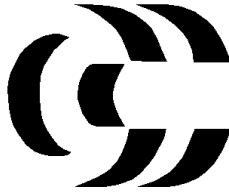


# PUBLIC COPY



ISSN NO. 0114-2720  
J4162

## COMMERCE COMMISSION Decision No. 404

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

**THE SOUTHERN CROSS MEDICAL CARE SOCIETY**

**AND**

**AETNA HEALTH (NZ) LIMITED**

**The Commission:** M J Belgrave (Chair)  
M N Berry  
E C A Harrison

**Summary of Proposed Acquisition:** The Southern Cross Medical Care Society (or a direct or indirect subsidiary) has sought clearance to acquire all the issued share capital in Aetna Health (NZ) Limited.

**Determination:** Pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission determines to decline to give a clearance for the proposed acquisition.

**Date of Determination:** 13 September 2000

**CONFIDENTIAL MATERIAL IN THIS REPORT IS  
CONTAINED IN SQUARE BRACKETS [ ]**

## TABLE OF CONTENTS

THE PROPOSED ACQUISITION .....	3
THE PROCEDURES .....	3
THE PARTIES .....	4
Southern Cross.....	4
Aetna .....	4
OTHER RELEVANT PARTIES.....	5
BACKGROUND TO HEALTH INSURANCE .....	5
MARKET DEFINITION .....	5
COMPETITION ANALYSIS .....	6
Introduction .....	6
Deed of Undertakings.....	7
Conclusion .....	10
DETERMINATION ON NOTICE OF CLEARANCE .....	10

## THE PROPOSED ACQUISITION

- 1 Pursuant to section 66(1) of the Commerce Act 1986 (“the Act”), The Southern Cross Medical Care Society (“Southern Cross”) gave notice to the Commission on 30 August 2000 (“the current notice” or “the current application”) seeking clearance for the proposed acquisition by it, or a direct or indirect subsidiary of Southern Cross, of all the issued share capital in Aetna Health (NZ) Limited (“Aetna”). The proposed acquisition is subject to undertakings by Southern Cross given under the Act. The undertakings state that Southern Cross will execute the attached Deed of Undertakings (“the Deed”) and duly carry out all of its obligations under the Deed.
- 2 The current notice repeats sections 5 to 16 (inclusive) and Annex A of a notice given by Southern Cross under section 66(1) of the Act dated 18 July 2000 (“the previous application”). Under the previous application, the proposed business acquisition was the same as under the current application, but was not subject to undertakings. On 25 August 2000, the Commission made a determination declining to give a clearance for the proposed acquisition as detailed in the previous application.<sup>1</sup>
- 3 Southern Cross amended the form of the Deed several times during the course of the Commission’s consideration of the current application. In essence, the Deed now sets out an undertaking by Southern Cross to divest certain assets on or before [            ], following its acquisition of Aetna. Specifically, the Deed refers to, *inter alia*, selling or procuring “... the sale of such number of medical insurance policies of insured members of Aetna to a purchaser who is not an interconnected body corporate (as defined by section 2(7) of the Act) or an associated person (as defined by section 47(3) of the Act) of Southern Cross or Aetna (“Purchaser”) so that the Purchaser will have, following that acquisition, market share in the medical insurance market in New Zealand ... [            ].” A copy of the Deed is contained in the Appendix.

## THE PROCEDURES

- 4 The Commission on 30 August 2000 registered the current application. Section 66(3) of the Act requires the Commission, within 10 working days after the date of registration of a notice, or such longer period agreed to by the Commission and the person giving a notice, to either give a clearance or decline to give a clearance for the acquisition proposed. The tenth working day after the registration of the current notice is 13 September 2000.
- 5 Southern Cross did not request confidentiality from the Commission for the fact of the current application. It did, however, request confidentiality for specific information contained in the current notice (including in relation to certain parts of the undertakings referred to earlier) on the grounds that the information is commercially sensitive and disclosure would be likely unreasonably to prejudice the commercial position of the parties to the current notice. The Commission, in accordance with section 100 of the

<sup>1</sup> Commerce Commission, Decision No. 399, 25 August 2000 (“*Decision No. 399*”).

Act, made a Confidentiality Order on 30 August 2000 prohibiting the publication or communication of specific information until 20 working days from the Commission's determination of the current notice. When the Confidentiality Order expires, the provisions of the Official Information Act 1982 will apply to the information.

- 6 The Commission's determination is based on an investigation conducted by its staff, and their subsequent advice to the Commission. The majority of the investigation work was carried out in respect of the previous application and is relevant to the current application. As indicated above, the essential difference between the previous application and the current application is that in the latter case the proposed acquisition, which is identical in both instances, is subject to undertakings by Southern Cross.
- 7 In the course of their investigation of the acquisition proposed by Southern Cross in the previous application, Commission staff had discussions with and sought the views and comments of a number of parties. The parties included insurance companies, insurance brokers, the New Zealand Treasury, the Health Funds Association of New Zealand and the New Zealand Private Hospitals Association. In addition to discussions held, a number of written submissions were received in respect of the previous application. Staff sought the views and comments of a number of industry participants in relation to the current application. The Commission also received a number of submissions on the current application, all of which argued against Southern Cross' proposed acquisition of Aetna.

## **THE PARTIES**

### **Southern Cross**

- 8 Southern Cross is a "not for profit" health care organisation incorporated as a friendly society under the Friendly Societies and Credit Unions Act 1982. The current application states that Southern Cross has four discrete activities:
- the provision of indemnity health insurance;
  - ownership of 13 hospitals, which are operated on an arm's length basis by The Southern Cross Hospital Trust;
  - travel insurance, through its wholly owned subsidiary Southern Cross Benefits Limited; and
  - worker's compensation claims processing, injury prevention and case management activities carried out by Southern Cross Benefits Limited and its 51% owned subsidiary, GMV Associates Limited.

### **Aetna**

- 9 Aetna is a health risk management services company which is ultimately wholly owned by Aetna Inc., located in Connecticut, United States of America. Aetna is being sold as part of an international reorganisation by Aetna Inc. of its operations. The main business activities of Aetna are:

- the provision of private indemnity health insurance and programmes designed to help manage work place injury and absenteeism; and
- the provision of health management services in the publicly funded primary care market, through its wholly owned subsidiary First Health Limited and its interest in PrimeHealth Limited, a 50/50 joint venture with a network of Tauranga physicians (through the company PrimeHealth Network Limited). Both these companies have management contracts with the Government's Health Funding Authority to provide patient services in their region on a capitation basis.

## **OTHER RELEVANT PARTIES**

- 10 Apart from Southern Cross and Aetna, major parties relevant to the Commission's consideration of competition for health or medical insurance services in New Zealand were identified in light of the proposed acquisition investigated as a result of the previous application. These parties, which are listed in *Decision No. 399*, mainly included insurance providers. Some such providers offer only general insurance products, while others offer both general and medical insurances or only medical insurance.

## **BACKGROUND TO HEALTH INSURANCE**

- 11 In *Decision No. 399* the Commission provided a brief background to health insurance. The background covered the function of health insurance, the principal types of health insurance, general methodologies used by health insurers to price their products, some statistical trends in health insurance, the regulatory environment within which insurance providers in New Zealand must operate, and the role of brokers.

## **MARKET DEFINITION**

- 12 Market definition is an important first step in the process of assessing competition and market dominance. As the Commission stated in *Decision No. 399*, "The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered, and in which the application of section 47(1) of the Act can be examined." The Commission briefly outlined in *Decision No. 399* the relevant principles relating to defining markets for the purposes of competition analysis.
- 13 As the Commission noted in *Decision No. 399*, the only area where the acquisition proposed by Southern Cross would result in significant aggregation of activities carried out by both Southern Cross and Aetna is for the provision of indemnity health insurance. Accordingly, in that determination the Commission considered that the only relevant market for the purposes of competition analysis was "the market for the provision of medical insurance in New Zealand". In respect of assessing the current application, the

Commission sees no reason to depart from the relevant market definition in *Decision No. 399*.<sup>2</sup>

## COMPETITION ANALYSIS

### Introduction

- 14 In *Decision No. 399* the Commission considered the impact on the medical insurance market of the acquisition proposed by Southern Cross in the previous application. Taking into account various factors, the Commission concluded in *Decision No. 399* that it was not satisfied that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in the medical insurance market. Accordingly, the Commission made a determination declining to give a clearance for the proposed acquisition.
- 15 Southern Cross' response to the Commission's determination was to file the current application with the Commission. As noted previously, under the current application, the proposed acquisition is subject to undertakings by Southern Cross, given under the Act, stating that Southern Cross will execute a divestment Deed and duly carry out all of its obligations under that Deed. The Commission's understanding of the intended objective of the Deed is that Southern Cross, through its disposal of a number of medical insurance policies, would attempt to ensure a competitive constraint, equivalent to Aetna [ ] remained in the medical insurance market. Southern Cross considers that a competitor with market share of this size would be a significant constraint on it, and would preserve the competitive structure of the medical insurance market notwithstanding the acquisition of Aetna by Southern Cross.
- 16 The Commission's objective under the competition analysis section is to assess the impact of the proposed acquisition, as specified in the current application, including the undertakings contained therein, on the medical insurance market.
- 17 Section 69A(2) of the Act prohibits the Commission from accepting an undertaking in relation to the giving of a clearance under section 66 of the Act other than an undertaking given under section 69A(1) of the Act. Section 69A(1) provides that, in giving a clearance under section 66 of the Act, the Commission may accept a written undertaking given by or on behalf of the person who gave a notice under section 66(1) of the Act to dispose of assets or shares specified in the undertaking. The Commission takes the view that any other undertakings relating to how an applicant will conduct their business or dealings regarding the shares or assets to be disposed of do not comply with the statute and, therefore, cannot form part of an undertaking given under section 69A.
- 18 The Commission notes that the decision as to whether to accept an undertaking under section 69(A)(1) of the Act is a discretionary matter for the Commission. As the Court

---

<sup>2</sup> Hereafter also referred to as "the medical insurance market".

of Appeal said in *Goodman Fielder Ltd & Wattie Industries Ltd v Commerce Commission* (1987) 2 TCLR 270 at p. 279:

“When a proposal, original or revised, includes some divestment, it will be for the Commission to decide the bearing of that element in determining whether in its opinion the proposal would result or be likely to result in market dominance or, if so, would result or be likely to result in any outweighing public benefit. The decision must be a discretionary one for the commission. For instance, it may be satisfied with a contract, to be settled after clearance, or it may insist on completed divestment before clearance. Or it may be satisfied with an undertaking, having regard to factors including the terms of the undertaking and its confidence in those who have proffered the undertaking.”

## Deed of Undertakings

19 The Deed includes the following covenants:

- “1. Southern Cross will on or before [ ] sell or procure the sale of such number of medical insurance policies of insured members of Aetna to a purchaser who is not an interconnected body corporate (as defined by section 2(7) of the Act) or an associated person (as defined by section 47(3) of the Act) of Southern Cross or Aetna (“Purchaser”) so that the Purchaser will have, following that acquisition, market share in the medical insurance market in New Zealand (“Policies”), [ ].”
- “2. [ ].”
- “3. That the sale of the Policies from Aetna referred to in clause 1 will be by way of transfer of the interests in the Policies.”
- “5. That during the period from the time of execution of this deed until completion of the sale and divestment of the Policies Southern Cross will:
  - (a) not transfer any of the existing Aetna health insurance policies to any interconnected bodies corporate (as defined by section 2(7) of the Act) or associated persons (as defined by section 47(3) of the Act);
  - (b) not, subject to its obligations to ‘rebrand’ the Policies so as to exclude the ‘Aetna’ brand, change the content or cover of the policies;
  - (c) maintain a separate corporate structure from Southern Cross in respect of the Policies for the purposes of maintaining the integrity of Aetna’s health insurance policies.”
- “8. If any question arises as to the interpretation or implementation of this deed Southern Cross and the Commission will confer and consult together to resolve such questions.”

20 For the following reasons, the Commission is not satisfied that the proposed acquisition, together with the undertakings, contained in the current application would not result, or be likely to result, in the acquisition or strengthening of dominance in the medical insurance market. The Commission reaches this conclusion for a number of reasons:

- (i) There is no certainty that Southern Cross will be able to comply with the Deed to ensure that the purchaser of the medical insurance policies disposed of by Southern Cross will have, following the acquisition, [ ]. During the

sale process, the Commission considers it likely that Aetna policy holders will be aware that such a process is in train, and that a significant number of them may look for alternative insurers as their policies expire. There will be nothing preventing some insured members of Aetna from switching to another insurer, including to Southern Cross, for this or other reasons, once their policies have expired. If a significant number of Aetna policy holders respond in this way, a potential purchaser may end up with a modest market share [ ]].

In this respect, the Commission notes that the nature of the Deed is different to other divestment undertakings given under the Act which the Commission has considered. Previous divestments have involved the removal of market share or market power from the merged entity. The identity of the ultimate acquirer of the assets or shares in question (other than to a party interconnected or associated with the applicant) was not a relevant consideration. The assets could have gone to current participants or to new entrants to the market. In the present case, however, Southern Cross is attempting to bring about a specific competitive outcome in the marketplace, and its certainty and effectiveness as a competitive constraint cannot be known until after the obligations contained in the Deed have been fulfilled (or attempted to be fulfilled). As such, the divestment by Southern Cross differs from previous undertakings where there was no inquiry necessary post-acquisition about the market share of the purchaser.

- (ii) Underlying the Deed is an assumption that there will necessarily be a competitive constraint in the medical insurance market equivalent to Aetna's, after Southern Cross' acquisition of Aetna, and once the obligations contained in the Deed have been carried out. In the Commission's view, such an assumption is not necessarily valid. For instance, Southern Cross' divestment undertaking could have varying effects depending on potential market dynamics. Depending on the identity of the purchaser of the insurance policies, it would be possible for Southern Cross to increase its share of the medical insurance market, giving it greater economies of scale. Another significant consideration for the Commission is that the purchaser will not, on the basis of market share alone, necessarily provide the same level of competitive constraint over Southern Cross as did Aetna. This could be so even if the purchaser were to acquire Aetna's entire indemnity book.
- (iii) Southern Cross would have more than [ ] in which to complete the divestment under the Deed. Prospective purchasers of the medical insurance policies will have an incentive to 'game', and it is possible that none will ultimately be prepared to make the specific acquisition. In addition, [ ]

[ ] the Commission has received a number of submissions expressing concern that Southern Cross will not present for sale a quality mix of policies. The Commission considers that there is significant risk of major disputes between Southern Cross and prospective purchasers, such that an actual sale of the policies would be jeopardised. In the situation where a sale was not possible, for whatever reason, it would be unlikely that the Commission could effectively unravel Southern Cross' acquisition of Aetna so as to restore the medical insurance market to its pre-acquisition state. The fluidity of the market, and the unilateral power of consumers to decide their insurance provider when existing



policies lapse, would, in the Commission's view, simply prevent such an outcome.

- (iv) Despite the Deed containing an obligation on the part of Southern Cross to 'ring fence' the medical insurance policies of Aetna's insured members, by maintaining a separate corporate structure in respect of those policies, the Commission considers that Southern Cross will be positioned to gain access to commercially sensitive information relating to those policies and the businesses associated with them. This will give Southern Cross a distinct advantage in subsequently (after the disposal of the policies) competing to secure the more lucrative customers.
- (v) Concerns have been raised in submissions made to the Commission on the current application about the importance of Aetna's computer system to the medical insurance policies maintained on that system. It has been stated to the Commission that the medical insurance policies disposed by Southern Cross under the Deed could not be maintained without Aetna's computer system because the policies have been designed around the system. The Commission has been unable to assess the importance of Aetna's computer system in relation to the disposal of the policies under the Deed. However, questions remain about whether Southern Cross would be further enhancing its competitive position by acquiring Aetna's computer system, and whether the divestment under the Deed is likely without including that system in the divestment. The Commission notes that the system is said to be highly advanced and that Commission staff were told by Southern Cross that one of the motivations for acquiring Aetna was the nature of the computer system.
- (vi) The Commission is reluctant to accept an undertaking given under the Act where there is the potential for an ongoing involvement by the Commission in the undertaking, where the Commission might be called upon to act as an arbitrator between Southern Cross and third parties or there may be necessity for the Commission to enter into negotiations of a commercial nature as a result of the undertaking. The Commission considers that there is sufficient uncertainty about the outcome of the Deed to lead it to believe that there is a likelihood that the Commission will need to take an involvement in the Deed beyond a normal level. As the Court of Appeal noted in *Goodman Fielder* (supra), the greater the enforcement difficulties associated with an undertaking, the more understandable it would be for the Commission to be reluctant to approve a merger on that basis.
- (vii) There exists the possibility that a purchaser under the Deed could enter into an arrangement with Southern Cross whereby Southern Cross would manage the medical insurance policies acquired by the purchaser. For example, some industry participants have suggested to the Commission that Southern Cross could under such an arrangement manage the policies, collect premiums, pay claims etc. In this situation, effective operational control and market presence in respect of the acquired policies could well remain with Southern Cross. While it is possible that such a situation happening may be prevented because of the associated person test in section 47(3) of the Act, the potential for a dispute arising in relation to section 47(3) exists.

21 For the reasons given above, the Commission is not satisfied that a divestment undertaking of the kind offered by Southern Cross could have addressed its concerns

about retaining a competitive constraint equivalent to that exercised by Aetna in the current medical insurance market.

### **Conclusion**

- 22 Having regard to the various elements of section 3(9) of the Act, and all the other relevant factors, the Commission concludes that it is not satisfied that the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in the market for the provision of medical insurance in New Zealand.

### **DETERMINATION ON NOTICE OF CLEARANCE**

- 23 Accordingly, pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission declines to give a clearance for the proposed acquisition by The Southern Cross Medical Care Society, or a direct or indirect subsidiary of Southern Cross, of all the issued share capital in Aetna Health (NZ) Limited.

Dated this 13<sup>th</sup> day of September 2000

M J Belgrave  
Chair