

Determination

Connor Healthcare Limited and Acurity Health Group Limited [2014] NZCC 39

The Commission:	Dr Mark Berry Sue Begg Anna Rawlings
Summary of application:	Connor Healthcare Limited seeks clearance to acquire all the shares in Acurity Health Group Limited that it does not already own.
Determination:	Under s 66(3)(b) of the Commerce Act 1986, the Commerce Commission declines to give clearance to the proposed acquisition.
Date of determination:	11 December 2014

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Executive summary

- X1. The applicant, Connor Healthcare Limited (Connor) seeks clearance to acquire all of the shares in Acurity Health Group Limited (Acurity) that it does not already own. Acurity owns Bowen and Wakefield hospitals in Wellington. Connor is wholly owned by Evolution Healthcare (NZ) Pty Ltd (Evolution). Evolution owns Boulcott Hospital in the Hutt Valley. The outcome of the acquisition will be that Acurity will be wholly owned by Connor. Evolution will have a 25% interest in Connor (with Austron Limited holding the remaining 75% interest in Connor) as well as ownership of Boulcott Hospital.
- X2. By virtue of that shareholding and other factors, including Evolution's acknowledgment that it intends to have a substantial degree of influence over the activities of the applicant, the outcome is effectively a merger of two of the three private hospital groups in the Wellington region. This would leave Southern Cross Hospital as the only other private hospital provider in Wellington, with its hospital also based in Wellington City.
- X3. We have defined the relevant markets as the markets for the provision of elective secondary surgical procedures for:
- X3.1 patients funded by the Accident Compensation Corporation (ACC) wider than the Wellington region;
 - X3.2 patients funded by a District Health Board (DHB) in the Wellington region;
 - X3.3 patients funded by health insurance companies in the Wellington region; and
 - X3.4 self-funded patients in the Wellington region.
- X4. There are many secondary elective procedures that both Boulcott Hospital and Bowen/Wakefield hospitals provide. The evidence we have collected indicates they compete with and constrain each other in these procedures. There is no overlap between the merging parties in elective tertiary surgery.
- X5. For many procedures in orthopaedics, otolaryngology, general surgery, oral and maxillofacial surgery, and plastic surgery specialties, Boulcott and Bowen/Wakefield are the only providers. Southern Cross Hospital either does not provide these procedures or does so only on a limited basis and is restricted in its ability to expand. Absent entry or expansion, clearance would allow the creation of a monopoly in respect of these procedures in the Wellington region.
- X6. For the remaining procedures in those specialities and in urology, ophthalmology, and gynaecology, while clearance would result in the removal of the existing competition between Boulcott and Bowen/Wakefield hospitals, Southern Cross Hospital would remain as an option. Absent entry or expansion, clearance would reduce the number of hospital providers in the Wellington region from three to two.
- X7. The evidence we have collected indicates that certain key customers – the ACC and the DHBs – have other options open to them in addition to these hospitals. The ACC

would use private hospitals outside the Wellington region for its private elective surgery needs. DHBs use private hospitals as an overflow to manage peaks in their ability to provide elective surgery. Faced with a price increase, they have the option of increasing their own provision of the work by hiring locums, or transferring patients to another public hospital in the region to manage the workload.

- X8. Since these customers have these additional options, the loss of competition between Boulcott Hospital and Bowen/Wakefield hospitals is unlikely to adversely affect the ACC or the DHBs.
- X9. We are not satisfied the same is true for Boulcott Hospital and Bowen/Wakefield hospitals' remaining customers: self-funded patients and the private health insurance companies who fund many patients' treatment. The evidence we have collected indicates that the loss of Boulcott Hospital is significant and that private hospitals outside the Wellington region are not viable substitutes for these customers (as they are for the ACC).
- X10. Nor do we consider that these customers have the same options open to them in terms of transferring patients to another public hospital as the DHBs do. While we consider that the public hospitals impose some constraint on private hospitals for these customers, this is best described as providing a ceiling constraint. The public hospitals provide a limit or ceiling on what private hospitals can charge, which is mainly a function of eligibility criteria and waiting times. The mere fact that public hospitals provide elective surgery is not in itself sufficient to prevent a substantial lessening of competition.
- X11. We are not satisfied that expansion by Southern Cross Hospital or entry by a new provider would constrain the merged entity. We are not satisfied that expansion or entry is likely primarily due to our concern about Southern Cross Hospital's (or another entrant's) ability to attract the surgeons they need to expand to provide additional procedures or more of the procedures they already provide. We consider that Southern Cross Hospital faces physical capacity constraints, including sufficient car-parking and consulting rooms to underpin expansion.
- X12. Nor is there any evidence to suggest that insurance companies would be able to exercise sufficient countervailing power to offset any exercise of market power by the merged firm; to the contrary, we consider that the insurance companies' bargaining power would be reduced as a result of the lessening in competition. We have seen no evidence where insurance companies have leveraged negotiations across procedures. We do not consider that Southern Cross Insurance would be able to direct insurance consumers to Southern Cross Hospital.
- X13. For these reasons we are not satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
- X14. We therefore decline to give clearance.

The proposed acquisition

1. On 27 August 2014, the Commission received an application from Connor Healthcare Limited (Connor), seeking clearance to acquire all of the shares in Acurity Health Group Limited (Acurity) that it does not already own.
2. As Acurity is publicly listed on the New Zealand Stock Exchange, Connor is seeking to acquire the shares through a takeover offer regulated by the Takeovers Code. The takeover offer is conditional, amongst other things, on clearance from the Commission.
3. From a competition standpoint the acquisition would result in an increase in aggregation between two of the three private hospital operators in the Wellington region.
 - 3.1 Acurity owns and operates Wakefield and Bowen hospitals in Wellington City.
 - 3.2 Connor already owns 11.7% of Acurity, and is itself owned by Evolution Healthcare (NZ) Pty Ltd (Evolution). Evolution owns and operates the Boulcott Hospital in Lower Hutt, meaning that Evolution is both the 100% owner of Boulcott Hospital and has an 11.7% interest in Wakefield and Bowen hospitals through Connor and Acurity.
 - 3.3 On completion of the takeover, Evolution's interest in Wakefield and Bowen hospitals will increase from 11.7% to 25% (Acurity will continue to own Bowen and Wakefield hospitals, Connor will wholly own Acurity and Evolution will hold a 25% interest in Connor). Evolution will also obtain other rights, including veto rights and the right to appoint directors on the Connor Board, and will retain 100% ownership of Boulcott Hospital. Acurity will have no interest in Boulcott Hospital.
 - 3.4 The third private hospital owner in Wellington is Southern Cross Hospitals Limited (Southern Cross Hospitals). Southern Cross Hospital Wellington (Southern Cross Hospital) is not involved in the transaction.

The decision – clearance declined

4. We decline to give clearance to the proposed merger. We are not satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the markets for the provision of elective secondary surgical procedures for:
 - 4.1 patients funded by health insurance companies in the Wellington region; and
 - 4.2 self-funded patients in the Wellington region.

Our framework

5. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.¹

The substantial lessening of competition test

6. As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.
7. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).²
8. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price above the price that would exist in a competitive market (the 'competitive price'),³ or reduce non-price factors such as quality or service below competitive levels.
9. Determining the scope of the relevant market or markets can be an important tool in determining whether a substantial lessening of competition is likely.
10. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.⁴

When a lessening of competition is substantial

11. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.⁵ Some courts have used the word 'material' to describe a lessening of competition that is substantial.⁶
12. There is no bright line that separates a lessening of competition that is substantial from one that is not. What is substantial is a matter of judgement and depends on the facts of each case. Ultimately, we assess whether competition will be substantially lessened by asking whether consumers in the relevant market(s) are likely to be adversely affected in a material way.

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013.

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

³ Or below competitive levels in a merger between buyers.

⁴ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

⁵ *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

⁶ *Ibid* at [129].

When a substantial lessening of competition is likely

13. A substantial lessening of competition is ‘likely’ if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility, but does not mean that the effect needs to be more likely than not to occur.⁷

The clearance test

14. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.⁸ If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.⁹
15. The burden of proof lies with Connor as the applicant to satisfy us on the balance of probabilities that the acquisition is not likely to have the effect of substantially lessening competition.¹⁰ The decision to grant or refuse a clearance is necessarily to be made on the basis of all the evidence.¹¹ Where we have conflicting evidence from different market participants before us, we must determine what weight to give to the evidence of each party.¹²

Key parties

Connor

16. Connor is owned by Evolution which is 100% owned by Evolution Healthcare Partners Pty Ltd as trustee for the EHPO Trust. Evolution owns and operates four private hospitals in Australia as well as Boulcott Hospital in Lower Hutt.
17. Connor has an 11.7% shareholding in Acurity.

Acurity

18. Acurity is listed on the New Zealand Stock Exchange. Currently, Austron Limited (Austron) is the largest shareholder in Acurity. Austron is owned by Royston Hospital Trust Board and Medusa Limited.
19. Acurity owns and operates Wakefield Hospital and Bowen Hospital in Wellington and Royston Hospital in Hastings. Acurity is also an investor in part-owned private hospitals in Tauranga and Auckland.¹³

⁷ *Woolworths & Ors v Commerce Commission* (HC) above n 5 at [111].

⁸ Commerce Act 1986, s 66(3)(a) of the Commerce Act 1986.

⁹ In *Commerce Commission v Woolworths Limited* (CA), above n 2 at [98], the Court held that “the existence of a ‘doubt’ corresponds to a failure to exclude a real chance of a substantial lessening of competition”.

¹⁰ *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA) at [7] and *Commerce Commission v Woolworths Ltd* (CA) above n 2 at [97].

¹¹ *Commerce Commission v Woolworths Ltd* (CA) above n 2 at [101].

¹² *Brambles New Zealand Ltd v Commerce Commission* above n 4 at [64].

¹³ Acurity has a 60% shareholding in Grace Hospital (Tauranga), 40% shareholding in Endoscopy Auckland (Auckland) and a 40% shareholding in Laparoscopy Auckland (Auckland).

Southern Cross Hospitals

20. Southern Cross Hospitals is a subsidiary of Southern Cross Health Trust and is part of the Southern Cross Healthcare Group. Southern Cross Health Trust is a not-for-profit charitable trust established for the purposes of providing privately-funded hospital care to the general public.
21. Southern Cross Hospitals owns and operates nine private hospitals throughout New Zealand,¹⁴ and has partnerships in another nine.¹⁵
22. Relevant to this case is Southern Cross Hospital in Wellington, which was established as a private surgical hospital in 1992.

Customers of private hospital services

23. While patients are the beneficiaries of any surgery that is performed, there are a range of parties that fund the services that make up a surgical procedure.

Accident Compensation Corporation

24. The Accident Compensation Corporation (ACC) is the Crown agency responsible for the administration of the statutory insurance scheme for accident-related injuries and disabilities. The ACC purchases, funds and manages healthcare contracts for injured claimants.

District Health Boards

25. District Health Boards (DHBs) are responsible for providing or funding the provision of public health services in their district. Each DHB is responsible for improving, promoting and protecting the health of the populations they serve. DHBs own and fund public hospitals. The DHBs may also contract for and fund elective surgery to be provided in private hospitals.
26. The Wellington region is serviced by two DHBs:
 - 26.1 Capital & Coast DHB which operates the Wellington and Kenepuru public hospitals; and
 - 26.2 Hutt Valley DHB which operates the Hutt Hospital.

Private health insurance providers

27. There are a range of private health insurance providers in New Zealand who compete to provide insurance cover to consumers.
28. We obtained evidence from the three largest health insurers in New Zealand, Southern Cross Medical Care Society, nib NZ Limited and Sovereign Health Limited, as together these three parties account for approximately 83% of the private health

¹⁴ Auckland Surgical Centre, Brightside, Christchurch, Hamilton, Invercargill, New Plymouth, North Harbour, Rotorua, and Wellington.

¹⁵ Auckland Radiation Oncology, Crest Hospital, Gillies Hospital, Grace Hospital, Manuka Street Hospital, Mercy Angiography, Ormiston Hospital, Southern Endoscopy Centre, Waitemata Endoscopy.

insurance market. Other providers include: Accuro Health Insurance, AIA Group Limited, OnePath Limited, Partners Life Limited and Union Medical Benefits Society Limited (UniMed).

Southern Cross Medical Care Society

29. Southern Cross Medical Care Society (Southern Cross Insurance) is New Zealand's largest health insurer. It provides cover for about 815,000 New Zealanders,¹⁶ (a market share of approximately 61%), and pays 72% of the country's health insurance claims.¹⁷
30. Approximately []% of Southern Cross Insurance's members are on extensive cover plans under which they do not self-fund any surgery costs. The remaining []% of Southern Cross Insurance's members are on policies which involve making a co-payment.^{18 19}
31. Southern Cross Insurance is a not-for-profit friendly society and is part of the Southern Cross Healthcare Group.
32. Southern Cross Insurance and Southern Cross Hospitals are related parties.²⁰ However, Southern Cross Insurance and Southern Cross Hospitals, respectively, described their relationship as "unlinked",²¹ with no vertical integration or exclusivity.²²

nib NZ Limited

33. nib NZ Limited (nib) is the second largest health insurer in New Zealand with a market share of approximate 13-14% and a total benefit outlay of \$[] a year.²³ nib launched in New Zealand in October 2013.
34. nib also operates in Australia, where it is the fourth largest health insurance provider.²⁴

Sovereign Health Limited

35. Sovereign Health Limited (Sovereign) is New Zealand's third largest health insurer with an approximate 8% market share.²⁵

¹⁶ Commerce Commission interview with Southern Cross Insurance (24 September 2014).

¹⁷ Southern Cross Medical Care Society 2014 Annual Report.

¹⁸ Letter from Southern Cross Insurance to the Commerce Commission (10 October 2014).

¹⁹ Some elective procedures are not covered by insurance policies, while some consumers may have the full cost of the procedure covered under their policy, or if the consumer is on a shared cover plan, they may need to make a co-payment to the insurance company (this is a certain percentage of the total cost of the procedure).

²⁰ This is because the Directors of Southern Cross Insurance are trustees of Southern Cross Health Trust, Southern Cross Hospitals' parent company. Southern Cross Insurance's 2014 Annual Report at 37 states that Southern Cross Insurance and the Southern Health Trust "...are separate legal entities operating at 'arm's length'."

²¹ Commerce Commission interview with Southern Cross Insurance (24 September 2014).

²² Commerce Commission interview with Southern Cross Hospital (23 September 2014).

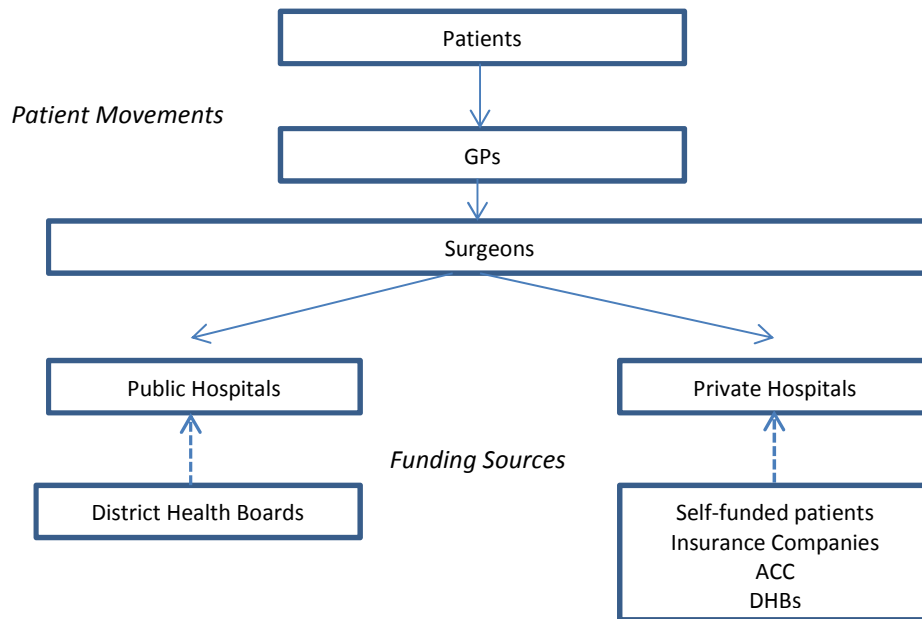
²³ Commerce Commission interview with nib (9 October 2014).

²⁴ Ibid.

Industry background

36. Healthcare is provided by a range of medical practitioners and facilities. The main industry participants in the healthcare sector that are relevant to this merger are shown in Figure 1 below.

Figure 1: Main industry participants in the New Zealand healthcare sector



How surgery is recommended

37. As set out in previous Commission decisions,²⁶ the healthcare industry is characterised by a relatively complex set of relationships which create a series of pathways for a patient to obtain surgery.
38. The starting point is that a patient will (in the majority of cases) consult his or her GP.²⁷ If required, the GP will then refer the patient to a surgeon²⁸ for a further consultation. A patient will generally follow the advice of his or her GP as to which surgeon to visit.²⁹
39. The patient discusses surgical options with their surgeon, whether the patient meets the public hospital eligibility criteria and, if so, the length of the waiting list for that

²⁵ Commerce Commission interview with Sovereign (13 October 2014).

²⁶ For example, see Southern Cross Hospitals Limited and Aorangi Hospital Limited (Commerce Commission Decision 729, 28 July 2011).

²⁷ Evolution Healthcare 6 month Strategic update, December 11-12 2013, 'Referral Comparison'.

²⁸ In this document 'surgeon' refers to medical specialists including surgeons, internal medicine specialists and diagnostic specialists such as radiologists.

²⁹ Commerce Commission interview with nib (9 October 2014).

procedure.³⁰ If the patient does not meet the public hospital eligibility criteria, the patient decides the waiting time for a public procedure is too long, or the patient has health insurance which covers the procedure being performed privately, then the patient may choose to have surgery performed at a private hospital.

Facilities provided by a private hospital

40. Private hospitals have traditionally provided facilities for elective surgery. Elective surgery is defined as non-urgent procedures, including related diagnostic services, where the condition is not life threatening and does not require immediate surgery.³¹
41. Those facilities include operating theatres, patient beds and medical equipment, as well as the related services such as administrative and nursing staff.³²
42. A distinction is made between secondary and tertiary elective surgery. Secondary surgery refers to relatively straightforward procedures (eg, cataract surgery), while tertiary surgery refers to more specialised and complex procedures (eg, neurosurgery and cardiac surgery), which require more specialised equipment and facilities. This decision relates only to secondary elective surgery, as there is no overlap in elective tertiary surgery.

Where surgery is performed

43. The decision as to which private hospital or other facility will be used to perform a procedure is heavily influenced by where the relevant surgeon operates. Typically patients will follow their surgeon's recommendation about where the surgery is to be performed.³³
44. If a surgeon only operates at one private hospital, a patient would not have a choice of private hospital unless the patient is willing to switch surgeons. However, some surgeons operate at more than one private hospital in Wellington.³⁴ [] advised that surgeons who operate at multiple private hospitals give patients an option of available time slots at all hospitals and the patient will choose where the procedure will take place.³⁵ Self-funded patients may also choose between the

³⁰ As discussed below, we consider public hospitals are in a separate market to private hospitals for secondary elective surgery. However, we acknowledge that public hospitals provide some level of constraint.

³¹ See Southern Cross Hospitals Limited and Aorangi Hospital Limited (Commerce Commission Decision 729, 28 July 2011) as cited in the Application at [34].

³² See Part 2 of the Application.

³³ Commerce Commission interview with Southern Cross Hospital (23 September 2014).

³⁴ We do not have sufficient data to make the relevant calculations. However, based on information provided to us by Evolution, 70% of Boulcott Hospital's surgeons work exclusively at Boulcott Hospital (Meeting with Evolution (2 October 2014)). Acuity has also provided us with the names of a number of surgeons working at Wakefield and Bowen hospitals who operate at multiple sites. Acuity's response to the Commission's letter of unresolved issues (28 November 2014).

³⁵ Commerce Commission interview with [] (31 October 2014).

hospitals offered by their surgeon on the basis of price³⁶ (discussed further at paragraph 143).

Surgeons' choice of hospital

45. In previous decisions, the Commission found that factors influencing surgeons' choice of hospital included:³⁷
 - 45.1 whether or not they have a shareholding in a facility;
 - 45.2 the ability for a surgeon to schedule surgery at a time convenient to the surgeon; and
 - 45.3 the particular private hospital's charges to patients for the provision of the necessary facilities (ie, are charges so high as to reduce the likelihood of a patient wanting a procedure performed).

46. The evidence shows that surgeons take into account a range of other factors when deciding whether to work at a hospital, including:
 - 46.1 the convenience of the hospital location to either the public hospital at which they work,³⁸ or to their consulting rooms/home;^{39 40}
 - 46.2 access to consulting rooms on the hospital campus;⁴¹
 - 46.3 the capacity of the hospital (efficiency and quality of equipment);^{42 43}
 - 46.4 whether the hospital has ACC and DHB contracts, as these contracts underpin a certain volume of work for some procedures;⁴⁴
 - 46.5 the trust they have in the teams they work with and have practised routines with;⁴⁵
 - 46.6 whether the hospital has contracted with Southern Cross Insurance for a certain procedure;⁴⁶ and

³⁶ Commerce Commission interview with [] (14 October 2014).

³⁷ The Southern Cross Health Trust and Aorangi Hospital Limited (Commerce Commission Decision 650, 4 September 2008) at [22]. Southern Cross Hospitals and Aorangi Hospital Limited (Commerce Commission Decision 729, 28 July 2011) at [21].

³⁸ Commerce Commission interview with Evolution (2 October 2014).

³⁹ Commerce Commission interview with [] (24 October 2014).

⁴⁰ Commerce Commission interview with [] (3 November 2014).

⁴¹ Commerce Commission interview with Southern Cross Hospital (23 September 2014).

⁴² Ibid.

⁴³ Commerce Commission interview with [] (14 October 2014).

⁴⁴ Commerce Commission interview with Southern Cross Hospital (23 September 2014).

⁴⁵ Commerce Commission interview with Acurity (6 October 2014).

⁴⁶ As noted in the Application at [68]: "Hospitals that do not have APSs [affiliated provider schemes] in place for procedures that fall under the scheme cannot accept Southern Cross Insurance patients for those procedures."

- 46.7 if the hospital is the lead provider, the amount of money the surgeon is paid by the hospital⁴⁷ (ie, for a procedure under the Southern Cross Insurance Affiliated Provider Scheme (APS), discussed below at paragraph 65. Where the hospital is the lead provider the hospital provides the facilities, and negotiates the procedure fee with Southern Cross Insurance on behalf of itself and the surgeon).⁴⁸

What services the different customers acquire from private hospitals

47. As described, private hospitals provide facilities such as operating theatres, patient beds and medical equipment, as well as the related services such as administrative and nursing staff. Some customers pay a hospital for its facilities, and pay for the services of the surgeon and anaesthetist separately. Others pay a hospital for this bundle of services – which essentially encompass the entire procedure – together.

ACC

48. As part of its activities, the ACC enters into contracts with healthcare providers to treat, care for, and rehabilitate injured persons. The ACC contracts with public and private hospitals, individual surgeons and groups of surgeons that provide secondary elective surgery services.
49. The ACC contracts with private hospitals directly as lead providers. A contracted hospital is required to provide all of the services stipulated in the contract within a capped budget, meaning the hospital is responsible for delivering the required surgical procedure. These services include the services of surgeons and anaesthetists. The hospital pays the surgeons and anaesthetists to carry out the surgery.⁴⁹
50. The ACC has developed its own benchmark prices for core procedures set according to a national pricing schedule. In the rare occurrence of a procedure not being listed in the schedule (a ‘non-core’ procedure), the ACC will negotiate a price with the hospital.⁵⁰
51. The ACC funding provides a significant source of funding for some private hospitals, particularly in regards to orthopaedics, which makes up approximately 80% of elective surgery purchased by the ACC each year.⁵¹

⁴⁷ One surgeon advised that a colleague had shifted from [] to [] as [] charges higher fees and are the lowest payers. Commerce Commission interview with [] (14 October 2014).

⁴⁸ If the hospital is the lead provider, the hospital contracts with Southern Cross Insurance and takes responsibility for paying the surgeon and anaesthetist fees, as well as all the associated equipment costs. See paragraphs 65 to 71 for further information on Southern Cross Insurance’s billing arrangements.

⁴⁹ Commerce Commission interview with ACC (1 October 2014).

⁵⁰ Ibid.

⁵¹ Ibid.

DHBs

52. DHB secondary elective work is outsourced as required to manage peaks in each DHB's workload. The tenders are often for less complex secondary work, which would otherwise be performed in a public hospital.
53. As with the ACC, DHBs acquire procedures from private hospitals, ie, the DHBs buy a bundle consisting of the hospital's facilities and the surgeons and anaesthetists.⁵² The hospitals sub-contract with surgeons and anaesthetists to carry out the surgery.
54. Hutt Valley DHB and Capital & Coast DHB occasionally invite all private hospitals in Wellington to tender for outsourced work, except where some hospitals do not offer the services/specialties being tendered for.
55. [].⁵³
56. [].⁵⁴].⁵⁵

Insurance companies

57. Each of Southern Cross Insurance, nib and Sovereign have different ways of arranging medical procedures with private hospitals and/or surgeons for their insured customers. This also means that insurance company customers (or members) have different ways of paying for their procedure or claiming for the procedure under their insurance policy.
58. We set out below how Southern Cross Insurance, nib and Sovereign arrange for their respective customers' procedures in the Wellington region. In summary:
- 58.1 Southern Cross Insurance has categorised all procedures covered by its policies into two types of billing arrangements.⁵⁶
- 58.1.1 fee-for-service procedures, which is the traditional way in which health insurance has worked and means that the member will receive three bills for the procedure – one from the hospital, one from the surgeon and one from the anaesthetist – which the insurer then reimburses or pays direct by prior arrangement; or

⁵² Commerce Commission interview with Capital & Coast DHB (6 October 2014).

⁵³ DHB tender data attached to Capital & Coast DHB's email to the Commerce Commission (6 November 2014).

⁵⁴ [].

⁵⁵ E-mail from Hutt Valley DHB to the Commerce Commission (20 November 2014).

⁵⁶ Commerce Commission interview with Southern Cross Insurance (24 September 2014).

58.1.2 affiliated provider procedures, which means that the ‘affiliated provider’ (doctor, specialist or medical facility/hospital, ie, the lead provider) is contracted to provide Southern Cross Insurance members with a bundled procedure (surgeon, anaesthetist and hospital services) at an agreed price. See paragraph 65 below.

59. In Wellington, nib and Sovereign currently operate fee-for-service billing arrangements only.

Fee-for-service – three separate bills for the patient

60. A patient will typically self-fund a consultation with a surgeon prior to contacting their insurer to obtain approval for a procedure.⁵⁷ If the insurer gives approval, the surgeon will schedule the procedure at a private hospital.
61. After the surgery, the patient will receive three invoices: from the hospital, the surgeon and the anaesthetist, respectively. The patient will pass on the invoices to the insurance company who will pay the three separate bills on the patient’s behalf.⁵⁸
62. Alternatively, if a patient has not obtained prior approval from their insurance company, they will likely pay the full cost of the invoices and then seek to claim back that expense from the insurer.⁵⁹
63. Under this fee-for-service model, insurance companies have told us they rarely question the invoices they receive from the hospital, the surgeon, or the anaesthetist.⁶⁰
- 63.1 nib advised that it queries the amount if it appears to be an outlier from the normal range of prices, and in rare situations might ask the provider to moderate the charge.⁶¹
- 63.2 Southern Cross Insurance told us it can invoke the ‘reasonable charges’ clause in its fee-for-service contract with the provider if the invoiced amount is an outlier. This clause allows Southern Cross Insurance to charge its members a co-payment to top-up the amount above what Southern Cross Insurance is willing to pay.⁶² Southern Cross Insurance said: [

] ⁶³

⁵⁷ Commerce Commission interview with Southern Cross Insurance (6 November 2014).

⁵⁸ Commerce Commission interview with Southern Cross Insurance (24 September 2014).

⁵⁹ Southern Cross Health Society ‘Prior Approval’ (<https://www.southerncross.co.nz/society/for-members/claims/prior-approval.aspx>) (10.06am 9/12/14).

⁶⁰ Commerce Commission interview with nib (9 October 2014).

⁶¹ Ibid.

⁶² Commerce Commission interview with Southern Cross Insurance (24 September 2014).

⁶³ Letter from Southern Cross Insurance to the Commerce Commission (10 October 2014).

64. Southern Cross Insurance indicated that as a result of the limited control it has under fee-for-service, it is developing methods to try to contain their costs and the impact rising healthcare costs have on members' premiums.⁶⁴

Southern Cross Insurance Affiliated Provider Scheme (APS)

65. An important development in the provision of private health insurance is the growth and evolution of Southern Cross Insurance's APS.⁶⁵ While it is not new (APS has been in existence for over 13 years),⁶⁶ Southern Cross Insurance wants to grow the number of procedures covered by APS contracts with lead providers, rather than enter into individual affiliated provider arrangements with surgeons, specialists or medical facilities as may have been the case in the past.⁶⁷
66. Currently, nationally, approximately 40% of Southern Cross Insurance's total claims (by value) are included in the APS.⁶⁸ Southern Cross Insurance's goal is to increase this percentage to 60% by 2016.⁶⁹ This is unlikely to be the upper limit and Southern Cross Insurance expects to continue, where possible, to extend the range/number of procedures covered by its APS beyond 2016.⁷⁰
67. Southern Cross Insurance stated that "... historical comparisons suggest future inflation is better moderated within a contracted procedure compared to that previously charged under a fee-for-service."⁷¹
68. If the acquisition adversely impacts on the effectiveness of these cost containment initiatives, these impacts will be felt not only on procedures that are already under APS contracts, but also on those that will be moved from fee-for-service to APS in the future.
69. Southern Cross Insurance told us that it seeks to negotiate APS contracts in high volume/high value fee-for-service procedures in which there have been large variations between providers.⁷² By making the procedures APS only, Southern Cross Insurance is aiming to bring outlying prices closer to the market rate.⁷³
70. Under the APS Southern Cross Insurance agrees a fixed price for a procedure with a lead provider. The lead provider is usually a private hospital. Southern Cross

⁶⁴ Commerce Commission interview with Southern Cross Insurance (6 November 2014).

⁶⁵ Wherever possible, Southern Cross Insurance asks its members to seek referral to affiliated providers. Some procedures are only covered by a member's insurance policy if they are performed by an affiliated provider. These are called 'affiliated provider-only services'.

⁶⁶ Letter from Southern Cross Insurance to the Commerce Commission (10 October 2014).

⁶⁷ These affiliated provider arrangements involve surgeons, specialists and facilities who are contracted to provide Southern Cross members with certain procedures at agreed prices. Compare Wakefield Hospital Limited and Bowen Hospital Limited (Commerce Commission Decision 492, 19 February 2003) at [187].

⁶⁸ Commerce Commission interview with Southern Cross Insurance (6 November 2014).

⁶⁹ Commerce Commission interview with Southern Cross Insurance (24 September 2014).

⁷⁰ Commerce Commission interviews with Southern Cross Insurance (24 September 2014) and (5 December 2014).

⁷¹ Letter from Southern Cross Insurance to the Commission at 3 (10 October 2014).

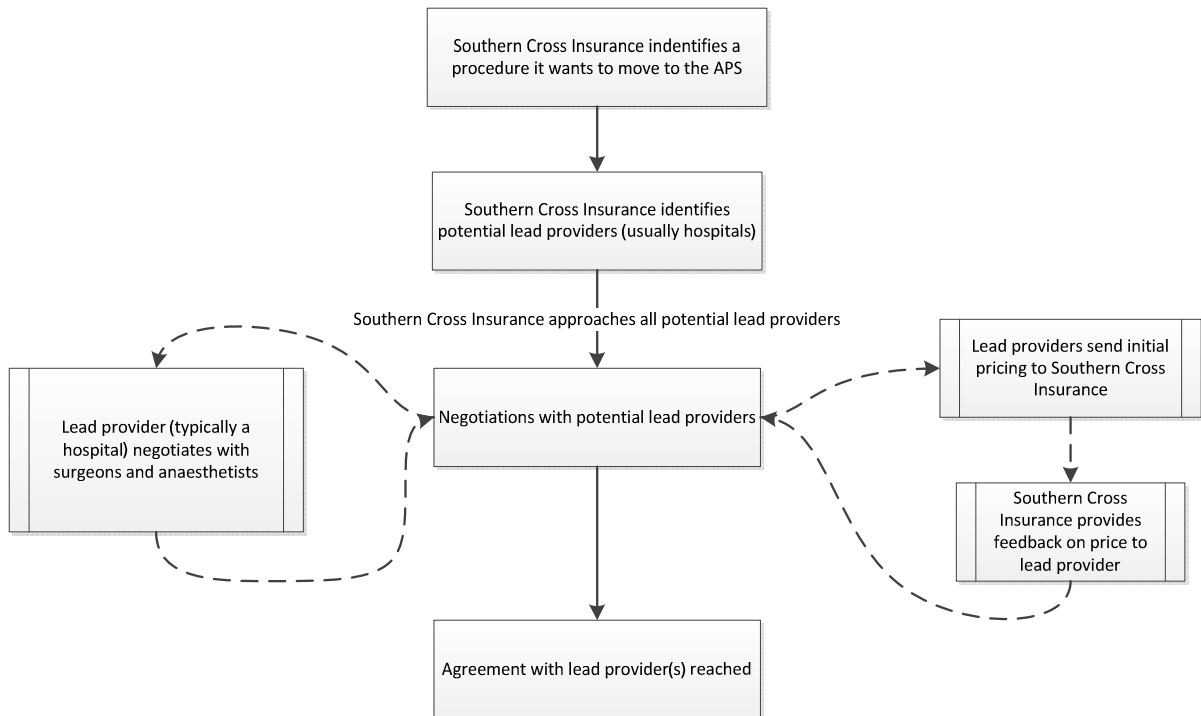
⁷² Commerce Commission interview with Southern Cross Insurance (6 November 2014).

⁷³ Commerce Commission interview with Southern Cross Insurance (21 November 2014).

Insurance negotiates APS pricing with the hospital, with renegotiation typically occurring every two or three years.⁷⁴ [.⁷⁵]

- 71. The hospital is responsible for obtaining and paying for the other services necessary to provide the procedure, such as the surgeon and anaesthetist.⁷⁶ The negotiations between the hospitals and the surgeon and anaesthetist are held independently of Southern Cross Insurance. There are either formal contracts or verbal agreements between the hospital and the surgeon, and the hospital and the anaesthetist, which determine the price each is paid.⁷⁷

Figure 2: Moving fee-for-service procedures to APS



Source: Commerce Commission

⁷⁴ Commerce Commission interview with Southern Cross Insurance (21 November 2014).
⁷⁵ Commerce Commission interview with Southern Cross Insurance (24 September 2014).
⁷⁶ To be an accredited APS provider, specialists/surgeons need to have vocational registration with the New Zealand Medical Council, relevant credentialing and registration as a health practitioner under The Health Practitioners Competence Assurance Act 2003. (See <https://www.southerncross.co.nz/society/for-health-professionals/affiliated-providers.aspx>)
⁷⁷ Commerce Commission interview with Southern Cross Insurance (21 November 2014).

nib maximum reimbursement scheme

72. nib is currently using the fee-for-service model in Wellington.
73. However, nib intends to move towards setting benchmark prices for its most common procedures (and may expand this later). Under benchmark pricing a nib member would pay a co-payment if the hospital's or surgeon's price for that procedure exceeds nib's maximum threshold.⁷⁸
74. nib will look to contract with hospitals and surgeons separately (depending on the type of the procedure). If nib can agree a price with the hospital (or surgeon in the case of a surgeon), nib will inform members that it guarantees no co-payment if the member attends the contracted hospital/surgeon.⁷⁹ In that scenario, nib members will have two options:
- 74.1 use a preferred (contracted) provider for the procedure and not pay a co-payment; or
- 74.2 have their procedure performed at a hospital that is not a preferred provider and pay the difference between nib's maximum benefit and the total procedure charge.
75. The idea behind this is to contain costs by incentivising patients through the charging of co-payments to self-select cheaper hospitals and surgeons. If sufficient patients self-select, this may place downward price pressure on those hospitals and surgeons whose fees are higher and result in a co-payment.
76. nib has contracted with some providers around New Zealand for certain day-stay procedures already [
-].⁸⁰ It
- does not currently have any contracts with Wellington providers.⁸¹

Sovereign's potential contracting arrangements

77. Sovereign has not yet implemented any contract payment arrangements. It is currently using a 'fee-for-service' model for all payments. Sovereign noted that [

].⁸²

⁷⁸ Commerce Commission interview with nib (9 October 2014).

⁷⁹ Commerce Commission interview with nib (21 November 2014).

⁸⁰ Commerce Commission interview with nib (9 October 2014).

⁸¹ Commerce Commission interview with nib (21 November 2014).

⁸² Commerce Commission interview with Sovereign (13 October 2014).

Self-funded patients

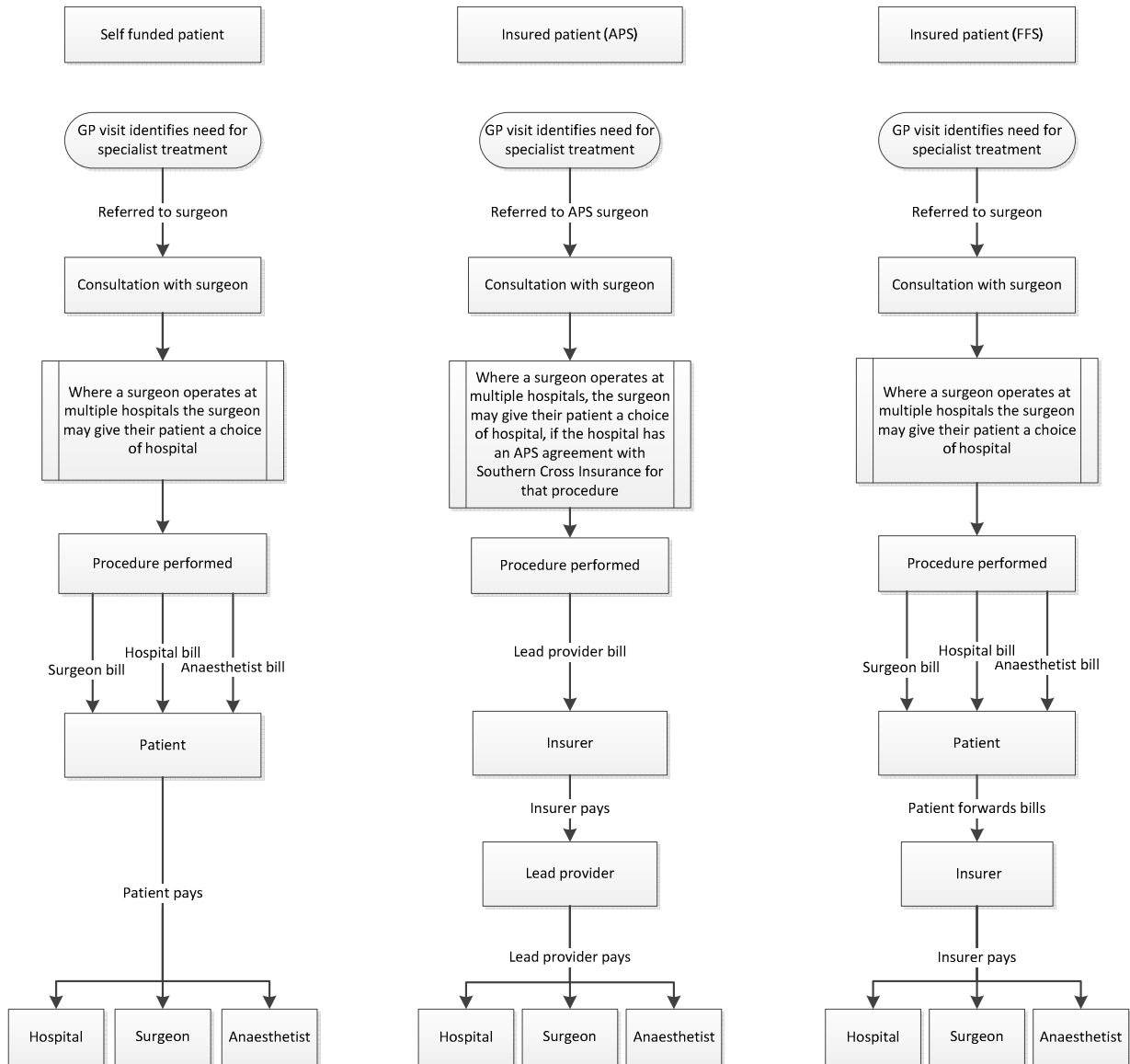
78. Self-funded patients are charged the same prices as insurance companies (in regards to fee-for-service payment by insurers).⁸³ Following surgery, the patient will receive three separate bills, one each from the hospital, surgeon and anaesthetist.
79. In this decision, we have considered together the effects of the proposed merger on self-funded patients and any other party that is required to make a co-payment towards the cost of treatment. Therefore, in this decision when we refer to self-funded patients, we are also including those patients who make a co-payment.

Summary of payment and funding mechanisms

80. In summary of the above, Figure 3 below sets out the referral and payment systems for self-funded patients and those covered by insurance.

⁸³ Commerce Commission interview with Southern Cross Hospital (23 September 2014), [] (14 October 2014), [] (20 November 2014), [] (19 November 2014), letter from Acurity in response to Commission's request for further information (18 November 2014) and letter from Boulcott Hospital in response to Commission's request for further information (undated).

Figure 3: Patient Flow Chart⁸⁴



Source: Commerce Commission

⁸⁴ Pre-approved insurance covered procedures may vary from this model.

Previous decisions

81. The Commission has previously considered a number of private hospital mergers in various markets throughout New Zealand.⁸⁵
82. The Commission specifically considered the Wellington market in 2003, when the then owners of Wakefield Hospital sought clearance to acquire Bowen Hospital. The Commission cleared the merger as it was satisfied that it was unlikely to substantially lessen competition.⁸⁶ That merger created the Wakefield/Bowen hospital group which Acurity now owns.
83. In clearing the merger of Wakefield and Bowen hospitals, the Commission:
 - 83.1 considered the relevant market to be the provision of hospital facilities and related non-specialist services for elective secondary surgery to private patients in the Wellington region (excluding the Wairarapa);
 - 83.2 was satisfied that Boulcott Hospital Limited (now owned by Evolution) and Southern Cross Hospital would provide sufficient constraint on Wakefield and Bowen hospitals; and
 - 83.3 in respect of potential competition, concluded that:⁸⁷

... there are not significant barriers to entry into the hospital services market that would prevent entry or expansion. While the threat of de novo entry of a hospital is low, the merged entity is likely to be constrained by the threat of expansion by an existing competitor and by the potential entry of day surgeries. Therefore, the Commission considers it likely that a new entrant would enter the market or an existing participant would expand if the merged entity attempted to exercise market power.

⁸⁵ Since 2003 the Commission has considered the following private hospital mergers: Wakefield Hospital Ltd and Bowen Hospital (Commerce Commission Decision 492, 19 February 2003).
Southern Cross Oxford Hospital Limited and The Oxford Clinic (Commerce Commission Decision, 537, 11 November 2004).

The Southern Cross Health Trust and Auckland Surgical Centre Limited (Commerce Commission Decision 546, 17 February 2005).

Southern Cross Health Trust and QE Hospital Limited (Commerce Commission Decision 620, 28 September 2007).

The Southern Cross Health Trust and Aorangi Hospital Limited (Commerce Commission Decision 650, 4 September 2008).

Southern Cross Hospitals and Aorangi Hospital Limited (Commerce Commission Decision 729, 28 July 2011).

⁸⁶ Wakefield Hospital Ltd and Bowen Hospital (Commerce Commission Decision 492, 19 February 2003).

⁸⁷ Ibid at [166].

With and without scenarios

With the acquisition

84. The acquisition would involve a partial merger between Evolution (as 100% owner of Boulcott Hospital) and Acurity (as owner of the Bowen and Wakefield hospitals). If this transaction proceeds:
- 84.1 Acurity will be 100% owned by Connor;
 - 84.2 Connor will be 75% owned by Austron Limited and 25% by Evolution;
 - 84.3 Evolution will be entitled to appoint [] out of [] directors to the Connor board and Austron will be entitled to appoint the remaining [] directors;
 - 84.4 Connor will own 100% of Wakefield Hospital and Bowen Hospital; and
 - 84.5 Evolution will retain full ownership of Boulcott Hospital so Austron would not acquire any interest in Boulcott Hospital through the proposed acquisition.

Without the acquisition

85. Without the acquisition, we consider that the status quo would prevail. Boulcott Hospital would continue to have an ownership link with Wakefield Hospital and Bowen Hospital via Evolution's 11.7% shareholding in Acurity. The applicants did not present any evidence that any alternative scenario was likely to occur.

Evolution's substantial degree of influence over Acurity

86. As the acquisition does not result in a full merger between the parties, we have considered whether Evolution's 25% shareholding in Connor would result in Evolution, as owner of Boulcott Hospital, having a substantial degree of influence (from a competition point of view) over the actions of Acurity, owner of Bowen and Wakefield hospitals.
87. Our approach to this question is set out in the Mergers and Acquisitions Guidelines.⁸⁸ We consider that a person (A) has a substantial degree of influence over another person (B), if person A has the ability to bring real pressure to bear on the decision making process of person B.
88. Whether a person has a substantial degree of influence over another is a question of fact. In making this assessment, we consider a number of factors, including:
- 88.1 the nature and extent of ownership links between the companies;
 - 88.2 the presence of overlapping directorships;

⁸⁸ *Mergers and Acquisitions Guidelines* above n 1 at [2.4]-[2.9]. The Commerce Act provides no guidance on when a person has a substantial degree of influence over another.

- 88.3 the rights of one company to appoint directors of another;
- 88.4 the nature of other shareholder agreements and other links between the companies concerned (including family and financial links); and
- 88.5 the nature and extent of communications between the persons, and the apparent influence of one person on the key strategic decisions of the other.

Shareholding and Board representation

- 89. The acquisition would see Evolution increase its ownership interest in Acurity from 11.7% to 25%. The other 75% of Acurity will be owned by Austron Limited (via Austron's 75% ownership of Connor), with the remaining shareholders removed.
- 90. Evolution will have [] out of [] seats on the Connor Board. Austron Limited will have the remaining shares and directors.

Ability to defeat shareholder resolutions

- 91. Evolution's involvement in Connor is one of negative control in that it has a veto right in respect of "Restricted Actions".
- 92. Evolution, through its seats on the Connor Board, has the ability under the draft Constitution to veto Acurity's decisions, including in respect of []].
- 93. While Evolution has no apparent veto ability or other role in respect of []], Evolution has expressed to us that it plans to have a substantial degree of influence over the activities of Acurity, and that it is a "...hands-on hospital owner and operator and will be heavily involved in the operations and management decision making of Acurity".⁸⁹ The veto rights described above would also arguably allow it to influence key funding decisions made by the hospitals (and in doing so, the long term strategic direction of the hospitals).

Conclusion on substantial degree of influence

- 94. Based on the information provided, we consider that Evolution is likely to be able to exert a substantial degree of influence over Acurity's high level strategic and budgetary decision making processes and therefore the operation of Bowen Hospital and Wakefield Hospital.
- 95. Taking into account:
 - 95.1 Evolution's shareholding and number of seats on the Connor Board;

⁸⁹ E-mail from Evolution to the Commission (16 October 2014).

95.2 Evolution's veto rights over [

]; and

95.3 Evolution's indications that it wishes to be a 'hands-on hospital owner and operator' and 'heavily involved in the operations and management decision making of Acurity',

we consider that Evolution will have a substantial degree of influence over Acurity (via Connor). We have therefore assessed the proposed acquisition as though it were a full merger between the three hospitals – Bowen Hospital, Wakefield Hospital and Boulcott Hospital.

96. In our letter of issues we advised Connor that we considered Evolution to have a substantial degree of influence over Acurity and that we therefore proposed to assess the acquisition as though it were a full merger between the three hospitals – Bowen Hospital, Wakefield Hospital, and Boulcott Hospital.⁹⁰
97. In its response, Connor said that it "...agrees with the Commission's proposal to treat the proposed acquisition as though it were a full merger between the three hospitals, on the basis that Evolution's increased shareholding is likely to provide it with a substantial degree of influence over Acurity".⁹¹

Market definition

Our approach to market definition

98. Market definition is a tool that provides a framework to help identify and assess the close competitive constraints the merged firm would likely face. Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market, while recognising potential substitutability and constraints from products that fall outside the market.⁹²
99. To help us establish whether customers would switch sufficient purchases to alternative products, we use the hypothetical monopolist test as a conceptual tool. It considers whether a hypothetical sole supplier of a set of products would profitably increase prices for at least one of the merging firms' products by at least a small, but significant, amount.⁹³ This small, but significant, amount is often referred to as a SSNIP – a small, but significant, non-transitory increase in price.
100. In general, the smallest set of products in which the SSNIP can be profitably sustained is defined as the relevant product market.

⁹⁰ Commerce Commission letter of issues sent to Connor (11 November 2014).

⁹¹ Connor's response to the Commission's letter of issues (18 November 2014) at [3].

⁹² *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 at [123].

⁹³ The test assumes that all other prices are held at current levels.

The applicant's view of the relevant markets

101. The applicant submitted that the relevant markets are those for the provision of hospital facilities and related non-specialist services to private patients in Wellington (excluding the Wairarapa) delineated by:⁹⁴
- 101.1 short and long-stay facilities;⁹⁵ and
 - 101.2 elective secondary and tertiary surgery.

The Commission's view of the relevant markets

102. As noted at paragraph 42 above, there is no overlap in elective tertiary surgery raised by this application. We have defined markets for the provision of elective secondary surgical procedures for:
- 102.1 patients funded by the ACC wider than the Wellington region;
 - 102.2 patients funded by a DHB in the Wellington region;
 - 102.3 patients funded by health insurance companies in the Wellington region;
 - 102.4 self-funded patients in the Wellington region.
103. We consider that these markets serve to best isolate and highlight the competition issues arising from the merger, and reveal the effective competitive constraints that would be likely to operate on the merged firm's behaviour if the acquisition were to proceed.
104. We acknowledge that in previous decisions the Commission focused on the supply of hospital facilities independently of complementary surgeon services in defining markets. The ability for a hospital to have a surgeon perform a procedure at that hospital was considered by the Commission as a condition of expansion for a hospital seeking to expand into supplying facilities for a procedure it did not currently provide procedures for.⁹⁶
105. In this decision we considered the complementary nature of surgeons' services and hospital facilities when defining markets. Customers who need surgery require a surgeon's service, hospital facilities and anaesthetist services all at the same location at the same time. Should the price of the hospital facility increase, the customers of these services would not be in a position to discipline that price increase by changing to another hospital, even if that hospital has the requisite facility, should the hospital not also have available the requisite surgeon and anaesthetist services. For this reason, we consider that the competitive effects of the proposed merger are best

⁹⁴ Application at [43].

⁹⁵ Connor indicated that this approach reflects the Commission's past findings in which the Commission found separate markets for short-stay (less than 24 hours) and in-patient surgery – see Application at [44.3].

⁹⁶ See for example Wakefield Hospital Limited and Bowen Hospital Limited (Commerce Commission Decision 492, 19 February 2003) at [154].

addressed by considering a market for procedures rather a market for facilities. Moreover as a matter of fact under Southern Cross Insurance’s APS, DHB and ACC contracts, those services are billed together by a lead provider (usually the hospital), and for self-funded and fee-for-service cases they are billed separately.

Product markets

106. As described above, private hospitals provide facilities including operating theatres, patient beds and medical equipment, as well as the related services such as administrative and nursing staff. Patients (and thereby their insurers) do not demand hospital facilities independently of associated services. Rather, they demand a procedure and the hospital service is an input into that procedure.
107. The relevant question is whether a customer (a self-funding patient, insurance company, DHB or the ACC) would consider purchasing a different procedure should the price of the prescribed procedure increase (SSNIP).
108. From a patient’s perspective, alternative procedures achieving a different end are not substitutes (for example, a patient seeking cataract surgery will not be interested in the price or quality of a hip replacement).⁹⁷ A patient’s choice of treatment is based on their surgeon’s advice and driven by clinical considerations.
109. Further, Southern Cross Insurance,⁹⁸ the ACC,⁹⁹ and the DHBs¹⁰⁰ contract with hospitals to acquire a procedure. These parties cannot contract with a hospital for the provision of a procedure that the hospital does not offer because it does not have the requisite surgeons.
110. Therefore, from the demand-side, consumers do not demand hospital services in isolation but demand a procedure, and those different surgical procedures are not substitutable themselves.
111. Different procedures will be part of the same market if they are substitutable on the supply-side. Supply-side substitutability refers to the competitive constraint imposed by producers entering the market when attracted by a price increase in that market.¹⁰¹ These near competitors are considered when defining markets rather

⁹⁷ “By this measure, each individual medical procedure could give rise to a separate market” but the FTC held that these markets should be ‘clustered’ along an ‘administrative-convenience’ theory based on similar competitive conditions theory. “This theory holds, in essence, that there is no need to perform separate antitrust analyses for separate product markets when competitive conditions are similar for each.” Unlike our own analysis, the FTC focuses solely on demand substitution factors when defining a market as set out in Section 4 of their Guidelines. (*ProMedica Health Sys., Inc. v. Fed. Trade Commission*, 749 F.3d 559, 562 (6th Cir. 2014)). Available at: <http://www.ca6.uscourts.gov/opinions.pdf/14a0083p-06.pdf>

⁹⁸ Commerce Commission interview with Southern Cross Insurance (6 November 2014).

⁹⁹ The ACC sets a national price by procedure. Commerce Commission interview with ACC (1 October 2014).

¹⁰⁰ Commerce Commission interview with Capital & Coast DHB (6 October 2014).

¹⁰¹ Motta, M. 2004. *Competition policy: theory and practice*. Cambridge, MA at 103.

than when considering entry conditions because of their ability to easily, rapidly and profitably enter without incurring significant costs.¹⁰²

112. While hospital facilities may generally be substitutable between procedures if the necessary equipment is available (specific equipment may be required for some surgical procedures), this overlooks the complementary nature of the hospital facilities and the surgeon services, particularly given the way that procedures are now increasingly being acquired.
113. Surgeons cannot typically perform procedures across specialties.¹⁰³ Moreover, the health market is increasingly sub-specialised as Acurity acknowledges.^{104 105 106} Although some surgeons may be able to undertake a range of procedures within a specialty, they may not necessarily be able to undertake all of those procedures. For instance some general surgeons specialise in upper gastrointestinal surgery (also known as upper GI surgery)/breast surgery.¹⁰⁷
114. Indeed, the Southern Cross Insurance expenditure data, which we assess at paragraphs 167 to 243, indicates that although Southern Cross Hospital has surgeons within each specialty,[
-].
115. Therefore, following a SSNIP in the price of hospital facilities in sub-specialty A, a competing hospital could not quickly and easily move into the provision of sub-specialty A, even if it has available the appropriate hospital facilities, unless it has or can easily, rapidly and profitably attract the necessary surgeons.

¹⁰² *Mergers and Acquisitions Guidelines*, above n 1 at 24.

¹⁰³ The UK Competition Commission, which considers supply-side substitution, and subsequent decisions by the Office of Fair Trading/Competition Markets Authority, acknowledge that “The resources (consultants [specialists], equipment, infrastructure) required to treat patients in a given specialty will generally be quite different from those required to treat patients in another specialty (although there will be some common resources and these may be quite significant in the case of related specialties).” (Competition Commission, 17 October 2013, ‘The Royal Bournemouth and Christchurch Hospitals NHS Foundation Trust/Poole Hospital NHS Foundation Trust’. Available at:

<http://webarchive.nationalarchives.gov.uk/20140402141250/http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/royal-bournemouth-and-christchurch-poole>

¹⁰⁴ Acurity’s response to the Commission’s letter of unresolved issues at 3 (28 November 2014).

¹⁰⁵ There is substantial literature on improved outcomes following specialisation over procedures or groups of procedures which have been attributed to or learning-by-doing or “selective referral” by GPs. See for example Luft, Hunt, and Maerski (1987) and Ho (2002), cited in Dafny, LS. *Entry deterrence in hospital procedure markets: a simple model of learning-by-doing*. NBER Working Paper 9871, July 2003. Cambridge, MA. Available at: <http://www.nber.org/papers/w9871.pdf>

¹⁰⁶ The OFT has also recognised the increasing sub-specialisation “resulting in consultants being less able to provide a wide range of treatments than in the past” and further that “supply-side substitution within specialties is likely to apply at least to a core set of procedures “ See http://webarchive.nationalarchives.gov.uk/20140402141250/http://www.competition-commission.org.uk/assets/competitioncommission/docs/2013/royal-bournemouth-and-christchurch-poole/131017_final_report.pdf

¹⁰⁷ Southern Cross Hospital’s response to Commerce Commission information request (19 November 2014).

116. We have been told that attracting surgeons is not straightforward (see discussion below at paragraphs 259 to 261). This is a key issue in this case as it is central to understanding the competitive constraints that will operate on the merged firm. Therefore, we consider that the market definitions which best highlight this issue are market definitions which do not treat hospital services as supply-side substitutable across specialties following a SSNIP.
117. Rather, we consider the markets that best illustrate the competition effects of the merger are those based on individual procedures or groups of procedures. For ease of analysis, we have considered the competitive effects of this merger by specialty. Wakefield/Bowen and Boulcott hospitals overlap in the provision of the following specialties:
- 117.1 cardiology services;
 - 117.2 oral and maxillofacial surgery;
 - 117.3 plastic surgery;
 - 117.4 otolaryngology (ear, nose and throat);
 - 117.5 general surgery;
 - 117.6 gastroenterology;
 - 117.7 gynaecology;
 - 117.8 ophthalmology;
 - 117.9 orthopaedics; and
 - 117.10 urology.
118. The extent to which public hospitals might constrain the merging parties is considered in paragraphs 245 to 252.

Separate customer markets

119. Consistent with previous Commission decisions, we consider that separate customer markets – the ACC, DHBs, private health insurance providers, and self-funded patients – are still appropriate for considering this merger. Prices charged by private hospitals typically vary by customer category, and the customer groups face different competitive alternatives. We consider these differing prices are at least in part the result of differing competitive alternatives or differing ability by Southern Cross Insurance to exert competitive pressure.

Are there different markets for short- and long-stay procedures?

120. The Commission has previously defined separate markets for short-stay and in-patient (ie, long-stay) facilities.¹⁰⁸
121. However, given our approach to defining markets on a procedure-by-procedure basis, we have not considered it necessary to further segregate the market by long-stay facilities and short-stay facilities. The different entry conditions associated with the procedures of concern are considered in the potential competition section.

Geographic markets

122. Evolution's Boulcott Hospital is based in the Hutt Valley. Acurity's Bowen and Wakefield hospitals are based in Wellington City, as is Southern Cross Hospital.
123. In the Wakefield/Bowen Decision,¹⁰⁹ the Commission defined the relevant geographical market as the Wellington region, including Lower Hutt and Porirua, but excluding the Wairarapa.
124. In this case, it is appropriate to define:
- 124.1 wider than regional markets for the ACC; and
- 124.2 regional markets for the DHBs, insurance companies and self-funded customers.

Wider geographic markets for the ACC

125. A wider geographic market than the Wellington region is appropriate if the ACC would purchase hospital services outside of the Wellington region in order to mitigate against a price increase by Wellington private hospitals.
126. The ACC have told us that they would move patients to private hospitals outside of the Wellington region should they face a price increase (SSNIP).¹¹⁰ This willingness to transport patients outside the Wellington region results in part from the ACC's national fixed price model per procedure whereby private hospitals are paid a set price regardless of location.¹¹¹ Under this model, if the ACC agreed to a price increase in Wellington it would essentially be agreeing to an increase in prices across the country.¹¹² The cost of transporting patients outside of the Wellington region would likely be outweighed by a national price increase for a procedure.¹¹³

¹⁰⁸ The Southern Cross Health Trust and Aorangi Hospital Limited (Commerce Commission Decision 650, 4 September 2008).

¹⁰⁹ Wakefield Hospital Limited and Bowen Hospital Limited (Commerce Commission Decision 492, 19 February 2003).

¹¹⁰ Commerce Commission interview with ACC (1 October 2014).

¹¹¹ Ibid.

¹¹² Ibid.

¹¹³ "ACC has transported patients out of the region before when there's been a problem. Transport costs are nothing compared to cost of surgery." (Commerce Commission interview with ACC (1 October 2014)). As mentioned, the ACC has a national price per procedure.

127. Therefore, the number of hospital options available to the ACC for Wellington patients is greater than the merging parties and Southern Cross Hospital in Wellington.
128. Related to this, the ACC did not raise any concerns about this merger and we do not consider that the ACC is likely to be adversely affected by the merger. Therefore, we do not consider these markets further.

Wellington regional markets for the DHBs

129. A narrower geographic market than the Wellington region may be appropriate if the Capital & Coast DHB and Hutt Valley DHB would not consider purchasing private hospital services from private hospitals outside of Wellington City and Hutt Valley respectively in the event of a price increase (SSNIP). Conversely, a wider geographic market than the Wellington region would be appropriate if the DHBs would consider purchasing private hospital services from outside of the Wellington region in order to mitigate against a price increase (SSNIP) by Wellington hospitals.
130. As described earlier, the two DHBs outsource little of their caseload. When they do there is little cross-tendering between the Hutt and Wellington City by Hutt Valley DHB and Capital and Coast DHB. In addition, Hutt Valley DHB told us it would consider moving patients outside of the region but only as a last resort.¹¹⁴
131. Therefore, while we do not consider the market is wider than the Wellington region, we do consider it is at least possible that for DHBs the markets may be narrower than the Wellington region. However, we have proceeded on a conservative basis and considered a Wellington regional market for the DHBs.

Wellington regional markets for insurance companies

132. The merging parties submitted that Boulcott Hospital in the Hutt Valley does not impose a strong constraint on Acurity's Wakefield and Bowen hospitals (in Wellington City). The applicant submitted that 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".¹¹⁵
133. A narrower geographic market than the Wellington region may be appropriate if the insurance companies would not consider purchasing sufficient services from private hospitals outside of Wellington City for their Wellington region insurance customers even in the event of a price increase (SSNIP) by the Wellington private hospitals. However, the evidence suggests that insurance companies consider the Wellington city hospitals to be substitutes for Boulcott Hospital for a particular procedure and would consider purchasing additional services from Boulcott Hospital or the Wellington hospitals in response to a price increase from the other.

¹¹⁴ Commerce Commission interview with Hutt Valley DHB (7 November 2014).

¹¹⁵ Application at [46].

133.1 []¹¹⁶ [

].¹¹⁷

133.2 []¹¹⁸ []¹¹⁹ have told us [

].¹²⁰

134. Further, as discussed below, information provided by the merging parties' shows that both Acurity hospitals and Boulcott Hospital draw over []% of their patients from outside Wellington City and the Hutt Valley respectively.¹²¹
135. A wider geographic market than Wellington may be appropriate if the insurance companies would consider purchasing sufficient services from private hospitals outside of the Wellington region for their Wellington region insurance customers in order to mitigate against a price increase (SSNIP) by Wellington hospitals. Connor and Acurity have said that the ability of Southern Cross Insurance to move its customers outside of the Wellington region would provide a constraint on the merged entity.¹²²
136. Southern Cross Insurance, the only insurer currently contracting in the Wellington Region, does not consider hospitals outside of Wellington when negotiating with Wellington hospitals¹²³ (as noted above) and would not normally transport patients outside of a region if these procedures are available within the region.¹²⁴ The results of Southern Cross Insurance's 2013 patient survey¹²⁵ showed that patients in cities prefer not to travel to have surgery.¹²⁶

¹¹⁶ [

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¹¹⁷ [Commerce Commission interview with []].

¹¹⁸ Commerce Commission interview with []].

¹¹⁹ Commerce Commission interview with []].

¹²⁰ Commerce Commission interview with [] .

¹²¹ Spreadsheet from Evolution – response to information request (9 October 2014).

¹²² Spreadsheet from Acurity – response to information request (10 October 2014).

¹²³ Commerce Commission interview with Southern Cross Insurance (21 September 2014).

¹²⁴ Commerce Commission interview with Southern Cross Insurance (24 September 2014) and letter from Southern Cross Insurance (10 October 2014).

¹²⁵ Letter from Southern Cross Insurance (10 October 2014).

¹²⁶ [

137. In a single episode of which we are aware, [

].¹²⁷ There is no evidence of Southern Cross Insurance using this inferior (for patients) alternative to discipline hospitals in markets with more competitors and therefore we do not consider that Southern Cross Insurance would consider non-Wellington region hospitals as substitutes following a price increase (SSNIP).¹²⁸

Wellington regional markets for self-funded patients

138. []% of Acurity’s patients (by revenue)¹²⁹ and []% of Boulcott’s patients¹³⁰ are self-funded.

139. Self-funded patients, as previously noted, typically attend the hospital where their surgeon operates. There is little available evidence as to the extent to which switching currently occurs by such patients based on price.

140. Nevertheless, a number of patients appear willing to travel between the Wellington hospitals. Boulcott Hospital draws proportionally more patients from the Hutt Valley ([]%) than from Wellington ([]%) and conversely, the Wellington City hospitals draw proportionally more patients from Wellington city (approximately []%) than from the Hutt Valley (between []% and []%).¹³¹ However, that still leaves a significant number who already travel to and from Hutt Valley to Wellington and vice versa. Moreover, between []% and []% of patients are also drawn from Porirua and the Kapiti Coast which are between Wellington City and Hutt Valley hospitals.

141. These figures are for all patients, not just self-funded patients. Moreover they only represent the proportion of patients who currently travel and they do not show the proportion of customers who would travel in the face of a price change.

142. The relevant question is whether a self-funded patient referred to a surgeon at a Wellington City hospital would consider purchasing this procedure at a hospital in

¹²⁷ []].

¹²⁸ The ‘cellophane fallacy’ refers to customers (such as Southern Cross Insurance) replacing a monopoly product (in this case []) with an inferior product [] not because these are economic substitutes but because the price of the monopoly good is so high. (Motta, M. 2004. *Competition policy: theory and practice*. Cambridge, MA. p.105)

¹²⁹ Commission analysis of spreadsheet from Acurity – response to information request (10 October 2014). It is not clear whether this figure is the percentage for 100% self-funded patients or whether this figure also includes patients who make a co-payment.

¹³⁰ Evolution’s submission to the Commission (1 September 2014).

¹³¹ Commerce Commission market share analysis.

the Hutt Valley should the hospital fees at the Wellington City hospital increase (SSNIP).

143. In this respect, there is some evidence of self-funded patients comparing hospital prices when deciding where to have a procedure performed.¹³² While self-funded patients, including those insured patients on co-payment plans, may be expected to be price sensitive they may not shop around as hospital fees are opaque to these consumers because:

143.1 final prices are observed upon invoicing after the procedure has taken place and the total cost is seldom fixed and depends on the length of time the procedure takes as well as any further complications or issues; and

143.2 although in some cases the GP might be able to direct a patient towards a cheaper hospital,¹³³ in other cases hospital fees are unlikely to be comparable unless either the surgeon operates at multiple hospitals and is able to offer a choice or the patient incurs the expense of being assessed by another surgeon to obtain a competing quote.

144. Given the material proportion of patients who already travel within the Wellington region to have procedures performed and the evidence that some patients do compare prices, we consider that the relevant geographic market for self-funded patients is the Wellington region.

Conclusions on market definition

145. For these reasons, we have defined the relevant markets as the markets for the provision of elective secondary surgical procedures for:

145.1 patients funded by the ACC wider than the Wellington region;

145.2 patients funded by a DHB in the Wellington region;

145.3 patients funded by health insurance companies in the Wellington region; and

145.4 self-funded patients in the Wellington region.

¹³² Commerce Commission interviews with [] (14 October 2014) and [] (15 October 2014) and Sovereign (8 December 2014).

¹³³ This includes considering the quality and cost of the facility and surgeons. For instance, [] told us that Wakefield Hospital is the most expensive hospital in Wellington (Commerce Commission interview with [], 9 October 2014) but patients that can have procedures at other Wellington hospitals are still referred there. This might be because patients are not price sensitive, Wakefield Hospital offers a higher quality service in terms of facilities and surgeons, or the cost of the bundled service (hospital facility, surgeons' fees and anaesthetist fees) are lower.

Impact of the merger in the market for the provision of elective surgical procedures for patients funded by a DHB in the Wellington region

146. As already described, the DHBs occasionally contract with private providers to cover overflow for certain procedures.¹³⁴ However, the Wellington DHBs – Hutt Valley/Wairarapa and Capital & Coast – are seeking to limit their outsourcing by sending patients from one DHB to each other.^{135 136}
147. The price paid when contracting work to private hospitals is based on a ‘case weight price’¹³⁷ which is benchmarked against the DHB’s own costs usually with a retainer for administration.¹³⁸ We understand the DHBs negotiate a price lower than the ACC, insurance providers and fee-for-service prices.¹³⁹
148. DHBs have the option of sending patients outside of Wellington (like the ACC) but prefer to limit this. Another option could include bringing in locum surgeons from DHBs in other parts of the country to countervail a price increase.¹⁴⁰ The DHBs advised that they could accommodate these additional surgeons in their hospitals.¹⁴¹ Because of these options, both DHBs consider they will retain the ability to obtain as competitive bids with the acquisition as they could absent the acquisition.
149. Neither the Capital & Coast DHB nor Hutt Valley DHB raised any concerns with the proposed acquisition. We are satisfied that the proposed acquisition is not likely to result in a substantial lessening of competition in the markets for the provision of elective surgical procedures for patients funded by a DHB in the Wellington region.

¹³⁴ For example, Capital & Coast DHB told us that contracts are tendered as and when required and may have several rights of renewal (telephone call with Capital & Coast DHB, 6 October 2014).

¹³⁵ Commerce Commission interview with Hutt Valley DHB (7 November 2014).

¹³⁶ Commerce Commission interview with Capital & Coast DHB (6 October 2014).

¹³⁷ Case weights measure the relative complexity of the treatment given to each patient. For example, a cataract operation will receive a case weight of approximately 0.5, while a hip replacement will receive 4 case weights. This difference reflects the resources needed for each operation, in terms of theatre time, number of days in hospital etc.

¹³⁸ The DHBs would not accept a price that varied significantly from this case weight price. Commerce Commission interview with Hutt Valley DHB (7 November 2014).

¹³⁹ Email from [redacted].

¹⁴⁰ Commerce Commission interview with Hutt Valley DHB (7 November 2014). While DHBs could use locums from other DHBs, this option is not likely to be available to private hospitals. This is because there are some DHB surgeons that do not undertake private surgery (particularly the less experienced surgeons) compared to private surgeons who typically also have DHB placements. See the following ‘Association of Salaried Medical Specialists’ 2014 publication and Adams, J 2013. The organisation of medical services in New Zealand. Chapter 2 in St George IM (ed.). Cole’s medical practice in New Zealand, 12th edition. Medical Council of New Zealand, Wellington, for further information <http://www.asms.org.nz/wp-content/uploads/2014/09/Taking-the-temperature-of-the-public-hospital-specialist-workforce-August-2014-FINAL.pdf> and <http://www.mcnz.org.nz/assets/News-and-Publications/Coles/Chapter-2.pdf> Therefore, while moving a public surgeon to another hospital may be viable, doing so with a private surgeon is unlikely as this would impact on that surgeon’s regional DHB work.

¹⁴¹ Commerce Commission interview with Hutt Valley DHB (7 November 2014).

How the acquisition could lead to a substantial lessening of competition in markets for the provision of elective surgical procedures for self-funded patients and patients funded by health insurance companies

150. When a firm merges with a competitor that would otherwise provide a competitive constraint, in theory, the loss of that constraint may give the merged entity the market power to substantially increase prices, or decrease quality, range, innovation efforts or service levels to the purchasers of that product.¹⁴²
151. The key questions relevant to determining whether this acquisition is likely to substantially lessen competition for insurance companies and self-funded patients¹⁴³ are:
- 151.1 does Boulcott Hospital currently constrain Bowen Hospital and Wakefield Hospital?
 - 151.2 would Southern Cross Hospital's or any other existing provider's existing offering in Wellington sufficiently constrain the merged entity?
 - 151.3 would the public hospitals sufficiently constrain the private hospitals in Wellington?
 - 151.4 would Southern Cross Hospital or another new entrant be likely to expand or enter in a way that would sufficiently constrain the merged entity?
 - 151.5 would the insurance companies be able to exercise sufficient countervailing power to discipline any attempted price increase by the merged entity?
 - 151.6 would the acquisition result in efficiencies that would offset any substantial lessening of competition?

¹⁴² Horizontal aggregation between hospitals has the potential to result in a reduced choice of hospitals for surgeons, as there will be one less facility for surgeons to work at as a result of the proposed merger. We do not consider that there will be a significant change in the hospitals' buying market power when negotiating surgeons' fees (and any related compensation) under APS contracts and so do not consider the effect of this merger on surgeons. However, as surgeons value the quality of hospital services including equipment it is unlikely that this merger would result in decreased quality of the hospital offering.

¹⁴³ As noted above, when we refer to 'self-funded' patients, we are also including those patients that make a co-payment.

Existing competition for insurance companies and self-funded patients

Overview

152. We have considered each of the overlapping specialties identified in the market definition section above. However, before going through each specialty we have provided an overview of our conclusions common to all specialties.

Constraint provided by Boulcott Hospital

153. We consider that Boulcott Hospital currently provides a constraint on Wakefield Hospital and Bowen Hospital for procedures provided to insurance companies and self-funded patients, in each specialty, with the exception of secondary cardiology services.

Concerns with the reduction of two hospitals to one

154. Putting aside constraints from public hospitals, entry and expansion, countervailing power and efficiencies which we address in later sections, the competition concerns are most acute in those specialties where the proposed acquisition reduces the immediate choice of insurance companies and self-funded patients from two hospital providers to one. These are procedures where Southern Cross Hospitals either does not provide the procedure, or provides only limited coverage. This occurs for some procedures in the orthopaedics, otolaryngology (ENT), general surgery, oral and maxillofacial, and plastic specialties.

Concerns with the reduction of three hospitals to two

155. For the remaining overlapping specialties (urology, ophthalmology and gynaecology specialties), Southern Cross Hospital provides an alternative, but the acquisition would still reduce the number of providers from three hospital providers to two. However, we have fewer concerns in respect of certain urology and ophthalmology procedures that do not require general anaesthetic. This is because the procedure can be performed in other facilities, such as consulting rooms, including under local anaesthetic.

156. The Commission has previously concluded that: “As a general rule of thumb, a merger that reduces the number of competitors from three to two is, *a priori*, likely to reduce levels of rivalry to the detriment of customers”.¹⁴⁴ In endorsing that approach on appeal in *Woolworths*, the Court of Appeal said that “...the Commission was right to give weight to the theoretical concerns raised by a 3:2 merger in markets such as these, characterised by high barriers to entry”.¹⁴⁵

157. For reasons we discuss later, the Commission has concerns about the likelihood of entry (and other constraints) into these markets. Furthermore, the evidence from

¹⁴⁴ Foodstuffs (Auckland) Limited, Foodstuffs (Wellington) Co-operative Society Limited, and Foodstuffs South Island Limited and (separately) Woolworths Limited (Commerce Commission Decisions 606 and 607, 8 June 2007) at [193].

¹⁴⁵ *Commerce Commission v Woolworths Ltd & Ors* (CA) above n 2 at [200].

market participants is that there are consumer benefits to be derived from having three providers in this market as opposed to two.

158. Southern Cross Insurance wants to ensure that it has sufficient coverage for its members before moving a procedure to APS only provider coverage. If the two remaining hospitals each have the ability to ensure coverage then Southern Cross Insurance could sign an APS contract with a single hospital before moving that procedure to APS only. Once a procedure is 'APS only' (can only be provided by a contracted hospital(s)) then the uncontracted hospitals are likely to settle negotiations with Southern Cross Insurance in order not to forgo revenues derived from Southern Cross Insurance members/patients.
159. This three to two merger would leave Southern Cross Hospital in a weaker bargaining position compared to having three independent hospitals to negotiate with.
160. Further, if Southern Cross Insurance requires two hospitals to ensure coverage in certain procedures, then it currently has the option of coming to an agreement with any combination of two of the three hospitals. Post-merger Southern Cross Insurance would lose the ability to leverage negotiations across these sets of hospitals since the remaining hospital would not on its own be able to provide sufficient coverage.
161. As a result, the Commission also has concerns for some procedures in urology, ophthalmology and gynaecology for insurance companies and self-funded patients.

The impact on competition of having more than one hospital provider

162. Southern Cross Insurance stated that when contracting for APS procedures there would be a greater chance of competitive tension and success with more than two operators in a market.¹⁴⁶
163. Southern Cross Insurance said it typically seeks to negotiate APS contracts with all providers within a region that have provided particular fee-for-service procedures over the past 12 months.¹⁴⁷ (It does not generally have any exclusive APS arrangements).¹⁴⁸ ¹⁴⁹ Southern Cross Insurance approaches those providers and negotiations for APS contracts commence. Southern Cross Insurance advised that "...where there are three hospitals providing the same specialty and it gets one or

¹⁴⁶ Letter from Southern Cross Insurance to the Commission at 3 (10 October 2014).

¹⁴⁷ Commerce Commission interview with Southern Cross Insurance (5 December 2014).

¹⁴⁸ Letter from Southern Cross Insurance to the Commission (10 October 2014).

¹⁴⁹ Southern Cross Insurance told us on 5 December 2014 that [

].

two over the line that will put the second/third hospital in a difficult position”.¹⁵⁰
 “This is because at that point we would typically have coverage [

].¹⁵¹ However, if Southern Cross Insurance doesn’t have enough coverage, then the negotiations can go on for a while.¹⁵²

164. That is, should Southern Cross Insurance sign both Southern Cross Hospital and Boulcott Hospital for a particular procedure, then this might be sufficient to leverage against Acurity, whereas Boulcott Hospital or Southern Cross Hospital individually may not be sufficient to provide that coverage.
165. Self-funded patients are also likely to benefit from the ability to shop around at three hospitals rather than two.
166. The Commission has been advised by the merging parties that some self-funded patients shop around to seek lower prices and to reduce costs.¹⁵³ We have been advised by Connor and Acurity that they receive calls from people enquiring about the prices charged at their hospitals.¹⁵⁴ This is facilitated by the fact that some surgeons in the Wellington region operate out of multiple hospitals.¹⁵⁵
- 166.1 There is also some evidence to indicate that self-funded patients are becoming more price-sensitive. For example, a general surgeon told us that self-funded patients are very sensitive to price and will hunt around for a good price.¹⁵⁶
- 166.2 An ENT surgeon told us that patients shop around to find out the costs of procedures at private hospitals.¹⁵⁷
- 166.3 One plastics surgeon advised that in his view surgeons are also increasingly looking at the price of hospital facilities due to the falling numbers of people covered by private health insurance and therefore the increasing price sensitivity of patients.¹⁵⁸

¹⁵⁰ Commerce Commission interview with Southern Cross Insurance (21 November 2014).

¹⁵¹ Ibid.

¹⁵² Ibid.

¹⁵³ Commerce Commission interviews with Acurity (5 December 2014) and Connor (5 December 2014) and Connor’s response to the Commission’s letter of unresolved issues (28 November 2014) at [44.1].

¹⁵⁴ Commerce Commission interviews with Acurity (5 December 2014) and Connor (5 December 2014).

¹⁵⁵ See above n 34 for further details.

¹⁵⁶ Commerce Commission interview with [] (20 November 2014).

¹⁵⁷ Commerce Commission interview with [] (19 November 2014).

¹⁵⁸ Commerce Commission interview with [], plastics surgeon (19 November 2014).

Analysis by specialty

167. We set out the market shares in respect of each specialty below, as well as any concerns insurance companies and surgeons have raised with the Commission in respect of procedures in each specialty. In setting out the market shares, we have reported both APS and fee-for-service procedures.¹⁵⁹ Southern Cross Insurance intends to move more procedures onto APS in the future.

Orthopaedics

168. Table 1 below shows that the merging parties will provide approximately []% of the private orthopaedic procedures in Wellington.

Table 1: Market shares for orthopaedics 2014

	Hospital	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital	Total
Procedures	#	[]	[]	[]	[]	[]
	%	[]%	[]%	[]%	[]%	100%
Revenue	\$	[\$]	[\$]	[\$]	[\$]	[\$]
	%	[]%	[]%	[]%	[]%	100%

Source: Industry participants

169. Orthopaedic procedures, such as hips and knee replacements, represent one of the highest volume procedures for insurance companies both in APS and fee-for-service work. In 2014 orthopaedics accounted for approximately []% of private hospital patient revenues in Wellington.¹⁶⁰

170. The tables below show the proportion of Southern Cross Insurance's work undertaken by each of the Wellington hospitals. [

].

171. Table 2 below sets out the orthopaedic procedures funded by Southern Cross Insurance and for which the merging parties overlap.

¹⁵⁹ We do not include Southern Cross Insurance's "Other" procedure funding in these tables as we are concerned with the loss of constraint by procedure. This category includes a bundle of procedures.

¹⁶⁰ Commission analysis from information provided by parties during the investigation.

Table 2: Share of Southern Cross Insurance claims for orthopaedic procedures 2014

	Total revenue	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%

Source: Submission from Southern Cross Insurance (9 December 2014)

* procedures funded under both APS and fee-for-service. All other procedures that are not marked with an asterisk are fee-for-service only at present.

- 172. Table 2 shows that orthopaedic services at Wakefield Hospital, Bowen Hospital and Boulcott Hospital are more comprehensive than Southern Cross Hospital.
- 173. []

].¹⁶¹ [

].¹⁶²

174. Southern Cross Hospital told us that:¹⁶³

[

].

175. [] and []¹⁶⁴ have both identified orthopaedics as a specialty that is likely to raise concerns should this merger proceed. [] considers that its ability to use Boulcott Hospital to moderate prices in orthopaedics would be lost as [] considers []¹⁶⁵
[

].¹⁶⁶

176. Therefore, absent entry or expansion of sufficient scope or other constraints from public hospitals or countervailing power, competition for some procedures in this specialty, would likely be substantially lessened post-acquisition.

Otolaryngology

177. The table below shows that the merged entity would provide approximately []% of the otolaryngology (ear, nose and throat – (ENT)) procedures in Wellington.
[]¹⁶⁷

178. In 2014 otolaryngology accounted for approximately []% of private hospital patient revenues in Wellington.¹⁶⁸

¹⁶¹ []].

¹⁶² []].

¹⁶³ Southern Cross Hospital's response to information request (19 November 2014).

¹⁶⁴ The other specialty identified by [] as giving rise to concerns was endoscopy. Commerce Commission interview with []].

¹⁶⁵ Email from [] to the Commission []].

¹⁶⁶ []].

¹⁶⁷ Commerce Commission interview with [] (19 November 2014).

¹⁶⁸ Commission analysis from information provided by parties during the investigation.

Table 3: Market shares for otolaryngology 2014

	Hospital	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital	Total
Procedures	#	[]	[]	[]	[]	[]
	%	[]%	[]%	[]%	[]%	100%
Revenue	\$	[\$]	[\$]	[\$]	[\$]	[\$]
	%	[]%	[]%	[]%	[]%	100%

Source: Industry participants

179. Currently, Boulcott Hospital and Southern Cross Hospital are the only facilities in the Wellington region that have been contracted by Southern Cross Insurance under the APS to provide low level ENT procedures (ie, adenoidectomy, grommets and tonsillectomy).¹⁶⁹ Southern Cross Hospital has a [] market share for all these procedures as shown in the table below. Boulcott Hospital has [] market share in each of these APS procedures except for grommet insertion.
180. Table 4 below sets out the otolaryngology procedures funded by Southern Cross Insurance and for which the merging parties overlap.

Table 4: Share of Southern Cross Insurance claims for otolaryngology procedures 2014

	Total market revenue	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%

Source: Submission from Southern Cross Insurance (9 December 2014)

All procedures are fee-for-service only at present. However, as set out on Southern Cross Insurance's website, adenoidectomy, grommets and tonsillectomy procedures are currently in a transition period. "A transition period is the time between a healthcare service becoming 'Affiliated Provider-only' and,

¹⁶⁹ Commerce Commission interview with []

[] (19 November 2014).

in [Southern Cross Insurance's] view, there being sufficient Affiliated Providers in place to provide that healthcare service."¹⁷⁰ All other procedures are currently fee-for-service only.

181. [

.¹⁷¹

182. The acquisition would result in the aggregation of the largest providers of ENT procedures in Wellington – Wakefield/Bowen hospitals and Boulcott Hospital. [

]. Therefore, absent entry or expansion of sufficient scope or other constraints from public hospitals or countervailing power, competition for some procedures in this specialty, would likely be substantially lessened post-acquisition.

General surgery

183. General surgery deals with a wide range of conditions within the abdomen, breast, neck, skin and vascular (blood vessel) system.¹⁷² General surgery is complemented by other specialists including gastroenterologists and endoscopists.¹⁷³

183.1 Gastroenterology is the internal medicine specialty of the stomach and related organs such as the colon.¹⁷⁴ These specialists offer medical rather than surgical solutions to a patient complaint.

183.2 Endoscopists are specialists trained in the use of an endoscope – a diagnostic tool used to visually examine the interior of a bodily canal or hollow organ such as the colon, bladder, or stomach.¹⁷⁵

184. Each of these three specialties is typically performed by different surgeons; however some surgeons undertake procedures in more than one of these specialties. We have assessed these specialties together as they are complementary.

¹⁷⁰ <https://www.southerncross.co.nz/society/for-members/claims/affiliated-provider/affiliated-provider-only-procedures.aspx>

¹⁷¹ Commerce Commission interview with [] (19 November 2014).

¹⁷² For example see <http://www.bowen.co.nz/specialists-and-services/specialties/general> and the Capital & Coast DHB website at <http://www.healthpoint.co.nz/public/general-surgery/capital-coast-dhb-general-surgery-service/>

¹⁷³ These medical and surgical specialists take care of patients with problems related to the Gastrointestinal Tract. See the Wakefield Hospital website for more information at: <https://www.wakefield.co.nz/specialists-and-services/specialties/gastroenterology>

¹⁷⁴ See the Capital & Coast DHB website for more information at: <http://www.healthpoint.co.nz/public/gastroenterology-hepatology-liver/capital-coast-dhb-gastroenterology-gi-endoscopy/>

¹⁷⁵ See the Capital & Coast DHB website for more information at: <http://www.healthpoint.co.nz/public/gastroenterology-hepatology-liver/capital-coast-dhb-gastroenterology-gi-endoscopy/>

185. Table 5 shows that the merging parties will provide approximately []% of the procedures focused on the torso. Further, [

].

186. In 2014 general surgery/gastroenterology/endoscopy accounted for approximately []% of private hospital patient revenues in Wellington.¹⁷⁶

Table 5: Combined market shares for general surgery, gastroenterology and endoscopy 2014

	Hospital	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital	Total
Procedures	#	[]	[]	[]	[]	[]
	%	[]%	[]%	[]%	[]%	100%
Revenue	\$	[\$]	[\$]	[\$]	[\$]	[\$]
	%	[]%	[]%	[]%	[]%	100%

Source: Industry participants

187. Southern Cross Hospital has seven general surgeons compared to Wakefield Hospital's 19, Bowen Hospital's eleven and Boulcott Hospital's six. Some of the Southern Cross Hospital surgeons undertake DHB outsourced work at Southern Cross [

].¹⁷⁷

188. Southern Cross Hospital offers [

]. Table 6 below lists those procedures funded by Southern Cross Insurance and for which the merging parties overlap.

Table 6: Share of Southern Cross Insurance claims for general surgery procedures 2014

	Total market revenue	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%

¹⁷⁶ Commission analysis from information provided by parties during the investigation.

¹⁷⁷ Southern Cross Hospital's response to information request (19 November 2014).

[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%

Source: Submission from Southern Cross Insurance (9 December 2014)

* procedures funded under both APS and fee-for-service. All other procedures that are not marked with an asterisk are fee-for-service only at present.

189. These tables indicate that both Wakefield/Bowen and Boulcott hospitals have a significant combined offering (over []%) in all but two general surgery procedures and over []% in many. [

].

190. The acquisition would result in the aggregation of the major provider of general surgery in Wellington – Wakefield Hospital/Bowen Hospital– with the second largest (albeit considerably smaller) provider in Boulcott Hospital. [

]. Therefore, absent entry or expansion of sufficient scope or other constraints from public hospitals or countervailing power, competition for some procedures in this specialty would likely be substantially lessened post-acquisition.

Gastroenterology and endoscopy

191. As noted above, [

].¹⁷⁸

192. Southern Cross Hospital advised us [

].¹⁷⁹ [

].¹⁸⁰

193. The acquisition would result in aggregation of the only two dedicated endoscopy units in Wellington. [

],

absent entry or expansion of sufficient scope or other constraints from public hospitals or countervailing power, competition would likely be substantially lessened in this specialty post-acquisition.

Oral and maxillofacial surgery

194. The merging parties will be the sole providers of all oral and maxillofacial surgical procedures undertaken under general anaesthetic in Wellington. Southern Cross Hospital does not currently provide this specialty, but has provided facilities for this specialty in the past.

195. In 2014 general oral and maxillofacial surgery accounted for approximately []% of private hospital patient revenues in Wellington.¹⁸¹

196. While a number of oral and maxillofacial procedures, such as tooth removal, can be done in consulting rooms under local anaesthetic,¹⁸² some patients prefer to undergo these procedures with general anaesthetic. Other procedures which are more surgically invasive or complex require general anaesthetic. All procedures involving general anaesthetic must be performed in a hospital.¹⁸³

197. The oral and maxillofacial specialty is small in comparison to other specialties. Southern Cross Insurance has an APS contract with Bowen Hospital and Boulcott Hospital for tooth extraction, a high volume procedure on which Southern Cross Insurance spends over \$[] per annum. This figure is set out in the table below. Information on other procedures was not available.

¹⁷⁸ Southern Cross Hospital's response to information request (19 November 2014).

¹⁷⁹ Commerce Commission interview with Southern Cross Hospital (6 November 2014).

¹⁸⁰ Ibid.

¹⁸¹ Commission analysis from information provided by parties during the investigation.

¹⁸² For instance, [], an oral and maxillofacial surgeon told us that three quarters of his procedures are undertaken in his consulting rooms. Interview with [] (19 November 2014).

¹⁸³ Commerce Commission interview with [] (19 November 2014).

Table 7: Share of Southern Cross Insurance claims for oral and maxillofacial surgery [] procedures in 2014

	Total market revenue	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital
[]	\$([])	[]%	[]%	[]%	[]%

Source: Submission from Southern Cross Insurance (9 December 2014)

* Procedures funded under both APS and fee-for-service.

- 198. The merger would result in a reduction from two providers to one for oral and maxillofacial procedures requiring hospital facilities and would therefore leave insurance companies and self-funded patients with a reduced choice.
- 199. Therefore, absent entry or expansion of sufficient scope or other constraints from public hospitals or countervailing power, competition for some procedures in this specialty, would likely be substantially lessened post-acquisition.

Plastic surgery

- 200. Plastic surgery covers a wide range of different surgical procedures that repair, reconstruct or replace structures in many different parts of the body. Plastic surgery can generally be divided into reconstructive surgery and cosmetic surgery (which includes breast enlargement, face lifts and liposuction). The majority of cosmetic surgery procedures are not covered by private medical insurance.
- 201. The merging parties will provide approximately []% of the plastic surgery procedures in Wellington.
- 202. In 2014 plastic surgery (including cosmetic and reconstructive) accounted for approximately []% of private hospital patient revenues in Wellington.¹⁸⁴
- 203. Boulcott Hospital has eight plastic surgeons compared to Wakefield Hospital’s six, Bowen Hospital’s four and Southern Cross Hospital’s one surgeon. Although surgeons can do a broad range of procedures, they typically focus on sub-specialties.
- 204. []

].¹⁸⁵ []

],¹⁸⁶ []

¹⁸⁴ Commission analysis from information provided by parties during the investigation.

¹⁸⁵ Commerce Commission interview with [] (19 November 2014).

¹⁸⁶ []

].¹⁸⁷

205. [

].¹⁸⁸ [

] ¹⁸⁹ [

].¹⁹⁰

Table 8: Market shares for plastic surgery 2014

	Hospital	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital	Total
Procedures	#	[]	[]	[]	[]	[]
	%	[]%	[]%	[]%	[]%	100%
Revenue	\$	[\$]	[\$]	[\$]	[\$]	[\$]
	%	[]%	[]%	[]%	[]%	100%

Source: Industry participants

206. Table 9 below sets out the plastic surgery procedures funded by Southern Cross Insurance and for which the merging parties overlap.

Table 9: Share of Southern Cross Insurance claims for plastic surgery procedures 2014

	Total market revenue	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%

Source: Submission from Southern Cross Insurance (9 December 2014)

Note: All procedures are fee-for-service only at present.

¹⁸⁷ Commerce Commission interview with [] (19 November 2014).

¹⁸⁸ [].

¹⁸⁹ Commerce Commission interview with [] (13 November 2014).

¹⁹⁰ Ibid.

207. Southern Cross Hospital told us that plastic surgery is a reasonably small specialty,¹⁹¹ although the removal of skin lesions, which makes up [] claims for Southern Cross Insurance, can be performed by a plastic surgeon¹⁹² or carried out under local anaesthetic in specialists' own consulting rooms.
208. While we do not have the market shares for plastics procedures that are performed by providers outside a private hospital, ie, in consulting rooms, we acknowledge that there are other procedures within the plastics specialty (in addition to skin lesion removal), that specialists in Wellington undertake in their consulting rooms.
209. As a result, we have fewer competition concerns in respect of the plastics procedures that can be performed in consulting rooms. However, the acquisition would result in a significant aggregation of market share for the merged entity in the provision of plastic surgery procedures – []% and in effect a reduction of two hospital providers to one, given Southern Cross Hospital's low market share.
210. Absent entry or expansion of sufficient scope, we consider that competition for some procedures in this specialty would likely be substantially lessened post-acquisition, particularly for self-funded patients requiring cosmetic surgery. This is because the majority of cosmetic surgery procedures are not covered by private medical insurance.

Urology

211. The merging parties will provide approximately []% of the privately-funded urology procedures in Wellington with Southern Cross Hospital retaining the majority market share of []%.
212. In 2014 urology accounted for approximately []% of private hospital patient revenues in Wellington.¹⁹³
213. The table below sets out the urology procedures funded by Southern Cross Insurance and for which the merging parties overlap.

Table 10: Market shares for urology 2014

	Hospital	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital	Total
Procedures	#	[]	[]	[]	[]	[]
	%	[]%	[]%	[]%	[]%	100%
Revenue	\$	[\$]	[\$]	[\$]	[\$]	[\$]
	%	[]%	[]%	[]%	[]%	100%

Source: Industry participants

¹⁹¹ Commerce Commission interview with Southern Cross Hospital (23 September 2014).

¹⁹² www.healthpoint.co.nz/private/specialist/dr-david-glasson-mb-chb-fracs-plastic/

¹⁹³ Commission analysis from information provided by parties during the investigation.

214. Southern Cross Hospital advised the Commission that it is able to offer a reasonably full range of urology procedures at its Wellington hospital and has a good market share in this specialty.¹⁹⁴

215. []¹⁹⁵ []
].

216. []
].

217. Table 11 below sets out the urology procedures funded by Southern Cross Insurance and for which the merging parties overlap.

Table 11: Share of Southern Cross Insurance claims for urology procedures 2014

	Total market revenue	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%

Source: Submission from Southern Cross Insurance (9 December 2014)

* procedures funded under both APS and fee-for-service. All other procedures that are not marked with an asterisk are fee-for-service only at present.

218. Southern Cross Hospital []
].

¹⁹⁴ Southern Cross Hospital response to information request (19 November 2014).

¹⁹⁵ Commerce Commission interview with [] (14 October 2014).

219. [] Southern Cross Insurance and the other insurers have raised concerns about the strength of their bargaining position when negotiating with fewer suppliers. In addition, price sensitive self-funded patients have one less option available to them.
220. We also acknowledge that there are procedures within the urology specialty that specialists in Wellington undertake in their consulting rooms. We do not have the market shares for these urology providers, but as a result, we have fewer competition concerns in respect of the urology procedures that can be performed in consulting rooms.
221. Although Southern Cross Hospital is likely to provide constraint in certain urology procedures, the acquisition would reduce the options available to insurance companies and self-funded patients from three to two for those procedures requiring hospital facilities. Therefore in the absence of entry or sufficient expansion we consider that competition for some urology procedures would likely be substantially lessened post-acquisition.

Ophthalmology

222. Table 12 below shows that the combined entity will account for approximately []% of ophthalmology procedures by revenue. In 2014 ophthalmology accounted for approximately []% of private hospital patient revenues in Wellington.¹⁹⁶

Table 12: Market shares for ophthalmology 2014

	Hospital	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital	Total
Procedures	#	[]	[]	[]	[]	[]
	%	[]%	[]%	[]%	[]%	100%
Revenue	\$	[\$]	[\$]	[\$]	[\$]	[\$]
	%	[]%	[]%	[]%	[]%	100%

Source: Industry participants

223. Southern Cross Hospital is a large player in this specialty. Southern Cross Hospital estimates that it carries out approximately []% of eye surgeries in Wellington.¹⁹⁷ [

].¹⁹⁸

224. The merging parties overlap in the provision of APS cataract procedures as shown in table 13 below. Southern Cross Hospital provides []% of total cataract procedures.

¹⁹⁶ Commission analysis from information provided by parties during the investigation.

¹⁹⁷ Commerce Commission interview with Southern Cross Hospital (23 September 2014).

¹⁹⁸ Southern Cross Hospital response to information request (19 November 2014).

Table 13: Share of Southern Cross Insurance claims for ophthalmology procedures 2014

	Total market revenue	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital
[]	\$([])	[]%	[]%	[]%	[]%

Source: Submission from Southern Cross Insurance (9 December 2014)

* procedures funded under both APS and fee-for-service.

225. []¹⁹⁹ [

].²⁰⁰

226. Some ophthalmological procedures (eg, removal of cataracts) can be performed in a long-stay hospital or a short-stay hospital facility. Cataract surgery, although it typically requires local anaesthetic,²⁰¹ is performed in a hospital facility (including short stay facilities) owing to the specialised equipment required.^{202 203}

227. Other ophthalmological procedures (eg, laser treatments) may be carried out in a specialist's consulting rooms. We do not have the market shares for these ophthalmology providers, but as a result, we have fewer competition concerns in respect of the ophthalmological procedures that can be performed in consulting rooms.

228. While the merged entity would continue to face competition from Southern Cross Hospital and other providers for certain procedures, the acquisition would result in the number of hospital providers of eye surgery reducing from three to two.

229. [

] the insurance companies have raised concerns about the strength of their bargaining position when negotiating with fewer suppliers in

¹⁹⁹ [] is one of [] ophthalmologists affiliated by Southern Cross Insurance in the Wellington region.

²⁰⁰ Commerce Commission interview with [] (31 October 2014).

²⁰¹ Ibid.

²⁰² Cataract surgery involves removing the cataract-damaged lens and replacing it with a clear plastic lens known as an intralocular lens implant (IOL). This surgery involves the use of specialised equipment (for further details about cataract surgery see <https://www.southerncross.co.nz/AboutTheGroup/HealthResources/MedicalLibrary/tabid/178/vw/1/ItemID/202/Cataracts-causes-symptoms-treatment-surgery.aspx>)

²⁰³ Consultations may be held in eye clinics/consulting rooms.

general. In addition, price sensitive self-funded patients have one less option available to them.

230. Although Southern Cross Hospital is likely to provide constraint in certain eye procedures, the acquisition would reduce the options available to insurance companies and self-funded patients from three to two for those ophthalmology procedures requiring hospital facilities. Therefore in the absence of entry or sufficient expansion we consider that competition for some ophthalmology procedures would likely be substantially lessened post-acquisition.

Gynaecology

231. Southern Cross Hospital undertakes a reasonably wide range of gynaecological procedures. In 2014, gynaecology accounted for approximately []% of private hospital patient revenues in Wellington.²⁰⁴
232. Table 14 below shows that the merging parties will account for approximately []% of total gynaecology procedures post-merger.

Table 14: Market shares for gynaecology 2014

	Hospital	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital	Total
Procedures	#	[]	[]	[]	[]	[]
	%	[]%	[]%	[]%	[]%	100%
Revenue	\$	[\$]	[\$]	[\$]	[\$]	[\$]
	%	[]%	[]%	[]%	[]%	100%

Source: Industry participants

233. Southern Cross Hospital accounts for []% of total gynaecological procedures. The merging parties overlap in providing more than 11 procedures. Four of these procedures have APS contracts.
234. Table 15 below sets out the gynaecology procedures funded by Southern Cross Insurance and for which the merging parties overlap.

Table 15: Share of Southern Cross Insurance claims for gynaecology

	Total market revenue	Wakefield Hospital and Bowen Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%

²⁰⁴ Commission analysis from information provided by parties during the investigation.

[]					
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%
[]	[\$]	[]%	[]%	[]%	[]%

Source: Submission from Southern Cross Insurance (9 December 2014)

* procedures funded under both APS and fee-for-service. All other procedures that are not marked with an asterisk are fee-for-service only at present.

235. []

].²⁰⁵ []

].

236. The acquisition would result in the number of hospital providers of gynaecology procedures reducing from three to two. The merged entity would continue to face competition from Southern Cross Hospital in a range of procedures.

237. [] advised us that it would have concerns in this specialty with the acquisition,²⁰⁶ while [] advised us that Southern Cross Hospital is the leading Wellington private hospital for gynaecology.²⁰⁷

238. However, the insurance companies have raised concerns about the strength of their bargaining position when negotiating with fewer suppliers in general. So while Southern Cross Hospital is likely to provide constraint on the merged entity in a number of gynaecological procedures, the acquisition would reduce the options available to insurance companies and self-funded patients from three to two. In the absence of entry or sufficient expansion we consider that competition for some gynaecological procedures would likely be substantially lessened post-acquisition.

Cardiology services

239. Boulcott Hospital leases consulting space in its hospital to the Wakefield Heart Centre.²⁰⁸ The space is used by Wakefield Heart Centre cardiologists to provide

²⁰⁵ Commerce Commission interview with [] (14 October 2014).

²⁰⁶ Commerce Commission interview with [].

²⁰⁷ Letter from [].

²⁰⁸ Commerce Commission interview with [] (3 December 2014).

secondary cardiology services to its patients.²⁰⁹ [

].²¹⁰

240. []²¹¹ [

].

241. In 2014 cardiology accounted for approximately []%²¹² of private hospital patient revenues in Wellington.²¹³ [

].

Table 16: Share of Southern Cross Insurance claims for cardiology services 2014

	Total market revenue	Wakefield Hospital	Boulcott Hospital	Combined entity	Southern Cross Hospital
[]	\$ []	[]%	[]%	[]%	[]%

Source: Submission from Southern Cross Insurance (9 December 2014)

Note: All procedures are fee-for-service only at present.

242. We do not consider that Boulcott Hospital, which undertakes only []% of the value of this APS procedure, could provide Southern Cross Insurance with ‘coverage’ when negotiating this APS contract with Wakefield Hospital.

243. Given that Boulcott Hospital’s provision of cardiology services is unlikely to provide an effective competitive constraint, with or without the acquisition, we have fewer concerns with this specialty. We do not consider it further.

Overall conclusion on existing competition

244. After considering the existing competition the merged entity would face with the acquisition, we have concerns (to differing levels of degree) in each of the overlapping specialties as outlined in Table 17 below.

²⁰⁹ Commerce Commission interview with [] (3 December 2014).

²¹⁰ Ibid.

²¹¹ Commerce Commission interview with [] (14 October 2014).

²¹² This excludes patient revenues for cardiac surgery ([]%) and vascular surgery ([]%).

²¹³ Commission analysis from information provided by parties during the investigation.

Table 17: Overlapping specialties and concerns post-acquisition

Overlapping specialties	Level of constraint likely to be provided by Southern Cross Hospital and the concerns we consider arise as a result of the proposed acquisition
Orthopaedics	Southern Cross Hospital unlikely to provide sufficient constraint. The acquisition would effectively reduce the options available to insurance companies and self-funded patients from two to one in certain procedures.
Otolaryngology (ENT)	Southern Cross Hospital unlikely to provide sufficient constraint. The acquisition would effectively reduce the options available to insurance companies and self-funded patients from two to one in certain procedures.
General surgery Gastroenterology/endoscopy	Southern Cross Hospital unlikely to provide sufficient constraint. The acquisition would effectively reduce the options available to insurance companies and self-funded patients from two to one in certain procedures.
Oral and maxillofacial	Southern Cross Hospital unlikely to provide sufficient constraint. The acquisition would reduce the options available to insurance companies and self-funded patients from two to one for procedures requiring general anaesthetic.
Plastics surgery	The majority of cosmetic procedures in the plastics specialty are not covered by private health insurance. We have fewer competition concerns with plastics procedures that can be performed in consulting rooms. However, the acquisition would reduce the private hospital options available to insurance companies and self-funded patients from two to one for certain procedures.
Urology	Southern Cross Hospital and other providers are likely to provide constraint in certain procedures. We have fewer competition concerns with urology procedures that can be performed in consulting rooms. However, for those urology procedures requiring hospital facilities the acquisition would reduce the private hospital options available to insurance companies and self-funded patients from three to two.

Ophthalmology	Southern Cross Hospital and other providers are likely to provide constraint in certain procedures. We have fewer competition concerns with ophthalmology procedures that can be performed in consulting rooms. However, for those ophthalmology procedures requiring hospital facilities the acquisition would reduce the private hospital options available to insurance companies and self-funded patients from three to two.
Gynaecology	Southern Cross Hospital is likely to provide constraint in certain procedures, but the acquisition would reduce the private hospital options available to insurance companies and self-funded patients from three to two.
Cardiology services	Acurity currently has a large majority market share in this specialty in Wellington. Given that Boulcott Hospital's provision of cardiology services is unlikely to provide an effective competitive constraint, with or without the acquisition, we have fewer concerns with this specialty. We do not consider it further.

Constraint from public hospitals

245. In previous decisions the Commission considered public hospitals to be in a discrete market to private hospitals in respect of secondary elective surgery because of different funding mechanisms, different customer groups, and waiting times.
246. Despite being in a separate market, DHBs are an alternative supplier of elective surgery for those patients that meet the eligibility criteria.²¹⁴ We have therefore assessed what degree of constraint they impose on private hospitals.
247. Since the Commission's earlier decisions the government has allocated extra funding to public elective surgery. The expectation is that by January 2015 the volume of elective surgery performed in public hospitals will have increased such that waiting times will have reduced to four months.²¹⁵
248. Nevertheless, it remains the case that approximately half of the elective surgeries performed in New Zealand are undertaken in private hospitals. It is expected this will continue despite an increase in public sector supply as many patients either do not meet the eligibility criteria to be placed on the waiting list or cannot wait for a public procedure.^{216 217}
249. One surgeon told us that if a self-funding patient is referred to them by a GP for private surgery but is eligible for DHB referral, then the patient can be re-referred into the public system if they would prefer to undertake the procedure for free at the DHB.²¹⁸ The trade-off would be the willingness of the patient to wait for the procedure to be performed.
250. At a more general level, a patient deciding whether to purchase private health insurance will be likely to consider the service provided by the public hospitals: how likely is it that they will need a procedure that they will be eligible to have performed in the public system? And will they be willing to wait?
251. Therefore, it appears that while the public hospitals do impose some level of constraint, this is best described as providing a ceiling constraint. The public hospitals provide a limit or ceiling on what the private hospitals can charge, which is mainly a function of eligibility criteria and waiting times. Other relevant factors may include any actual or perceived differences in quality. As waiting times decrease this ceiling will drop.

²¹⁴ Once a fully insured patient is referred privately for treatment, it is unlikely that they would then switch to the public system (even if they were eligible) because at the time of the referral, they would have already paid for their insurance.

²¹⁵ Ministry of Health Annual report for the year ended 30 June 2012, p.24

²¹⁶ Fact file – health insurance in New Zealand (May 2013). *Health Funds Association of New Zealand* Available at: http://www.healthfunds.org.nz/pdf/HFANZ_Fact_File_April_2013.pdf

²¹⁷ 'Although there has been a 37% increase in elective surgical discharges since 2007/08' ... 'New Zealand will always have more patients than our publicly funded non-urgent medical and surgical services can cope with at any one time'. Submission from the Ministry of Health (26 November 2014).

²¹⁸ Commission interview with [] (19 November 2014).

252. However, in our view, competition between private hospitals occurs beneath this ceiling and the mere fact that public hospitals provide elective surgery is not in itself sufficient to prevent a substantial lessening of competition.

Potential competition

253. Notwithstanding that the acquisition reduces existing competition and results in very high market share aggregation, as the Court of Appeal noted in *Southern Cross*:²¹⁹

Market share is relevant to the level and significance of market power but it is not in itself the determinant of market power. What level of market power a firm has, as a result of its market share, will depend substantially on the level of barriers to entry and expansion which apply to the market. If the barriers are low, a high market share is unlikely to result in an insufficiently constrained level of market power. Conversely, if the barriers are high, a high market share is likely to lead to such a result.

254. While the proposition that a firm's market power depends substantially on the level of barriers to entry and expansion in the relevant market is well established in New Zealand competition law, New Zealand's courts have subsequently highlighted that the question of whether conditions in a market qualify as a barrier to entry, however defined, is less important than whether those conditions have the potential to prevent, impede or slow entry and expansion.²²⁰
255. We assess whether entry by new competitors or expansion by existing competitors is likely to be sufficient in extent in a timely fashion to constrain the merged firm and prevent a substantial lessening of competition (the LET test).²²¹
256. We have assessed whether Southern Cross Hospital is likely to expand into providing procedures it does not currently provide (or at least not to a great extent as it does not have the surgeons or is otherwise capacity constrained) so as to replace the competition lost by removing Boulcott as an independent competitor. This loss of competition occurs for some procedures in the orthopaedics, otolaryngology (ENT), general surgery/gastroenterology/endoscopy, oral and maxillofacial, and plastic specialties.
257. We have also assessed whether entry by another provider is likely. There is a recent example of a group of surgeons in Christchurch establishing a facility.²²²
258. While certain conditions of expansion, such as, existing site capacity constraints, may differ compared to entry, both entry and expansion share a common crucial condition – the ability to attract surgeons. We discuss this condition of expansion and entry first.

²¹⁹ *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 at [68].

²²⁰ See *Air New Zealand/Qantas v Commerce Commission (No 6)* (2004) 11 TCLR 347 (HC) at [102], endorsed in *New Zealand Bus Ltd v Commerce Commission* [2008] 3 NZLR 433 (CA) at [252].

²²¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, above n 1 at [3.95].

²²² Connor highlighted Forte Hospital, a four theatre private hospital, which opened in Christchurch. Application at [61].

Ability to attract surgeons

259. There are a number of considerations relevant to the determination of whether a private hospital is likely to be able to profitably expand the number and scope of procedures it provides. These include physical site capacity constraints and the requirement to invest in certain equipment for some specialities. Our examination of these markets indicates that a crucial condition is the ability to attract surgeons. As such we address it prior to discussing the other conditions of entry.
260. Surgeons – and surgeon time – are scarce. Without a surgeon to perform a procedure, a hospital will not earn revenue from selling its hospital services. Losing one surgeon is an important consideration as the hospital loses profitability.²²³ It follows that one of the key conditions for any new entrant or for Southern Cross Hospital to overcome in order to expand its current offering, is attracting surgeons. Southern Cross Hospital has historically faced difficulties attracting surgeons, apart from the case of vascular surgeons (discussed below at paragraphs 265 to 272).²²⁴
261. As described in the industry background section, there are a range of factors which influence where a surgeon chooses to perform surgery including:
- 261.1 the ability for a surgeon to schedule surgery at a time convenient to the surgeon;
 - 261.2 the convenience of the hospital location to either the public hospital at which they work, or to their consulting rooms/home;
 - 261.3 access to consulting rooms on the hospital campus;
 - 261.4 the capacity of the hospital (efficiency and quality of equipment);
 - 261.5 whether the hospital has ACC and DHB contracts (hospitals need these contracts to ensure a certain volume of work in some procedures – [];²²⁵
 - 261.6 the trust they have in the surgical teams they work with and have practised routines with;
 - 261.7 whether the hospital’s charges are so high as to reduce the likelihood of a patient wanting a procedure to be performed;
 - 261.8 whether the hospital has contracted with Southern Cross Insurance for a certain procedure;

²²³ Commerce Commission interview with Connor (5 December 2014) and information provided on 9 December 2014 in response to question 8.

²²⁴ While it appears that Southern Cross Hospital’s attraction of the vascular surgeons is not likely to be representative of the norm, we examine the circumstances surrounding the surgeons switching below.

²²⁵ Commerce Commission interview with [] (23 September 2014).

- 261.9 if the hospital is a lead provider and so providing both facilities and for procuring the surgeon's services, the amount of money the surgeon is paid by the hospital.
262. The question for expansion or entry is if the merged firm sought to exert its market power by increasing the hospital portion of prices, under what circumstances could Southern Cross Hospital or a new entrant attract new surgeons into the region. Or under what circumstances would a surgeon have an incentive to switch from the merged firm's hospitals (or to switch some of their time) to Southern Cross Hospital or a new entrant?

The ability for Southern Cross Hospital to attract surgeons

263. The ability for Southern Cross Hospital or another provider to attract surgeons will necessarily involve attracting surgeons away from competitors. The ability to attract surgeons to switch to Southern Cross Hospital or a new entrant would likely be based on whether their fees²²⁶ would be higher if they switched to Southern Cross Hospital and that difference was significant enough to outweigh the other factors highlighted above. Further, as mentioned, surgeons will also consider the quality of the hospital's offering, including equipment, on site labs, and imaging as these facilities can affect the quality of the service surgeons can provide.²²⁷
264. Connor submitted that Southern Cross Hospital is in a prime position to attract surgeons because of its scale advantage and financial advantage as a not-for-profit player.²²⁸ Acurity submitted that surgeons can and do readily switch to Southern Cross Hospital as they are enticed by Southern Cross' "rent free" offer for consulting rooms.²²⁹
265. However, we were told that Southern Cross Hospital has historically faced difficulties attracting surgeons (the one notable exception being the case of vascular surgeons).
266. Southern Cross Hospital advised that:²³⁰

[

].

²²⁶ This would be for Southern Cross Insurance APS funded procedures, where the hospital is the lead provider and negotiates the price for a procedure with Southern Cross Insurance. Under fee-for-service and self-funded procedures, the surgeon sets their own fee and bills the patient.

²²⁷ Commerce Commission interviews with Southern Cross Hospital (23 September 2014) and with [] (14 October 2014).

²²⁸ Connor's response to the Commission's letter of unresolved issues (28 November 2014) at [19].

²²⁹ Commerce Commission interview with Acurity (6 October 2014).

²³⁰ Southern Cross Hospital response to information request (5 December 2014). [

].

267. Southern Cross Hospital was successful in attracting vascular surgeons from Wakefield Hospital to work at its hospital using its new hybrid theatre and upgraded consulting facilities. Prior to the arrival of the vascular surgeons, Southern Cross Hospital had no presence in the vascular speciality.
268. Southern Cross Hospital advised that [].²³¹
269. We asked Southern Cross Hospital how it attracted the vascular surgeons from Wakefield Hospital to Southern Cross Hospital. It advised the following.²³²
[]
].
270. When asked whether it could replicate this process in relation to other specialty areas, Southern Cross Hospital advised.²³³
[]
].
271. The vascular example shows that surgeons can switch hospitals should they choose to do so, but we are interested in whether post-acquisition surgeons would be likely to switch hospitals. We consider that the circumstances in which the vascular surgeons moved to Southern Cross Hospital were unique and resulted (at least partially) from a breakdown of the relationship between Wakefield Hospital and the surgeons (there is no evidence of any similar planned large scale movement of surgeons to Southern Cross Hospital).
272. We do not consider this to be an example of where surgeons switched hospitals in response to the exercise of market power by the hospitals. Therefore, while the example illustrates that surgeons can switch if there is an option, it does not show that Southern Cross Hospital will be able to successfully attract surgeons in the absence of some precipitating event such as that which occurred in relation to the vascular surgeons.

²³¹ Southern Cross Hospital response to information request (5 December 2014).

²³² Ibid.

²³³ Ibid.

273. We acknowledge that Southern Cross Hospital advised us that it does [].

274. Moreover, this acquisition would increase the merged entity's market power. The merged entity will have an incentive to protect this market power by retaining surgeons. The ability for Southern Cross Hospital to attract surgeons away from the merged entity may therefore not alter post-merger.

The ability to attract new surgeons to the region

275. We do not consider that Southern Cross Hospital (or another new entrant) is well positioned to attract new surgeons to the Wellington region.

276. Southern Cross Hospitals, along with the other private hospitals, is largely dependent on public hospitals successfully recruiting new surgeons to a region.²³⁴ The private hospitals therefore rely on the public hospitals to attract the surgeons to the region, then subsequently seek to attract those surgeons to also work at their hospital once they have taken up appointments at the public hospitals.²³⁵

277. We understand that another private hospital in New Zealand, in an attempt to attract more surgeons, has looked nationally (and overseas) to recruit salaried surgeons. The hospital has been attempting to attract [] since June 2014 from London, USA and Australia but has been unsuccessful to date.²³⁶ In contrast, Connor advised that Accent Health Recruitment was commissioned in 2014 by Southern Cross Insurance to run a campaign in New Zealand, Australia and the United Kingdom to gauge the level of interest of potential orthopaedic surgeons to work in the private sector in Auckland. Connor notes that the agency had an "extremely positive response" with over 20 doctors having registered interest in a fortnight.²³⁷

Conclusion on attracting new surgeons

278. Southern Cross Hospital has faced difficulties in attracting surgeons. The evidence does not satisfy us that Southern Cross Hospital's (or another new entrant's) ability to attract surgeons away from the merged entity's hospitals (or to attract surgeons from overseas) towards Southern Cross Hospital (or another new entrant), will change with the proposed acquisition. Nor are we satisfied that the acquisition or

²³⁴ Application at [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."

²³⁵ Capital & Coast DHB advised us that secondary elective work is outsourced every year – often driven by staff shortages, influx of patients and difficulty in recruiting. See file note of interview with Capital Coast DHB (6 October 2014).

²³⁶ Commerce Commission interview with [] (21 November 2014) and Connor's response to the Commission's letter of unresolved issues (28 November 2014) at [26].

²³⁷ Connor's response to the Commission's letter of unresolved issues (28 November 2014) at [26].

any exercise of market power will change the balance of incentives such that surgeons will consider switching away.

279. Even if one or two surgeons decided to switch to Southern Cross Hospital, that switching would not mitigate the competition concerns we have identified in each of the specialities.
280. We are therefore not satisfied that it is likely that Southern Cross Hospital, or a new entrant, would be able to attract a sufficient number of surgeons in the foreseeable future to replace the competition lost from the acquisition.

Likelihood of expansion by Southern Cross Hospital

Availability of facilities

281. In this section we consider whether Southern Cross Hospital is likely to be able to expand into providing procedures it does not offer or expand its current offering post-acquisition.
282. Southern Cross Hospital has made significant investments in new theatres, short-stay improvements and intensive care unit (ICU) space over the past decade.²³⁸ In the last three to four years this has included:²³⁹
- 282.1 upgrading its short-stay areas;
 - 282.2 the fit-out and commissioning of a fifth operating theatre;
 - 282.3 adding a new six-bed High Dependency Unit/ICU;
 - 282.4 improving its consulting facilities and an area for a CT scanner; and
 - 282.5 establishing a vascular lab, including radiology equipment.
283. Southern Cross Hospital also has excess capacity, as can be seen in the table below. Its utilisation rate is []%, and while 100% is not achievable, the typical maximum utilisation rate, as measured by the number of hours a theatre could be available for use, is 80%.²⁴⁰ However, capacity, (in addition to the number of hours a theatre is available) is relative to the number of hours that a surgeon is available.

²³⁸ See letter from Southern Cross Hospital (14 October 2014) and file note of Southern Cross Hospital site visit (3 November 2014).

²³⁹ Letter from Southern Cross Hospital to the Commission (14 October 2014).

²⁴⁰ Commerce Commission interview with Southern Cross Hospital (4 December 2014).

Table 18: Hospital capacity and utilisation

	2014		
	Theatre Capacity		Utilisation rate
	Hours	% of market	
Wakefield	[]	[]%	[]%
Bowen	[]	[]%	[]%
Total Acurity	[]	[]%	[]%
Evolution (Boulcott)	[]	[]%	[]%
Total combined entity	[]	[]%	[]%
Southern Cross	[]	[]%	[]%
Total	[]	100%	[]%

Source: Industry participants

284. Despite the upgrading of its facilities in recent years, Southern Cross Hospital has identified the following general factors as limiting its ability to increase its theatre utilisation rate and to further expand its facility and therefore be able to offer other procedures at its Wellington hospital:

284.1 [

],²⁴¹

284.2 [

],²⁴²

284.3 [

];²⁴³ and

284.4 [

],²⁴⁴ [

].²⁴⁵

285. Southern Cross Hospital sought Board approval in July 2013 to [] site, noting that it had considered using this site for a multi storey car park but found that it was not economic. The Board paper also notes the shortage of medical consulting rooms on site. It says:²⁴⁶

[

].

²⁴¹ See letter from Southern Cross Hospital (14 October 2014).

²⁴² Ibid.

²⁴³ [

] – see

file note of Southern Cross Hospital site visit (3 November 2014).

²⁴⁴ Commerce Commission interview with Southern Cross Hospital (6 November 2014).

²⁴⁵ Ibid.

²⁴⁶ Southern Cross Hospital Board paper discussing land purchase – July 2013.

[

].

[

].

286. Southern Cross Hospital advised us that the purchasing of land did not occur for the following reasons:²⁴⁷

[

].

...
[

].

Conclusion on expansion by Southern Cross Hospital

287. Southern Cross Hospital has expanded its facilities over the past decade and specifically over the last three to four years. This expansion has seen Southern Cross Hospital growing in patient numbers and revenue, [

].²⁴⁸ The figures below imply that Southern Cross Hospital has been []²⁴⁹

²⁴⁷ Letter from Southern Cross Hospital to the Commission (14 October 2014).

²⁴⁸ Letter from Southern Cross Hospital to the Commission (28 October 2014) at [3], as per the management accounts and incorporate internal cost allocations.

²⁴⁹ See letter from Southern Cross Hospital to the Commission (14 October 2014): [

].

Table 19: Southern Cross Wellington Hospital growth 2010-2012

	Patients	Year-over-year percentage growth in patients	Growth in revenue	Year-over-year percentage growth in revenue
2010	[]		[\$]	
2011	[]	[]%	[\$]	[]%
2012	[]	[]%	[\$]	[]%

Source: Extract from Southern Cross Hospital Board report 30 April 2013 at 1 and Commission analysis.

288. A Southern Cross Board Report of 29 January 2013 discussed the capital expenditure for the fit-out and commissioning of the 5th theatre, it notes:

[

].

289. Despite this growth Southern Cross Hospital still has excess theatre capacity. We also have reservations over whether it has sufficient car-parking and consulting rooms to underpin expansion.
290. These concerns are layered on our conclusion about Southern Cross Hospital's ability to attract surgeons. As we have explained, we acknowledge that while Southern Cross Hospital may be able to attract some surgeons, we are not satisfied that a sufficient number of surgeons would move to replace the competition lost from the acquisition.
291. Specifically in relation to the procedures that Southern Cross Hospital does not currently provide (or at least not to a great extent), Southern Cross Hospital told us that:

291.1 it considers [

].²⁵⁰ [

].²⁵¹

291.2 [Cross Hospital advised that in terms []:²⁵³].²⁵² Southern

[

].

291.3 [

].²⁵⁴

292. Further, while it is possible that Southern Cross Hospital may be able to attract a few surgeons in different specialties, it is unlikely that it would be across all markets of concern.²⁵⁵
293. Accordingly, we are not satisfied that the merged entity is likely to be constrained by an existing competitor in the relevant markets. We are not satisfied that Southern Cross Hospital is likely to enter into those procedures which it does not currently provide (or not to a sufficient extent) to replace the competition lost from Boulcott.
294. Our conclusions on entry and expansion differ to those we reached in the Wakefield Hospital and Bowen Hospital decision.²⁵⁶ In that decision the Commission concluded that expansion of hospital facilities by an existing competitor was likely and that there were not significant barriers to entry or expansion. The Commission did not focus in detail on the likelihood of surgeons switching between hospitals, other than in the context of whether a surgeon would have an incentive to support a hospital in which he or she did not have a financial interest. The decision does not record industry participants as highlighting any impediments to expansion, including obtaining the necessary consents. The Commission's decision was also made in 2003,

²⁵⁰ Commerce Commission interview with Southern Cross (23 September 2014) and letter from Southern Cross Hospital (14 October 2014).

²⁵¹ [

].

²⁵² Commerce Commission interview with Southern Cross Hospital (6 November 2014).

²⁵³ Southern Cross Hospital response to information request (19 November 2014).

²⁵⁴ Ibid.

²⁵⁵ Southern Cross Hospital further told us that taking on surgeons (expanding their offering or entering certain sub-specialties) would come at the expense of other entry or expansion possibilities. Interview with Southern Cross Hospital (6 November 2014).

²⁵⁶ Wakefield Hospital Limited and Bowen Hospital Limited (Commerce Commission Decision 492, 19 February 2003).

relatively soon after the introduction of the substantial lessening of competition test for mergers and before the courts had opined on its application.²⁵⁷

295. Our conclusions on entry and expansion in this decision are based on the evidence and submissions we have received, and reflect the way the courts have described the substantial lessening of competition test and the LET test in cases since 2003.

Likelihood of entry into procedures provided by long-stay facilities

296. In its application, Connor noted that in Decision 492,²⁵⁸ the Commission found that the threat of de novo entry of a hospital is low.²⁵⁹
297. In our investigation of Southern Cross Health Trust's contemplated joint venture with Aorangi Hospital in Palmerston North,²⁶⁰ [] advised us that the prospect of de novo entry was:²⁶¹

...frightening due to the capital outlay and the success of your business would depend on your access to a sufficient number of surgeons. Only the Auckland region might attract greenfields entry in New Zealand.

298. During the same investigation, another Wellington private hospital advised us that:²⁶²

... de novo entry in New Zealand is very difficult because the barriers to entry are high.

299. We have not been provided with any evidence to suggest that the conditions of entry into the provision of facilities for long-stay procedures are any less onerous than was previously the case.
300. Establishing a new hospital remains a significant, largely sunk expense and, as discussed, attracting the requisite surgeons is challenging. New hospitals are generally either set up by surgeons or by an existing provider expanding into new geographic areas.
301. Regardless of the capital cost, in order for an investment to occur, the expected profit from the investment must be positive. The higher the portion of costs that are sunk, the greater the risk of investment and so lower the expected profits.
302. We have seen no evidence to suggest that surgeons in Wellington are likely to establish a new hospital facility. Moreover, we do not consider that surgeons have the incentive to incur the risk of developing their own hospital unless they are otherwise dissatisfied with their current arrangements or believe that they are likely to earn returns that are sufficiently high to compensate for the risk of entry.

²⁵⁷ See *Brambles v Commerce Commission* above n 4.

²⁵⁸ Wakefield Hospital Limited and Bowen Hospital (Commerce Commission Decision 492, 19 February 2003).

²⁵⁹ Application at [59].

²⁶⁰ The Southern Cross Health Trust and Aorangi Hospital Limited (Commerce Commission Decision 650, 4 September 2008).

²⁶¹ *Ibid* at [234].

²⁶² *ibid*.

303. More generally, we have seen no evidence that any other parties are considering entry into the Wellington market.
304. Given the high sunk costs, and the difficulty with attracting surgeons (for a new entrant), we are not satisfied that entry into long-stay facilities is likely to occur in the Wellington region so as to constrain the merged entity post-acquisition.

Entry into procedures provided by short-stay facilities

305. The applicant submitted that in previous decisions the Commission found that the potential entry of day surgeries would act as a constraint.²⁶³
306. In this decision, we have considered the likelihood of rooms-based entry, ie, consulting rooms and the likelihood of short-stay facility entry. Given that the line between short-stay and long-stay are converging,²⁶⁴ we have included in our definition of short-stay, procedures that can be performed in a day and procedures that may require up to a two night stay in a facility.
307. There are different types of short-stay facilities that provide different types of procedures. Some surgical procedures can be undertaken in a surgeon's consulting rooms as the procedure may require local anaesthetic but no sedation (eg, skin lesion removal or some urology procedures).²⁶⁵ Other procedures may require one or two nights in hospital,²⁶⁶ but depending on the specialty, not necessarily the full suite of equipment available at a long-stay hospital.
308. Groups of surgeons typically establish a short-stay facility for specific specialties. For example, Acurity advised that:²⁶⁷
- ...local ophthalmologists have established their own eye procedure centre in Cuba Street, and urologist Andrew Kennedy-Smith with other surgeons has established procedure rooms adjacent to CCDHB in Riddiford Street.
309. Connor also highlighted Forte Hospital, a four theatre private hospital, which was opened in Christchurch in 2013. Forte is owned by 25 surgeons.^{268 269}

²⁶³ Application at [60].

²⁶⁴ Acurity advised that short stay procedures are the vast majority of work done in a modern surgical hospital. Up to 90% of cases can be short stay. 'Short-stay' in Acurity's view is a length of stay of two days or less and not requiring complex facilities. See Acurity's comments on the Commission's letter of unresolved issues (28 November 2014).

²⁶⁵ Commerce Commission interview with Southern Cross Hospital (14 November 2014) at [3].

²⁶⁶ Acurity notes that the average length of stay at Bowen and Wakefield Hospitals over the past 12 months has been []. See Acurity's comments on the Commission's letter of unresolved issues (28 November 2014) at 7.

²⁶⁷ Acurity's comments on the Commission's letter of unresolved issues (28 November 2014) at 8.

²⁶⁸ Application at [61] and Connor's response to the Commission's letter of unresolved issues (28 November 2014) at [29.1].

²⁶⁹ Forte's website states: "Forté Health is a recently opened state-of-the-art surgical hospital in central Christchurch specialising in short stay surgery. We work with surgeons from multiple disciplines including otorhinolaryngology, gynaecology, urology, orthopaedics, dental/maxillofacial and general specialties". <http://www.fortehealth.co.nz/about/>

310. In addition, Connor advised that eye surgeons who previously worked at St George’s private hospital in Christchurch set up their own short-stay eye clinic in Christchurch. Connor also provided the example of the establishment of the Northland Orthopaedic Centre in Whangarei.²⁷⁰
311. We do not consider the requirement to find a consulting room difficult. This is evidenced by the fact that urology procedure rooms have recently been set up in Wellington.²⁷¹
312. We acknowledge that surgeons have the ability to establish consulting room facilities in the Wellington region, but for the reasons we have explained we are not satisfied that surgeons have the incentive to do so as a result of the merger.²⁷²
313. We are aware that one group of Wellington surgeons have recently turned their minds to setting up their own facility. While they considered this, they indicated that they do not currently have the incentive to leave the private hospital they currently work at because the threat of departure is enough to maintain the conditions they want at [].²⁷³
314. More generally, Wellington surgeons we spoke to about the possibility of entry told us the following.
- 314.1 Wellington is well catered for in short-stay capacity, so there is no reason for new facilities to enter.²⁷⁴ It is a different situation to Auckland where doctor-owned surgeries have developed.²⁷⁵ Wellington is too fragmented.²⁷⁶
- 314.2 Several surgeons advised it is too expensive with regulations and health and safety issues to set up a facility;²⁷⁷ ISO, Ministry of Health and ACC standards are very strict and it is very hard work to reach the standards.²⁷⁸
- 314.3 “While there is nothing to stop persons starting up day surgery clinics, there would be a huge financial risk and the facility would need to develop its own contract with ACC and Southern Cross Insurance. Also the level of privately insured patients is not high in Wellington compared to Auckland”.²⁷⁹

²⁷⁰ Connor’s response to the Commission’s letter of unresolved issues (28 November 2014) at [31]. Northland Orthopaedic Centre specialises in joint replacement, hip, knee, shoulder, back, foot, ankle and elbow.

²⁷¹ Commerce Commission interview with Southern Cross Hospital (14 November 2014) at [3].

²⁷² We are not aware of any entry that is otherwise planned into the Wellington region.

²⁷³ See Commerce Commission interviews [] (2 December 2014) and [] (3 November 2014).

²⁷⁴ Commerce Commission interview with general surgeon [] (15 October 2014).

²⁷⁵ Ibid.

²⁷⁶ Commerce Commission interview with eye surgeon [] (31 October 2014).

²⁷⁷ Commerce Commission interviews with plastics surgeon [] (13 November 2014) and urologist [] (14 October 2014).

²⁷⁸ Commerce Commission interview with ENT surgeon [] (19 November 2014).

²⁷⁹ Commerce Commission interview with orthopaedic surgeon [] (10 October 2014).

- 314.4 “It would take a brave person to invest capital in a standalone facility in the current environment. The Wellington market is reasonably well serviced and anyone setting up a facility would need to be confident of sufficient volume to be financially viable.”²⁸⁰ This surgeon did not consider that there is a huge market for another provider at this time.
- 314.5 An orthopaedic surgeon advised that he would not look at setting up his own facility.²⁸¹ The surgeon does not believe that this has been discussed at all by orthopaedic surgeons in Wellington. He noted that orthopaedics is very “hardware orientated” and so it is hard to set up a new facility.²⁸²
315. Short-stay hospital facilities have developed elsewhere in New Zealand. We are aware of a facility that was established in central Wellington by a group of plastics surgeons and an oral surgeon but subsequently failed),²⁸³ but we do not have evidence of any plans to establish short-stay facilities (including consulting rooms) without the merger.
316. We consider that while there may be available space for a short stay facility in Wellington, we are not satisfied that there is an incentive for the development of such a facility in the specialties concerned. We have seen no evidence that such entry is currently being contemplated and we do not consider that the merger will change the balance such that surgeons or other investors incur the risk of entry post-acquisition. In any event, even if there is some scope for entry of short-stay facilities in Wellington, these facilities would be unlikely to remedy the competition concerns we have identified in certain procedures such as hospital-only procedures in the orthopaedics, and general surgery/gastroenterology/endoscopy specialties. This is because full hospital facilities are likely required for certain procedures in these specialties.
317. We are therefore not satisfied that new entry into short-stay facilities in the Wellington region is likely to occur in the foreseeable future.

Countervailing power of buyers

318. A merged firm’s ability to increase prices profitably may be constrained by the ability of certain customers to exert substantial influence on negotiations.²⁸⁴
319. We consider that a customer is able to use countervailing power to resist a price increase if it can:²⁸⁵
- 319.1 sponsor entry;
- 319.2 vertically integrate into the relevant market; or

²⁸⁰ Commerce Commission interview with gynaecologist [] (14 October 2014).

²⁸¹ Commerce Commission interview with orthopaedic surgeon [] (24 October 2014).

²⁸² Ibid.

²⁸³ Commerce Commission interview with plastics surgeon [] (13 November 2014).

²⁸⁴ *Mergers and Acquisitions Guidelines*, above n 1 at [3.113].

²⁸⁵ Ibid at [3.115].

319.3 punish a price increase in other, more competitive markets.

320. However, in all of these cases the countervailing power must be sufficient to constrain the merged firm.²⁸⁶ While customers may have a degree of countervailing power, if the proposed acquisition, for example removes a hospital that was an important alternative for that customer (ie, insurance companies), it will usually reduce that customer's negotiating power. In that case, the customer's remaining countervailing power may be insufficient to constrain the merged firm effectively.²⁸⁷
321. In this case, hospitals may be able to price discriminate by identifying and charging different prices to different customers where those price differences are not related to differences in the costs of serving those customers.²⁸⁸
322. In this section, we consider the countervailing power of the insurance companies.

Countervailing power of insurance companies

323. The applicant submitted that private health insurance providers (in particular Southern Cross Insurance) have strong countervailing power.²⁸⁹ Connor submitted that there is very little scope for private hospitals to negotiate the procedure prices set by Southern Cross Insurance under the APS and the percentage of APS admissions is increasing.²⁹⁰
324. Connor further submitted that post-acquisition, Southern Cross Insurance will always have choice between Southern Cross Hospital and Bowen Hospital/Wakefield Hospital/Boulcott Hospital (except for specialised tertiary procedures).²⁹¹
325. As discussed above, in paragraphs 162 to 164, Southern Cross Insurance told us that when it contracts for APS procedures, there would be a greater chance of competitive tension and success with more than two operators in a market.

Ability to leverage in other procedures

326. nib advised that it has not been able to leverage negotiations for competitive procedures into negotiations for less competitive procedures.²⁹² Southern Cross Insurance advised that it is difficult to leverage negotiations in unrelated specialties because "...it is too complicated as you are dealing with two different professionals".²⁹³
327. The applicant did not provide us with any examples where insurance companies had attempted to or actually had exercised countervailing power by leveraging negotiations in other, more competitive, procedures.

²⁸⁶ *Mergers and Acquisitions Guidelines*, above n 1 at [3.116].

²⁸⁷ *Ibid.*

²⁸⁸ *Mergers and Acquisitions Guidelines*, above n 1 at [3.22].

²⁸⁹ Application at [63].

²⁹⁰ Application at [68].

²⁹¹ Application at [70].

²⁹² Commerce Commission interview with nib (21 November 2014).

²⁹³ Commerce Commission interview with Southern Cross Insurance (21 November 2014).

328. Therefore, we do not consider that the insurance companies would have sufficient countervailing power to prevent a substantial lessening of competition through the ability to exercise leverage in other procedures.

Ability to leverage in other regions

329. We are not satisfied the parties would have the ability to exercise countervailing power by punishing the merging parties in other more competitive markets. Evolution as owner of Boulcott does not operate elsewhere in New Zealand. Acurity owns the Royston Hospital in Hawke's Bay, however Royston is the Hawke's Bay's only private hospital, a less competitive market than the Wellington region.

Ability for Southern Cross Insurance to direct customers to Southern Cross Hospital

330. While it was not put to us during our investigation, we considered whether Southern Cross Insurance and Southern Cross Hospital (given they are both part of the Southern Cross Healthcare Group) would have the ability post-acquisition to direct Southern Cross Insurance insured customers to Southern Cross' Hospital. This is not, however, a credible option for the following reasons.

331. First, it appears that the two businesses are run separately.²⁹⁴ Secondly, and in any event, even if it was realistic, for the reasons set out above it would be to no avail if Southern Cross Hospital could not attract the surgeons to perform the procedures.

332. The real question is whether Southern Cross Insurance could contract with Southern Cross Hospital to perform the procedures, and use that fact to also constrain contracts with the merged entity. If it could not contract with Southern Cross Hospital because Southern Cross Hospital could not perform the procedures for the reasons set out above, then whether there is an ability by Southern Cross Insurance to "direct" or not is immaterial.

333. Southern Cross Insurance advised that it:²⁹⁵

...is not able to utilise capacity at Southern Cross Hospitals (or any other facility) if it is unable to agree contracts with providers. We are not aware of any examples, even inadvertent, that evidence such countervailing power.

²⁹⁴ Southern Cross Insurance advised us on 10 October 2014 that "The two Southern Cross businesses are separately owned businesses, operating with separate management teams in separate buildings with different systems, process and strategic priorities. While we accept that there is a good relationship, a shared brand, not for profit ethos and some common directorships, it is not on any continuum or model 'vertically integrated'. For example, the Society management have not had access to Southern Cross Hospital's business strategies, the benefit of cost, revenue or price information. As a result, contrary to perception, the Society has had to negotiate AP contracts with Southern Cross Hospitals as it would with any other facility owner – on a commercial arms-length basis".

²⁹⁵ Letter from Southern Cross Insurance (10 October 2014).

334. It went on to say:²⁹⁶

The Society cannot increase flow at Southern Cross Hospitals:

- Because they are not under the Society control (legally, effectively or otherwise);
- Even if they were under the Society's control the reality is the patient pathway and specialist control in large part determines short to medium term capacity planning. No funder or hospital (for that matter) cannot simply increase capacity because it would like to without having the necessary surgeon relationships with that hospital and those surgeons agreeing to place more patients at that hospital.

Conclusion on countervailing power of insurance companies

335. As a result of the proposed acquisition, we consider that the insurance companies' bargaining power will be reduced as they will no longer have Boulcott Hospital as an option. We have seen no evidence where insurance companies have leveraged negotiations across procedures and we do not consider that Southern Cross Insurance would be able to direct insurance customers to Southern Cross Hospital to a sufficient extent to mitigate against a price increase by the merged entity.

336. We are therefore not satisfied that the insurance companies' remaining countervailing power will be sufficient to constrain the merged entity effectively in procedures covered by its policies.

²⁹⁶ Letter from Southern Cross Insurance (10 October 2014).

Efficiencies

337. The applicant claims that this acquisition will result in both cost savings and increased quality at Acurity. Specifically, that:
- 337.1 Acurity's offering could improve by leveraging off Evolution's existing relationships with suppliers, specialists, funding bodies and professional associations in both New Zealand and Australia;²⁹⁷
 - 337.2 cost savings could be made at the Acurity hospitals by leveraging Evolution's buyer power to achieve cost efficiencies from third party suppliers, including materials (such as prostheses), insurance, cleaning supplies and maintenance;²⁹⁸ and
 - 337.3 Evolution will bring to Acurity new and enhanced technologies, abilities, expertise and specialised knowledge.²⁹⁹
338. Connor has not provided estimates or analysis of the magnitude of these anticipated efficiencies and whether they would be passed on to consumers, nor an analysis of how and to what extent the anticipated product quality enhancements may increase demand.
339. We cannot therefore be satisfied that these claimed efficiencies would prevent customers from being adversely affected in a material way, so that the proposed acquisition would not be likely to substantially lessen competition.

²⁹⁷ Application at [77.1].

²⁹⁸ Application at [17.3].

²⁹⁹ Application at [77.2].

Determination on notice of clearance

340. We are not satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
341. Under s 66(3)(b) of the Commerce Act 1986, the Commission declines to give clearance to Connor Healthcare Limited to acquire all the shares in Acurity Health Group Limited that it does not already own.

Dated this 11th day of December 2014

Dr Mark Berry
Chairman