies of Scope and Scale

88. Given the significant degree of complementarity in delivering the range of services provided by WBHL and EHL, there are significant economy of scope advantages to providing these in an integrated facility rather than separately. This leads to the more efficient deployment of expensive equipment as well as technical and staff expertise.

89. Further, economies of scale may exist for the provision of elective secondary healthcare services.

Capital Expenditure

90. There are high capital costs associated with the establishment of hospital facilities on a medium or large scale, and to the appropriate quality standards. However, the costs would be substantially lower if the facilities were leased or hired. If, for example, a contract for ACC elective services were awarded then it would be possible to sub-contract the necessary facilities to carry out the work.

Sunk Costs

91. There are likely to be high sunk costs involved in hospitals due to the highly specialised nature of the facilities.

Technical Expertise and Staffing

92. Access to, and retention of appropriate specialist clinical and technical staff is critical to the establishment of any new services.

Conclusion on Constraint Provided by Market Entrants

93. In view of the factors outlined above, staff consider that entry and expansion in relation to the provision of elective secondary healthcare services on a large scale would be unlikely. However, it is possible that entry may occur on a lesser scale (eg an ACC elective contract for orthopaedic surgery).

94. It is the view of staff that the acquisition is unlikely to have any material impact in terms of deterring new entry, or market expansion. The factors relating to entry and expansion would remain unchanged, irrespective of the scale of entry or expansion.

95. Further, there may be some scope for secondary providers from outside of the Bay of Plenty region to provide elective secondary healthcare services, and this option is likely to remain post-acquisition. Already, GHWL has been successful in capturing a HFA contract to provide ophthalmology services at Tauranga (see para 58 for further details). In the view of staff, the scope to undertake such contracts is unlikely to be diminished as a result of the acquisition.

Countervailing Power by Purchasers

96. Staff consider that the critical issue to determine when analysing the competition implications of the proposal is the role of the purchasers of healthcare services, particularly the HFA and ACC. This is discussed in more detail below.

Constraint Provided by the HFA

97. Currently, the HFA has a major influence on the behaviour of the parties (as indeed it has on all other HHSs) through its role as the monopsony purchaser of publicly funded elective secondary healthcare services.

98. The HFA is responsible, in collaboration with a range of other parties, for determining the health needs of the population of the Bay of Plenty, and then managing the allocation of Government funds to deliver the necessary services. Having established the services which it is prepared to fund, the HFA contracts with WBHL and EHL to provide secondary healthcare services for the Bay of Plenty region. These are conducted in terms of a national pricing framework, and requirements specifying the location and the volume of the relevant services. In these contracts, there is limited scope for either EHL or WBHL to exercise any discretionary power in terms of pricing, output, and even the location from which elective secondary healthcare services are to be provided.

99. Staff, consider therefore, that the amalgamating parties have limited market power to affect the delivery of elective secondary healthcare services in the Bay of Plenty, and are effectively constrained from exercising any market power in their own right. Staff believe that the acquisition is unlikely to alter the current situation.

100. In regard to the issue of countervailing power, staff note that the acquisition would result in the combined entity increasing its revenue from around $70 million to about $110 million, but it would remain very small in relation to the Midland region of the HFA, accounting for just over 12% of that region's funding.

101. Staff conclude that the HFA currently exercises a very strong countervailing power on the amalgamating companies, and that this power is unlikely to diminish to any significant extent, if the proposed acquisition proceeds.

Constraint provided by the ACC

102. Since 1 July 1997, ACC has been contracting for the purchase of elective secondary healthcare services directly from providers, including HHSs and private parties. In the last financial year, ACC let contracts to a value of $87 million for elective secondary care services, with private parties accounting for $67 million. Under the

new purchasing framework, ACC has entered into over 60 contracts with hospitals, private clinics and specialists for various elective services.

103. The tendering process for ACC elective services is highly competitive and attracts strong bidding from a range of parties. Although the proposed acquisition would lead to some reduction in the existing number of bidders for ACC contracts, staff consider that vigorous competition for such work in the Bay of Plenty would continue, if the acquisition proceeds. Further, once prospective entrants into ACC elective services have proven that they have the necessary competence, they face limited obstacles to carrying out such work. Indeed, there are many examples of private clinicians grouping together to bid for ACC elective service contracts, and then carrying out the contracts from leased facilities.

105. For these reasons, staff conclude that ACC exercises a strong constraint over the parties to the acquisition in respect of its elective secondary healthcare services, and that the acquisition is unlikely to change the market situation.

Conclusion on Dominance in the Markets for the Provision of Elective Secondary Healthcare Services and/or Facilities in the Bay of Plenty

106. Given the countervailing power of the HFA and ACC, and that there is unlikely to be any significant change in the level of actual or potential constraint provided by existing or future participants, it is concluded that the proposal would not result in any person acquiring or strengthening a dominant position in these markets.

The Markets for the Provision of Tertiary Healthcare Services and/or Facilities in the North Island

107. The acquisition, if implemented, would result in only negligible aggregation of market share in relation to the provision of tertiary healthcare services and/or facilities. The parties to the acquisition are involved in this market only to the extent that they provide support services for some tertiary healthcare through visiting specialists.

108. Most residents in the Bay of Plenty who require tertiary healthcare services usually travel to Health Waikato's hospital facility at Hamilton, or to one of the other tertiary care providers. Staff consider that the proposed acquisition would not affect the ability of the population from obtaining access to tertiary care services and/or facilities.

109. It is concluded, therefore, that the proposed acquisition would not result in any person acquiring or strengthening a dominant position in the market for the provision of tertiary healthcare services and/or facilities in the North Island.

OVERALL CONCLUSION

110. Staff conclude that implementation of the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in the markets for:

- the provision of primary healthcare services and/or facilities in the eastern and western Bay of Plenty regions;

- the provision of acute secondary healthcare services and/or facilities in the eastern and western Bay of Plenty regions;

- the provision of elective secondary healthcare services and/or facilities in the Bay of Plenty region; and

- the provision of tertiary healthcare services and/or facilities in the North Island.

RECOMMENDATION

111. It is recommended that, in terms of s 66(3)(a) of the Act, the Commission give clearance for the proposed acquisition.

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Geoff Thorn
Manager
Commerce Act Division

DETERMINATION ON NOTICE OF CLEARANCE

EASTBAY HEALTH LIMITED / WESTERN BAY HEALTH LIMITED

We agree/disagree with the recommendation.

We are satisfied/not satisfied that implementation of the proposal would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

Accordingly, pursuant to s 66 (3) (a) of the Commerce Act 1986, we hereby give clearance for Western Bay Health Ltd to amalgamate with Eastbay Health Limited.

Dated this day of November 1998

P C Allport	E C A Harrison	P Rebstock
Chairman	Member	Member

APPENDIX ONE

HEALTHCARE SERVICES PROVIDED BY WBHL AND EHL

1 WBHL

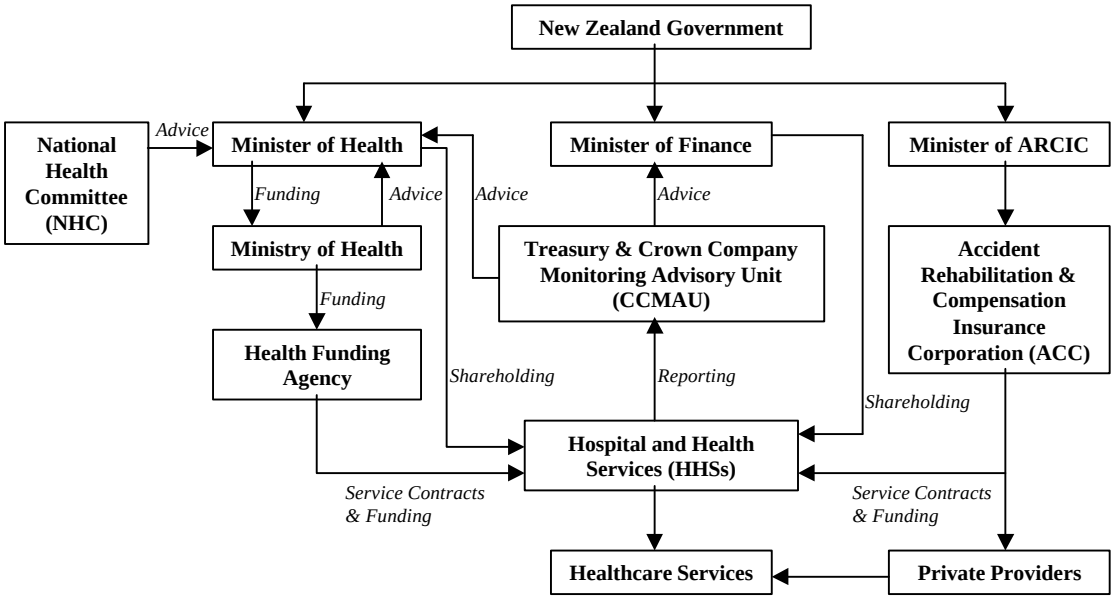
- Medical and surgical services, including acute and elective general, orthopaedic, and ENT services;
- Paediatric services;
- Mental health services;
- Maternity services;
- Community services, including Well Child services, health promotion services, and a school dental service;
- Maori secondary health services; and
- clinical support services (including radiology, laboratory and pharmacy services).

2 EHL

- Medical and surgical services, including acute and elective general, orthopaedic, and ENT services;
- Paediatric services;
- Mental health services;
- Maternity services;
- Community services, including district nursing services, rehabilitative services, dental services, health promotion services, and Well Child services;
- Maori health services; and
- clinical support services (including radiology, laboratory and pharmacy services).

APPENDIX TWO

STRUCTURE OF NEW ZEALAND HEALTH SECTOR



APPENDIX THREE

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