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COMMERCE COMMISSION

Decision No.729

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

SOUTHERN CROSS HOSPITALS LIMITED

and

AORANGI HOSPITAL LIMITED

The Commission:	Dr Mark Berry Gowan Pickering Dr Stephen Gale
Summary of Application:	The Applicants seek authorisation to acquire shares in a joint venture company (JV Co) and for JV Co to acquire the business assets of Southern Cross Hospitals Limited's and Aorangi Hospital Limited's Palmerston North Hospitals (the Acquisition).
Determination:	The Commerce Commission determines to grant an authorisation for the Acquisition pursuant to section 67(3)(b) of the Commerce Act 1986.
Date:	28 July 2011

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THE APPLICATION

1. On 25 May 2011, the Commission registered an application (the Application) from Southern Cross Hospitals Limited (Southern Cross) and Aorangi Hospital Limited (Aorangi, and together, the Applicants) seeking authorisation to acquire shares in a joint venture company (JV Co) and for JV Co to acquire the business assets of Southern Cross' and Aorangi's Palmerston North Hospitals (the Acquisition).

THE PARTIES

Southern Cross

2. Southern Cross is owned by the Southern Cross Hospital Trust, which is a registered charitable trust that (through its ownership of Southern Cross) owns 100% of each of nine private hospitals in New Zealand and has shareholdings in four other private hospital joint ventures. Southern Cross operates Southern Cross Hospital Palmerston North which has two operating theatres and 26 in-patient beds, and provides specialist consulting and elective surgical services to both day patients and in-patients.

Aorangi

3. Aorangi operates Aorangi Hospital in Palmerston North and is privately owned by a group of medical specialists who also practice at the hospital. This facility has four operating theatres and 32 in-patient beds and also provides a range of specialist consulting and elective surgical services to both day patients and in-patients.

STATUTORY FRAMEWORK

4. Any person who proposes to acquire assets of a business or shares and considers that the acquisition may breach s 47 can make an application for an authorisation under s 67 of the Act.

5. Section 67(3)(a) of the Act requires the Commission to give clearance for a proposed acquisition if it is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market. If the Commission is not so satisfied, clearance must be declined, although it may still grant an authorisation under s 67(3)(b) of the Act if the Commission is satisfied that the acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted.

6. If the Commission is not satisfied that the acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted, it must decline an authorisation under s 67(3)(c).

7. The burden of proof lies with the Applicants to satisfy the Commission on the balance of probabilities that the acquisition is not likely to substantially lessen competition and if it is likely to do so, that the public benefit is such that the Commission should authorise it.[1]

[1] *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA) at para {7}.

FRAMEWORK FOR ANALYSIS

Substantial Lessening of Competition

8. To assess whether or not the acquisition will have the effect of, or would be likely to lead to, a lessening of competition in a market, a counterfactual analysis is undertaken. This exercise requires a comparison of the likely state of competition if the acquisition proceeds (the factual) against the likely state of competition if it does not (the counterfactual).[2]

9. The High Court in *Air New Zealand v Commerce Commission (No.6)*[3] accepted that an absence of market power would suggest there had been no substantial lessening of competition in a market in the factual but did not see this as a reason to forsake an analysis of the counterfactual as well as the factual. Justice Rodney Hansen stated that "...a comparative judgment is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, that is, dominance has been attained."

10. The Court of Appeal in *Port Nelson v Commerce Commission*[4] noted that for something to be "likely" it must be "above the mere possibility but not so high as more likely than not and is best expressed as a real and substantial risk that the stated consequence will happen."

11. The High Court in *Woolworths & Ors v Commerce Commission* observed that "…a substantial lessening of competition is one that is "real or of substance" as distinct from ephemeral or nominal. Accordingly a substantial lessening of competition occurs if it is likely that there will be a reduction in competition that is real or of substance."[5]

The Public Benefit Test

12. Any assessment of detriment and benefit will be fact specific but a number of principles have emerged from the Courts' decisions. The High Court in *Air New Zealand v Commerce Commission (No 6)*[6] noted the following:

    - Benefits include efficiency gains (s 3A of the Act) and anything of value to the community generally: *Telecom v Commerce Commission* (1991) 4 TCLR 473 530.
    - Only net benefits are included. Any costs incurred in achieving efficiencies must be taken into account. Transfers of wealth which achieve no benefit to society as a whole should be disregarded.
    - The benefits must result from the acquisition. Benefits which would or would be likely to accrue whether or not the acquisition proceeds should be disregarded.
    - Benefits should be quantified where possible but benefits, which by their nature, are incapable of quantification, should still be taken into account.

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[2] *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA).
[3] *Air New Zealand v Commerce Commission (No.6)* (2004) 11 TCLR 347.
[4] (1996) 5 NZBLC 104, 150; (1996) 3 NZLR 562-563.
[5] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC).
[6] Above n3 at {319}.

COMMISSION PROCEDURES

13. This Decision provides the Commission's reasons for its determination on the Application.[7] The Commission has received submissions and obtained information from a wide range of sources. In the course of this process, the Commission has:

    - reviewed the information and analysis in the Application, including the economic report submitted by the Applicant's economic experts;
    - posted a public version of the Application and submissions from interested parties on the Commission's website;
    - sought further information and clarification from the Applicant on a range of subjects;
    - interviewed the Applicant and other interested parties (including health insurance companies and other private hospital providers);
    - published a Draft Determination on 1 July 2011 stating its preliminary view that it considered the acquisition would have such a benefit to the public that it should be permitted; and
    - invited submissions from interested parties on the Draft Determination.

PREVIOUS DECISIONS

14. The Commission has considered a number of applications in respect of the private hospital industry. Of particular relevance to this determination is *Decision 650: The Southern Cross Health Trust / Aorangi Hospital Limited*, 4 September 2008 (Decision 650).

Decision 650

15. In 2008, the Commission considered an application for clearance in respect of the formation of a joint venture between Southern Cross Palmerston North and Aorangi. The Commission declined to give clearance as it was not satisfied that the proposed joint venture would not have, or would not be likely to have, the effect of substantially lessening competition in the following markets:

    - the provision of private short-stay hospital facilities and related non-specialist services for elective secondary surgery in the MidCentral District Health Board (MidCentral DHB) region; and
    - the provision of private in-patient hospital facilities and related non-specialist services for elective secondary surgery in the MidCentral DHB region.

16. The Commission considered Southern Cross' assertion that it would close absent the proposed acquisition, and found it likely that Southern Cross would not close but would remain in business in the MidCentral DHB region.

17. Overall, the Commission considered that the scope for the exercise of unilateral market power was likely to be enhanced by the joint venture, compared to the counterfactual scenario in which Southern Cross remained as a competitor. In terms of competitive constraints, the Commission concluded:

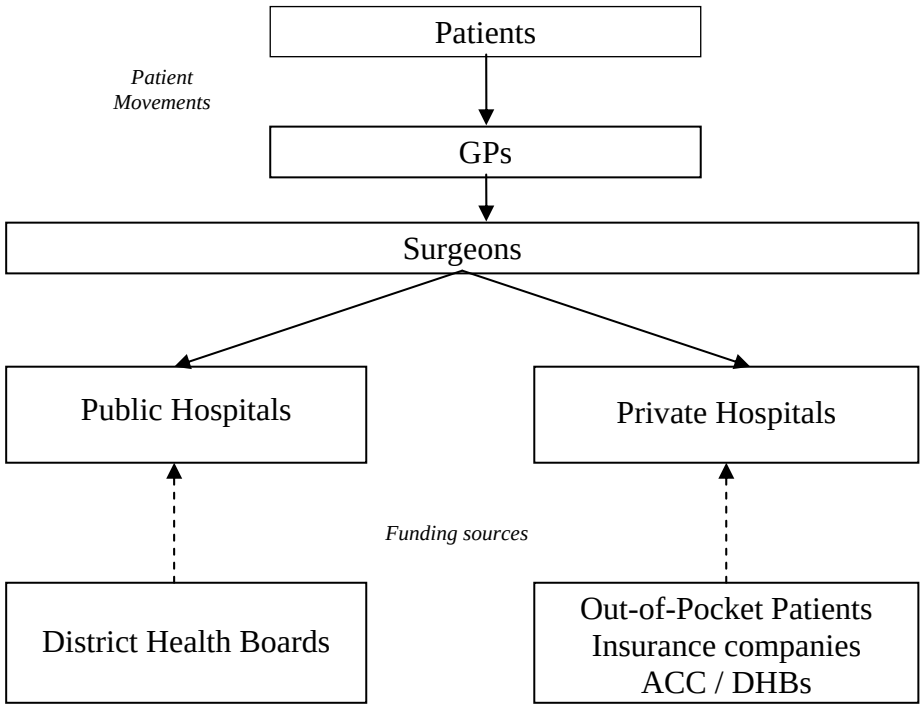
[7] As required by section 67(5) of the Act.

- the existing competition between Southern Cross Palmerston North and Aorangi, and the competitive constraints it brings, would be lost as a result of the joint venture;
- the joint venture would not face competitive constraint from any other existing competitors;
- barriers to entry into the relevant markets were considerable such that the joint venture would not face any competitive constraint from the threat of potential entry; and
- funding providers were unlikely to provide sufficient constraint on the joint venture.

INDUSTRY BACKGROUND

18. In New Zealand, healthcare is provided by a range of medical practitioners and facilities. The main industry participants relevant to this proposed acquisition are shown in the diagram below.

Figure 1: Main Industry Participants in Healthcare



19. There is a relatively complex set of relationships leading to a particular patient being operated on by a particular surgeon in a particular hospital. As shown in Figure 1, patients are first seen by a primary healthcare provider (usually a GP). If surgery is warranted, or specialist consultation is required, the patient will be referred to a surgeon.

20. When a surgeon recommends private elective surgery, the decision as to which private hospital will be used will be heavily influenced by the hospital (or hospitals) where that surgeon normally operates. Typically, patients will follow their surgeon's recommendation about where the surgery is to be performed.

21. Factors that influence surgeons' choice of hospital include:

- whether or not they have a shareholding in a facility (as is the case with Aorangi);
- the ability to schedule surgery at a time convenient to the surgeon at a particular private hospital; and
- the particular private hospital's charges for the provision of the necessary facilities.

22. Private hospitals provide facilities, namely, patient rooms and medical equipment, as well as the related services such as administrative and nursing staff. Private hospitals typically do not provide surgeons or the ancillary specialist skills such as the anaesthetists or physiotherapists. These medical professionals contract directly with the patient and therefore bill the patient separately.

23. Private hospitals focus almost exclusively on providing elective surgery. Elective surgery is defined as non-emergency treatments (including diagnostic services) where the condition is not life threatening and does not require immediate surgery.

24. Demand for the provision of elective surgery in the public system generally outstrips supply so rationing is imposed. The private system caters for those patients who would not otherwise receive treatment in the public system, or who want to receive private treatment for reasons such as timeliness.

MARKET DEFINITION

25. The Commission considers, and the Applicants concede, that the relevant markets for the purposes of assessing the present application are:

- the provision of private short-stay[8] hospital facilities and related non-specialist services for elective secondary surgery in the MidCentral DHB region (the short-stay market); and
- the provision of private in-patient hospital facilities and related non-specialist services for elective secondary surgery in the MidCentral DHB region (the in-patient market).

FACTUAL/COUNTERFACTUAL

26. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a with and without comparison rather than a before and after comparison. The comparison is between two hypothetical future situations, one with the acquisition (the factual) and one without (the counterfactual).[9] The difference in competition between these two scenarios is then attributed to the acquisition.

Factual

27. If the Acquisition proceeds, the joint venture would be the only provider of private elective surgical services in both of the relevant markets.

28. The Applicants state that they intend to consolidate the operations of the merged entity onto a single site, [ ]. This is to allow time to decide on the appropriate facilities and investment needed at the combined site, and to facilitate the transfer of surgeons. The Applicants submit that this consolidation could be achieved by [ ].

[8] For the purposes of this analysis, the Commission considers that short-stay is for surgery with less than 24 hours spent in hospital/clinic.
[9] *Air New Zealand v Commerce Commission* (No.6) (2004) 11 TCLR 347 at {42}.

Counterfactual

29. In framing a suitable counterfactual, the Commission bases its view on a pragmatic and commercial assessment of what is likely to occur in the absence of the proposed acquisition.[10]

30. In 2008, the High Court noted that:

> Because "likely" means something less than "more likely than not", there may be more than one "likely" counterfactual…We consider that where there is more than one real and substantial counterfactual it is not a case of choosing the one that we think has greater prospects of occurring…We are to discard those possibilities that have only remote prospects of occurring. We are to consider each of the possibilities that are real and substantial possibilities. Each of these real and substantial possibilities become counterfactuals against which the factual is to be assessed. [11]

31. The Court further noted that: [12]

> If in the factual, as compared with any of the relevant counterfactuals competition is substantially lessened then the acquisition has a "likely" effect of substantially lessening competition in a market.

32. Accordingly when there is more than one likely counterfactual, the Commission assesses the possibilities, discards those that have only remote prospects of occurring, and considers each of the real and substantial possibilities as counterfactuals against which the factual is to be assessed.

33. The Applicants assert that there are two likely counterfactual scenarios:

- that due to the financial situation of its Palmerston North Hospital, Southern Cross would likely close its Palmerston North Hospital and therefore it would not remain as a competitor in the relevant markets (counterfactual one); and
- that Southern Cross Palmerston North would remain as a competitor in the relevant markets (counterfactual two).

34. In the first counterfactual, there would be only one private hospital in the region (namely Aorangi) and so there would be no difference between the factual and counterfactual one.

35. The Commission has briefly assessed counterfactual one and whether or not Southern Cross' Palmerston North Hospital would remain in the relevant markets absent the Acquisition. Based on the information supplied to date, the Commission is not satisfied that absent the proposed acquisition, Southern Cross' Palmerston North Hospital would exit the relevant markets (which is also a conclusion it reached in Decision 650).

36. Further, given that Southern Cross also considers it is likely that it would continue to operate its Palmerston North hospital, the Commission has gone on to consider counterfactual two as the relevant counterfactual scenario. In their application for authorisation, the Applicants stated that they were content for the Commission to assess the acquisition on the basis that counterfactual two is a relevant likely counterfactual for the purposes of the competition assessment.

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[10] *Decision No. 277: New Zealand Electricity Market*, 30 January 1996, p 16.
[11] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 at 116, 118 and 122.
[12] Ibid at 122.

COMPETITION ANALYSIS

Existing Competition

37. Existing competition occurs between those businesses in the market that already supply the product and those that could readily do so by adjusting their product mix (near competitors).

38. In the factual scenario, the JV Co would result in the merger of the two established private hospital facilities in the Mid Central DHB region. Both operate in the short-stay and in-patient markets. Given the similar characteristics of these two markets, the Commission has assessed them together.

Private elective surgery in the short-stay and in-patient markets

39. Table 1 indicates the most recent market shares for Southern Cross and Aorangi.

Table 1: Patient Numbers in the MidCentral DHB Region for 2010

Facility	Short-stay Market		In-patient Market	
	Patients	**Market share**	**Patients**	**Market share**
Southern Cross	[ ]	[ ]%	[ ]	[ ]%
Aorangi	[ ]	[ ]%	[ ]	[ ]%
Total	**[ ]**	**100%**	**[ ]**	**100%**

Source: Southern Cross, Aorangi

40. Both Southern Cross and Aorangi consider that the MidCentral DHB region does not have a large enough population to support two private hospitals. A lack of patient numbers has meant that the hospitals are financially constrained which has limited their respective ability to invest and thereby improve the quality of their service and facilities. As a result, the Applicants consider that there is only limited existing competition between the two hospitals.

41. The Applicants also consider that there is little prospect of patient numbers increasing in the region and so there are limited options to improve the financial performance and viability of each facility. Rather, the Applicants submit that patient volume and revenues have continued to decline since 2008, when the Commission last investigated the relevant markets.

42. In addition, the Applicants submit that post acquisition, the joint venture would face a degree of competition from some smaller providers in Palmerston North. Certain procedures can now be performed in a GP clinic or consulting room which has further reduced the numbers of patients using either Southern Cross or Aorangi.

Accident Compensation Corporation (ACC) work

43. For historic reasons, the majority of the orthopaedic surgeons operating in Palmerston North are aligned with Aorangi.[13] As orthopaedic surgery makes up the bulk of ACC

[13] The majority of orthopaedic surgeons in the region are shareholders in Aorangi.

funded procedures, Aorangi has received the bulk of the ACC funded work in the region.[14]

44. Some orthopaedic surgeons who are not Aorangi shareholders do carry out work at Southern Cross and Southern Cross has actively attempted to increase its share of orthopaedic work, and ACC funded work in general, in the region.

45. However, the alignment of many of the orthopaedic surgeons in the region with Aorangi has limited, to some extent, Southern Cross' ability to increase the volumes of ACC funded work it performs. This situation is unlikely to change in the counterfactual.

46. The MidCentral DHB is currently the only DHB in New Zealand that does not have an elective surgical contract with the ACC. The MidCentral DHB advised that it intends to apply for a contract which, potentially, could direct ACC volumes away from either Southern Cross or Aorangi to the public hospital. If this were to happen, it would likely reduce the number of ACC patients at either Southern Cross or Aorangi in the foreseeable future.

MidCentral DHB Elective Surgery

47. In Decision 650, the Commission found evidence that both Southern Cross and Aorangi competed for elective surgery contracts offered by the MidCentral DHB. The contracts increased patient volumes and contributed to improving the financial performance of both hospitals.

48. These contracts were put out to tender to both Southern Cross and Aorangi. MidCentral DHB advised that [

].

49. However, the MidCentral DHB advised that since 2008 it has introduced a number of changes designed to improve the efficiency of its operations and that it has expanded its capability to undertake elective surgical procedures. As a consequence, the MidCentral DHB has not contracted out any elective surgical procedures to Southern Cross or Aorangi in the last two years and has no plans to contract out work in the near future.

50. As the MidCentral DHB considers it is no longer reliant on the two private hospitals for the provision of elective surgery, it has no concerns about the loss of any competitive tension between Southern Cross and Aorangi. Rather, it is in favour of the Acquisition. For example, Murray Georgel, Chief Executive, MidCentral DHB states:

> The DHB recognises the benefit that a private hospital brings particularly to the attraction and retention of the medical community. Whether there are one or two (or more) hospitals is of lesser importance to us than the fact that a private hospital exists, and preferably with a viable future.
>
> In regard to competitiveness we have little to no reliance on private hospitals now. In fact the only non-tertiary work that we have had provided elsewhere has been at Whanganui.
>
> Furthermore, if we were to seek to have services provided by a private provider, we cannot pay more to them than to ourselves (Ministerial direction).
>
> Based on these conditions we support the merger.[15]

51. Given such announcements from MidCentral DHB, the Applicants consider that they can no longer rely on any further DHB work to increase patient volumes.

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[14] In 2009/2010, orthopaedic surgery procedures accounted for approximately 64% of all elective surgery requests received by ACC. Source: http://www.acc.co.nz/PRD_EXT_CSMP/groups/external_communications/documents/reports_results/wpc093171.pdf

[15] June 2011 paper to the Hospital Advisory Committee of the MidCentral DHB.

52. However, several parties, notably surgeons and other private hospitals, have advised the Commission that, historically, the need for DHBs to contract out to private providers for elective work is cyclical and this need may arise in the future, particularly if the DHB were to receive additional funding and/or governmental directives. The Commission considers that while the MidCentral DHB currently has no intention of contracting out work to the private sector, the real possibility exists that the DHB will need to utilise private hospital facilities for elective work in the future.

Insured patients

53. The Applicants submit that the level of private health insurance cover is declining, and that this has reduced patient numbers and consequently the potential to perform additional operations.

54. The Health Funds Association of New Zealand, which represents the health insurance industry, notes that the number of lives covered has been declining since Decision 650 and the number of lives covered is now similar to 2007. This is mostly to do with an easing in general employment levels as well as a response to increase in premiums (particularly in older age groups).[16]

55. While the Commission notes that the number of patients with health insurance is decreasing, there remains a significant number of patients who may require elective surgery in the MidCentral DHB region. This would be the case in both the factual and counterfactual scenarios.

Competition from day-stay clinics and procedure rooms

56. The Applicants submit that post acquisition they would continue to face considerable competition from existing providers particularly in respect of certain day-stay procedures. For example, a number of procedures that have been traditionally performed in a surgical facility can now be performed in a GP's clinic or a specialist's consulting room.

57. The Applicants consider that the less invasive short-stay procedures are more susceptible to this type of competition, especially with procedures that have a low level of complexity and require minimal post-operative care. These include certain procedures such as endoscopy, ophthalmology and oral and maxillofacial surgery. In 2010, these types of procedures accounted for approximately [ ] of Southern Cross' and Aorangi's revenue respectively and [ ] of patient numbers respectively.

58. This type of competition would likely affect the short-stay market rather than the in-patient market.

59. Specialists advised the Commission that some minor surgical procedures, such as vasectomies and skin cancer removal can be and are performed in clinics, consulting and/or procedural rooms. This is because they can be performed in smaller facilities, without the need of a general anaesthetic.[17] This would continue to be the case in both the factual and counterfactual.

60. Broadway Oral Surgical Clinic (Broadway) advised that it is increasingly undertaking some oral and maxillofacial surgical procedures and some minor plastic surgery procedures on a strictly day-stay basis, which includes procedures under general anaesthetic. Some procedures would fall into the lower end of the short-stay market.

[16] http://www.healthfunds.org.nz/pdf/2010DecHealthInsuranceStatistics.pdf
[17] In the past the Commission has excluded procedural rooms from short-stay markets. See Decision 650.

Bruce Murdoch, specialist and owner of Broadway, advised that most of these procedures used to be performed in either of the two private hospitals but it is much more convenient (and cheaper) for the patient to have it performed at the clinic. Nevertheless, Mr Murdoch still retains a surgical list at Aorangi for his more invasive procedures.

61. This would suggest that for certain procedures in certain specialities, the merged entity would face a degree of constraint from speciality clinics, notably Broadway, in the short-stay market. Given that both Southern Cross and Aorangi supply a range of surgical facilities across a variety of surgical specialities, speciality clinics would still only represent a relatively minor constraint on the merged entity overall.

62. The Palms Medical Centre (a primary care medical and accident clinic) does not have any elective surgery facilities at present although it does provide facilities for minor surgical procedures using local (but not general) anaesthetic. The Palms Medical Centre considers that while it could potentially expand and convert some space for use as an operating theatre, it would [ ].

63. The Commission acknowledges that more and more procedures are able to be carried out in GP clinics and/or consulting rooms as technology and surgical techniques improve. This is more relevant to the short-stay market rather than the in-patient market. However, the Commission considers that the range of procedures able to be offered by a GP and/or specialist clinic tend to be very limited and restricted to specific specialities. As they do not have operating theatres, they cannot perform the full suite of services across a range of medical specialities currently offered by both Southern Cross and Aorangi.

64. In the short-stay market, the Commission considers that the merged entity would face some constraint from speciality clinics, such as Broadway, who now perform some simpler short-stay surgical procedures. However, this minor constraint would not affect the in-patient market.

65. Further, the Commission does not consider that procedure rooms, such as those at the Palms, or in a GP's or a surgeon's consulting room, would provide a significant degree of constraint on the merged entity in either the short-stay or in-patient markets.

Potential Competition

66. In the past, the Commission has considered the barriers to entry into any private hospital market to be relatively high. Other than in the Auckland region, there have been few examples of greenfields entry. The Applicants accept that greenfields entry into the in-patient market in Palmerston North is unlikely.

67. However, the Applicants consider that the barriers to establishing a small short-stay facility are much lower such that entry into the short-stay market is possible.

68. One of the key criteria for any private surgical facility is attracting surgeons to work there. One of the Applicants' rationales for the proposed acquisition is the relative shortage of surgeons in the regions. The Applicants also submitted that, with a combined six theatres at Southern Cross and Aorangi, there is significant over capacity of operating space in the region. The Commission considers that these factors would tend to reduce the likelihood of entry into the short-stay market in the factual scenario.

69. The Commission has found no evidence that any party is likely to enter either of the relevant markets in the foreseeable future. The Commission therefore considers that the

threat of new entry, in either the short-stay market or the in-patient market would be insufficient to constrain the merged entity.

Countervailing Power

70. In some circumstances the potential for the merged entity to exercise market power may be sufficiently constrained by a buyer or supplier to redress concerns that an acquisition may lead to a substantial lessening of competition.

71. There are four main sources of funding for the private hospitals in Palmerston North:

- ACC;
- DHB;
- health insurance companies;[18] and
- private 'self funded' patients.

72. The estimated volume of patients and revenue from each funding source is outlined in Table 2 for both Southern Cross and Aorangi.

Table 2: Estimated patient numbers and revenues from each funding source (2009/2010 FY)

Funding Source	Southern Cross				Aorangi			
	Patient Numbers	%	Revenue ($000's)	%	Patient Numbers	%	Revenue ($000's)	%
ACC	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
DHB	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Insurance Companies	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Self Funded	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total	**[ ]**	**100%**	**[ ]**	**100%**	**[ ]**	**100%**	**[ ]**	**100%**

Source: Southern Cross, Aorangi

ACC

73. ACC is a national purchaser of elective surgery procedures and operates a fixed price model whereby private hospitals are paid a fixed price for a particular procedure irrespective of who carries out the procedure and in which region.

74. In the factual, the number of private hospitals able to carry out ACC funded elective surgery in Palmerston North will decrease from two to one. This means that irrespective of ACC's fixed price policy it would face a lack of choice. The Commission estimates that approximately [ ]% of Southern Cross' patients and [ ]% of Aorangi's patients are funded by ACC.

75. The Commission considers that if the merged entity were to attempt to leverage its position to push for a higher price for ACC work, ACC could elect to send patients to

[18] The three main health insurance providers are Southern Cross Medical Care Society, Tower Health and Life Limited and Sovereign Assurance Company Limited. Together these providers account for approximately [ ] of insured policy holders.

other private hospitals outside of the MidCentral DHB region, which it has done in other regions, or look to punish the merged entity by excluding Southern Cross operated hospitals from ACC work in regions where it does have a choice of provider.

76. The Commission considers that there is some potential for the MidCentral DHB to provide ACC elective surgery services and the significant volumes represented by ACC work would also limit the merged entity's motivation to increase prices (or reduce the timeliness of procedures), as the risk of losing the volumes would be too large.

DHB

77. MidCentral DHB has, from time to time, contracted out elective surgery procedures to private hospitals either to reduce waiting lists or to meet agreed targets. Under a ministerial direction, the DHB is not able to pay private hospitals more for elective surgery procedures than its own deemed cost – in effect DHB funded surgery is subject to a fixed price.

78. The Commission considers that while MidCentral DHB is not currently outsourcing any elective surgery to the private sector, it is possible that it will in the future (in response to a change of Government policy, or additional funding). Were this to happen, MidCentral DHB would also face no choice in provider.

79. The only alternative for the DHB would be to send patients out of the region for elective surgery. The Commission notes that MidCentral DHB has previously sent patients to a private hospital in Whanganui for treatment.

Insurance Companies

80. Insurance-funded elective surgery can be divided into two groups:

- those with fixed pricing policies; and
- those with comprehensive or full cover policies.

81. The first group predominantly comprises surgery funded by the Southern Cross Medical Care Society (Southern Cross Health Insurance), which operates an affiliated provider scheme. Under this scheme the price of certain procedures is agreed between the insurer and the hospital facility, which in most cases is a Southern Cross hospital. Such a scheme provides all parties with certainty in respect of pricing. Insured patients under these schemes then have pre-approval for such procedures. The Commission estimates that approximately [ ]% of Southern Cross' patients and [ ]% of Aorangi's patients are funded under fixed price insurance contracts.

82. Elective surgery funded by insurance companies, other than the fixed price policies of Southern Cross Health Insurance, is not subject to any fixed price arrangements and in this respect the insurance companies view themselves as 'price takers'. The Commission estimates that approximately [ ]% of Southern Cross' patients and [ ]% of Aorangi's patients are funded by insurance companies without fixed price contracts. Their ability to respond to an increase in price in the factual would be constrained by their low market share and inability to punish Southern Cross in other regions.

83. However, the Commission considers that the low volume of claims stemming from the MidCentral DHB region would minimise the effect of any price increases to patients funded by other insurance companies. Any price increase would [ ] and would have a minimal impact on the premiums of individual patients in the MidCentral DHB region.

Self Funded

84. Approximately [ ]% of both parties' patient volumes are privately funded patients. The Commission considers that these patients would be least able to respond to an increase in prices in the factual, because they are not subject to any fixed pricing arrangement and must bear the cost dictated by the hospital.

85. Faced with an increase in price, self funded patients would have very few alternatives for private elective surgery in the MidCentral DHB region. The only potential options would be to consider options outside the relevant markets, which could include electing to travel out of region or seek treatment under the public system.

Conclusion on Countervailing Power

86. The Commission considers that, in the factual scenario, purchasers such as ACC and major insurance companies would be able to utilise national or fixed price arrangements to protect themselves to some extent from price increases by the merged entity. However, the Commission considers that in the factual, a significant volume of patients would lack any kind of price protection.

Conclusion on Competition Assessment

87. The Commission considers that while competition between the two hospitals appears to have been subdued in recent years, both Southern Cross and Aorangi would continue to compete in the relevant counterfactual as they have done so for many years previously.

88. In the factual, this competition would be eliminated and the merged entity would face limited competition from existing competitors and little threat of new entry. Furthermore, a significant volume of patients would lack any degree of countervailing power and so they could not protect themselves from an increase in price by the merged entity.

89. Accordingly, the Commission concludes that it is not satisfied that the Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in both the short-stay market and the in-patient market.

PUBLIC BENEFITS AND DETRIMENTS

90. As the Commission has concluded that it is not satisfied in terms of s 67(3)(a) of the Act that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the relevant markets, it must now consider whether it can be satisfied that the proposed acquisition will result or will be likely to result in such a benefit to the public that it should be permitted in terms of s 67(3)(b) of the Act.

91. The authorisation procedure requires the Commission to identify and weigh the detriments likely to flow from the acquisition and to balance those against the identified and weighed public benefits likely to flow from the acquisition as a whole.

Quantification

92. The Commission is mindful of the observations of Richardson J in *Telecom Corporation of New Zealand Ltd v Commerce Commission*,[19] on the Commission's responsibility to attempt to quantify benefits and detriments to the extent that it is feasible, rather than rely on purely intuitive judgement. This is not to say that only

[19] {1992} 3 NZLR 429.

those gains and losses which can be measured in dollar terms are to be included in the assessment; those of an intangible nature, which are not readily measured in monetary terms, must also be assessed.

93. The Commission regards quantification as simply a tool that enhances the Commission's final qualitative judgement. The estimates provided below are by their very nature only approximations of the implied public detriments and benefits. The Commission does not rely on a rigid balancing of the quantified detriments and benefits without applying a wider qualitative analysis.

94. The Applicants have estimated the benefits that would be achieved by the merger over a five year period. The Commission considers that this is an appropriate timeframe for this particular case but notes that the likely benefits and detriments could be assessed over a range of timeframes, given the timeframe for consolidation onto one site has yet to be determined by the Applicants. For example, the Commission has considered that the benefit accruing from the alternate use of the [ ] site should be included as a capitalised benefit in year 5, although the actual date of consolidation may occur before then.

Detriments

95. The Applicants have stated that the contestability of short-stay procedures and the actual and potential competition in the markets would limit any competitive detriments arising from the Acquisition. In addition, they submit that the proportion of revenue derived from fixed price arrangements would constrain the ability of the merged entity to raise prices post acquisition.

Potential for loss of allocative efficiency

96. In general, when the price of a product increases, demand for that product will fall as some consumers switch to alternative products which meet their requirements in a less satisfactory way or are more costly to produce than the product they replace. In effect, the country's resources are allocated less efficiently.

97. The potential for a loss of allocative efficiency depends on the ability and incentive of the merged entity to increase prices post acquisition. In this case, the Acquisition would reduce the number of private hospital providers in Palmerston North from two to one and would remove any price competition that currently exists between the two hospitals. Purchasers of elective surgery services would therefore be unable to switch to an alternative private hospital in the region if the merged entity was to raise prices.

98. The Applicants submit that a number of factors would constrain the merged entity's ability to raise prices, in particular:

- the level of existing and potential competition;
- the countervailing power of insurance providers and ACC;
- the increased capacity for the MidCentral DHB to carry out elective surgery at its own facility;
- the reluctance of surgeons to entertain significant price differences to different classes of patients; and
- the non-profit nature of Southern Cross Health Trust.

99. The Commission considers that the merged entity would only be able to raise prices to a proportion of its customers, namely those whose surgery is self-funded. This proportion would account for approximately [ ]% of the merged entities patients by volume.

Existing and potential competition

100. As previously outlined, the Commission considers that there would be insufficient existing and potential competition in the factual to constrain the merged entity.

101. The Applicants, however, have submitted that existing and potential competition from smaller day stay clinics would prevent the merged entity raising prices for those particular procedures in the factual.

102. The Commission notes, that price increases may be constrained for particular procedures that can be undertaken in day-stay clinics. The estimates for allocative efficiency losses below have not accounted for the fact that prices for some of these surgeries may be constrained, and as such, the estimates could be overstated.

Countervailing power of ACC and insurance providers

103. The Applicants submit that in the factual, the merged entity would be constrained in its ability to increase prices due to the volume of patients whose surgery is funded by parties with fixed price arrangements, namely ACC and insurance companies.

104. In 2010, approximately [ ]% of the combined revenues ([ ]% of patients) of both hospitals came from ACC funded procedures. ACC operates a national fixed pricing regime whereby it sets standard prices for a range of procedures. Providers are not able to charge ACC more for these procedures.

105. Similarly, approximately [ ]% of the combined revenues ([ ]% of patients) are funded through Southern Cross Health Insurance's affiliated provider scheme. Under this scheme, Southern Cross Health Insurance negotiates fixed prices for certain procedures if they are carried out at an affiliated provider. Both Southern Cross and Aorangi are affiliated providers.

106. Currently there is no DHB funded elective surgery carried out at either Palmerston North hospital and the DHB does not have any plan to utilise private facilities in the short to medium term. The Commission notes that were the DHB to outsource elective surgery to the merged entity, the DHB would be unable to pay private providers more than its own deemed cost.

107. The Commission considers that approximately [ ]% of the merged entity's patient numbers, or [ ]% of market revenue, would be subject to some form of fixed price regime, limiting the ability of the merged entity to raise prices for this proportion of its patients in the factual.

108. Of the remaining patients, the Commission estimates that approximately half to two-thirds are funded by insurers who either do not operate a fixed price or affiliated provider scheme (such as Tower Insurance or Sovereign Insurance), or are funded by Southern Cross Health Insurance under its other health insurance policies (i.e without fixed procedure prices).

109. Sovereign Insurance informed the Commission that faced with higher prices it would [

]

[20]

110. Tower Insurance informed the Commission that it does not anticipate that the proposed acquisition would lead to increased prices, [ ].

111. Both Sovereign Insurance and Tower Insurance informed the Commission that if prices were to increase in the factual, [ ]. This price increase will be nominal, particularly given the low volume of claims in the MidCentral DHB region. [ ].

112. If health insurers other than Southern Cross Health Insurance were faced with a significant price increase in the factual, the Commission considers that they would spread this increase across their nationwide portfolio. This is likely to have a minor impact on the level of premiums. Given the spreading of costs, the Commission does not consider that plausible price increases to non Southern Cross insured patients are likely to affect demand for insurance.

Capability for the MidCentral DHB

113. MidCentral DHB appears able to expand its elective surgery offerings. Indeed, the DHB has advised that it is considering tendering for an upcoming ACC contract. Therefore, the Commission considers that the threat of the DHB utilising its elective surgery capability from time to time for ACC work is likely to place an additional competitive constraint on the merged entity.

Influence of surgeons on prices

114. The Applicants submitted that surgeons would strongly resist any attempts by the merged entity to charge different prices for the same procedure, depending on the funding arrangements of the patient. The Applicants further asserted:

> "… many of the surgeons would be shareholders in Aorangi, which would give them considerable ability to directly resist any measures to impose such price discrimination."[21]

115. Surgeons spoken to by the Commission reflected this sentiment. [ ] noted that there is currently no difference in the prices surgeons charge for a procedure depending on the funding arrangements. He further noted that he is not aware of either hospital engaging in this type of price discrimination, and he added that were they to attempt it, surgeons would strongly resist.

116. The Commission accepts that surgeons would be reluctant to engage in price discrimination between privately funded and other patients, and that they would not support significant price discrimination behaviour by the merged entity. In addition, 50% of the shares in the JV Co would be held by surgeons who could directly resist any significant price discrimination, although this protection would diminish should those shareholdings be purchased by non – surgeon investors.

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[20] [ ].

[21] Response to Draft Determination – 18 July 2011, paragraph 17.

Non-profit nature of Southern Cross Health Trust

117. The Applicants further submit that the non-profit nature of Southern Cross Health Trust would constrain the incentive of the merged entity to raise prices in the factual. The Commission accepts that Southern Cross does not have profit maximisation as its primary driver and may take other factors into account when determining its behaviour.

118. The Commission also notes that in some other private hospital joint ventures involving Southern Cross (for example QE Hospital in Rotorua), the joint venture company is a registered charitable entity. In circumstances where the joint venture operates as a charitable trust, the Commission would likely place less weight on the profit maximising incentive of the joint venture.

119. However, the precise arrangement and structure of the proposed Southern Cross / Aorangi joint venture has not been finalised. The parties have signed a memorandum of understanding which states at [ ]:

[

]

120. Southern Cross informed the Commission that it [

]. [

], and there has been no formal discussion between the Applicants on this issue.

121. [

].

122. Industry participants interviewed by the Commission said that there is an increasing trend away from surgeon-owned hospitals. Surgeons have traditionally entered into ownership of private hospitals to ensure that the facilities are available for private work (as evidenced by the original purchase of Aorangi by surgeons from the Sisters of Mercy in 2000).

123. The Commission considers that the owners of Aorangi would have profit maximisation as their primary driver and the 50/50 ownership structure of the joint venture would give Aorangi shareholders equal control over the management of the business.

124. The Commission considers that in the short-to-medium term, it is likely that 50% of the shareholders of the joint venture would remain profit motivated. The Commission also considers that, although Southern Cross has an underlying not for profit motive, its influence would be tempered by the profit maximising incentives of the Aorangi shareholders.

125. However, the Commission recognises that were the merged entity to engage in significant price discrimination in the factual, there is a risk of reputational damage to the Southern Cross Group.

Conclusion on price increases

126. The Commission considers that the merged entity would have the ability to increase prices to certain groups of patients in the factual. However, there are a number of

factors that would diminish its ability to increase prices to these patients but only to a limited extent.

Estimating the loss of allocative efficiency

127. In order to determine the most appropriate estimate for the loss of allocative efficiency the Commission must make assumptions about the elasticity of demand for elective surgery. However, the Commission has not found any readily available information which shows the extent to which the demand for elective surgery services in New Zealand rises or falls as hospital charges increase.

128. Anecdotal evidence indicates that demand for elective surgery is relatively inelastic. Elective surgery is to a certain extent discretionary (as opposed to urgent surgery). To this extent, patients are able to defer surgery to a time that is convenient in terms of work, family or financial commitments. However, a consumer's willingness to defer surgery may depend on the severity of the medical issue together with the consumer's level of discomfort and willingness to enter the public health system.

129. The improving efficiency of the public health system may also impact on a patient's willingness to switch from privately funded elective surgery and enter the public waiting list for elective surgery.

130. Consumers can travel outside of the region for surgery but this comes with additional costs and inconvenience.

131. Due to the relative paucity of substitutes, the Commission considers that elasticity of demand for elective surgery is likely to be low, and has estimated possible losses over a range of elasticities from -0.1 to -0.5. The Commission has also considered the level of price increase that might cause patients to leave the MidCentral DHB region for private elective surgery.

132. As noted above, the Commission considers that [ ]% of patient volumes would not be subject to price increase due to the countervailing power and fixed price arrangements enjoyed by ACC and Southern Cross Health Insurance (for those patients covered under the affiliated provider scheme). The Commission also considers that those patients who are insured by Southern Cross Health Insurance under its other health insurance policies (approximately [ ]% of patients) would be similarly protected from price increases, as the joint venture would be unlikely to increase prices payable by one of its associated companies.

133. The Commission also considers that patients funded by other insurance companies (approximately [ ]% of patients) would also be protected from price increases. This is because the price increase would be likely absorbed across a nationwide premium and any costs that are passed on to the patient are unlikely to deter them from undergoing surgery.

134. Self-funded patients make up the remaining [ ]% of patients. The Commission considers that these patients would lack any form of price protection and could be subject to price increases for elective surgery services in the factual as they would have no alternatives in the region. The alternatives for these patients would be to travel outside of the region for surgery, have the surgery performed in the public health system where available, or forgo the surgery altogether.

135. The Applicants submitted that Southern Cross Health Insurance's affiliated provider scheme provides protection to a proportion of these patients because once a procedure is added to the affiliated provider scheme (and therefore effectively subject to a fixed price

for Southern Cross insured patients), the price for that procedure is effectively fixed for self funded patients as well.

136. The Applicants submitted that surgeons have resisted attempts in the past for self funded patients to be charged higher prices for procedures that are covered by the affiliated provider scheme. In particular, the Applicants asserted that when cataract surgery at Aorangi Hospital was accepted into the scheme in early 2011, revenue from all cataract procedures dropped, as all prices were amended to reflect the affiliated provider price.

137. The Commission accepts that surgeons may be unwilling to entertain significant levels of price discrimination between different patient groups for the same procedure. The presence of surgeons as 50% shareholders in the Joint Venture will also provide some constraint on significant price discrimination. However, the ability of surgeons to actively prevent price discrimination is limited, and would decrease should shareholding surgeons exit.

138. The Commission has modelled potential price increases along a range, from 10% to 50%, to reflect the uncertainty around potential price increases. Table 3 outlines the potential allocative efficiency detriments along this range. It should be noted that these estimates relate to:

- a price increase for [ ] of patients; and
- a price increase only pertaining to the hospital component of the ultimate price.

Table 3: Estimated allocative efficiency detriments (NPV over 5 years)

	Price Increase		
Demand Elasticity	**10%**	**30%**	**50%**
-0.1	[ ]	[ ]	[ ]
-0.3	[ ]	[ ]	[ ]
-0.5	[ ]	[ ]	[ ]

Note: A 10% discount rate was used in these calculations

Source: Commission estimates, the Applicants

139. In their response to the Commission's Draft Determination, the Applicants asserted that there is no evidence that this level of price discrimination exists in other regions where there is only one private hospital. In particular, the Applicants submitted that following the merger of the Southern Cross Hospital and Queen Elizabeth Hospital in Rotorua, price increases were in the range of [ ]% for a one hour theatre slot and [ ]% for a bed day rate.

140. The Commission has quantified the range for allocative efficiency detriments as $[ ] million for a five year NPV. As the range is so wide, the Commission needs to make a judgement as to what is the most likely level of detriment. The Commission considers that an intermediate value of detriment corresponding to a 30% price increase is the most likely because:

- the non profit nature of Southern Cross, coupled with the influence of Aorangi's surgeon shareholders, will temper the extent of price rises;

- at price rises above 30%, self funded patients would either travel outside of the region for surgery, defer surgery, or seek to have the surgery in the public system; and
- there is no evidence that private hospitals in other parts of New Zealand engage in aggressive price discrimination. The Commission notes that price discrimination in other private hospitals facing a lack of competition is around [ ]. Therefore the Commission's estimate of a price increase of 30% is likely to be conservative.

141. Therefore, the Commission is of the view that the likely allocative efficiency loss could plausibly be around an NPV of [ ] million over a five year period.

Potential for increased costs (productive inefficiency)

142. One outcome generally associated with a loss of competition is that the firm with additional market power has less incentive to minimise costs and to avoid waste. Determining the extent to which a firm may be susceptible to complacency can be very difficult. A firm seeking to maximise its profits will have an incentive to minimise its costs, irrespective of the level of competition in the market. Nevertheless, there is the possibility that management, without the day to day pressures of competitors and the benchmark they provide against which the firm's management can be measured, may become less productively efficient.

143. The Applicants submit that since 2008, patient numbers have been declining and that this trend will continue in the factual, which will incentivise them to minimise costs in order to be profitable. In addition, the Applicants assert that the provision of private hospital services requires the purchase of a substantial volume of equipment that is not fully utilised. They suggest that the Acquisition would eliminate duplication of this equipment.

144. The Commission accepts that patient numbers have been in decline since 2008 which could be due to a number of factors including a decrease in the level of private health insurance cover, a reduction in claims approved by ACC, and a greater number of procedures being undertaken in the public system. Parties spoken to by the Commission consider that this trend is likely to continue in the short to medium term.

145. The Commission considers that both hospitals have been under considerable financial pressure in recent years and this has driven both to operate as efficiently as possible to minimise the financial impact of declining patient numbers. In addition, the Commission recognises that some competition from smaller day-stay providers will exist in the factual.

146. Moreover, the Commission notes that as Southern Cross runs nine hospitals across New Zealand, it has the ability to benchmark the Palmerston North facility against other similar facilities. The ability to benchmark is likely to place a limit on productive efficiency losses as the owners will be able to accurately gauge the level of efficiencies achievable by the facility.

147. In addition, the Commission considers that the Southern Cross Group would be further incentivised to keep hospital costs to a minimum so that its health insurance business does not face increased costs.

148. While it recognises the uncertainty of any assumed productive efficiency losses, the Commission considers that productive efficiency losses are likely to be moderate and has set the upper range for loss of productive efficiency between 1% and 5% of pre merger variable costs. This equates to approximately [ ] per annum.

The Commission's judgement on what it considers to be the most likely loss of productive efficiency is the midpoint of this range - 2.5% of pre merger variable costs. This amounts to a five year NPV of [ ] million.

Potential for decreased innovation (dynamic inefficiency)

149. Dynamic inefficiency arises when a business is less innovative than it might be. In a merger context this can arise as a monopolist has less incentive to engage in innovation as it faces little or no competitive pressure to match or keep ahead of its rivals. The Applicants submit that the joint venture will not result in any dynamic inefficiency and will instead increase the incentive and ability of the parties to invest and innovate.

150. The Applicants submit that there has been little innovation in recent years and that which has occurred has been unsuccessful. Further, the Applicants cite the relatively low level of competition between Aorangi and Southern Cross as a key barrier to either party engaging in significant innovation or investment in the counterfactual.

151. The Commission notes that that there has been little innovation in recent years in the relevant short-stay and inpatient markets in the MidCentral DHB region. Given the poor financial performance of both Southern Cross and Aorangi, it is clear that the joint venture would be better placed to engage in innovation and investment. The Commission therefore considers that it is unlikely that the Acquisition would result in dynamic efficiency losses.

Benefits

Cost savings

152. The Applicants submit that the Acquisition would result in significant cost savings through the rationalisation of staff, the elimination of duplication and the ability of Aorangi to leverage off Southern Cross' existing buyer power. The Applicants submit that by[ ] cost savings of around $[ ] million are expected, rising to $[ ] million by[ ]. The Applicants submit that these cost savings will be realised through:

- a reduction in staffing;
- savings in supply costs (through access to Southern Cross' buying power and direct supply network; and
- savings in other costs (such as finance, communication and occupancy costs).

153. The Applicants further state that greater benefit in the form of cost savings will be realised once the parties fully rationalise on to one site, [ ]. Currently, the Applicants submit that conservatively, this full rationalisation would occur by [ ].

154. The Commission has reviewed the post merger cost modelling and proposed savings claimed by the Applicants. These costs savings include:

- a [ ];
- a [ ]; and
- significant savings in electricity and consumables (through access to Southern Cross' buyer network).

155. In its Draft Determination, the Commission considered that it was not appropriate to include any savings arising from access to Southern Cross' buyer network. The

Commission considered that these savings would, in effect, be a transfer and would not result in a public benefit being created.

156. In their response to the Draft Determination, the Applicants submitted that these cost savings should be included, as the vast majority of consumables are purchased from overseas companies and imported into New Zealand. Any cost savings realised would be a transfer to the merged entity from an overseas party and would therefore be a net benefit to New Zealand.

157. The Commission notes that while the majority of consumables purchased by both parties are manufactured overseas, neither Southern Cross nor Aorangi imports consumables themselves. Consumables are sourced through New Zealand based wholesalers and sales offices.

158. The extent to which any savings from Southern Cross' buyer power would transfer from New Zealand based parties as opposed to overseas based parties is difficult to gauge. The Commission is of the opinion that there is insufficient evidence to conclude that these costs savings would not merely be a transfer from a New Zealand party to the merged entity. Therefore, these cost savings should not be included as a benefit.

159. Apart from the consumable costs outlined above, the Commission concludes that the Applicants' calculations of expected cost savings post acquisition are accurate and reasonable.

160. The Commission is therefore satisfied that cost savings growing to [ ] over 5 years would be achieved over the timeframe considered by the Commission. The 5 year NPV for this benefit is [ ] million.

Consolidation to one site

161. The Applicants have stated that the joint venture will consolidate to one site, [ ], as soon as possible. In their application this consolidation is planned to be completed by [ ] due to a number of factors:

- the necessity to determine the investment needed at the [ ] site to accommodate the increased volumes and managing that investment; and
- the necessity to appropriately manage the requirements of surgeons (including consultation rooms and theatre list adjustments).

162. Following consolidation of both hospitals to one site, [ ].

163. The Applicants have further stated that the above requirements could be accommodated within a [ ].

164. The Commission considers that if the parties were able to consolidate to one site sooner, further significant benefits (in the form of cost savings and [ ]) would be realised. The key factor which would constrain the ability of the merged entity to consolidate to one site is the ability of [ ].

165. Southern Cross has stated [

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166. Southern Cross submits that [

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167. The Commission considers that while both parties have clearly indicated a desire to consolidate to one site as soon as possible, there has been little planning undertaken for how (or when) this consolidation will occur. Notwithstanding this, the Commission accepts that by [ ] the joint venture company will be operating from the one site which will therefore free up the majority of the [ ] property for alternative use.

168. Therefore, the Commission considers it appropriate to include as a benefit arising from the proposal, the alternative use of the [ ] property [

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169. [

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170. In its Draft Determination, the Commission considered that the appropriate value to use to determine the quantum of this benefit was the [ ].[22] This equated to a value of $[ ].

171. In their response to the Commission's Draft Determination, the Applicants submitted that this value did not take into account [

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172. [

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173. However, the Commission considers that it is appropriate to include as a one off benefit the freeing up of the [ ] upon full consolidation of the two hospitals. While the Applicants submitted that the full consolidation could (and ideally would) be achieved within two years, the Commission considers that it is appropriate to take a conservative approach to the timing of this benefit and include it in year five. The NPV for this benefit is [ ] million.

Capital Expenditure

174. As part of the consolidation of the two hospitals, in order to accommodate the additional patient numbers the Applicants would have to spend approximately:

- [ ] to convert consulting rooms to bedrooms;
- [ ] for the construction of a day stay and recovery area;
- [ ] to upgrade and renovate the laundry and kitchen at the [ ];
- [ ] to upgrade IT systems; and

[22] [ ]

- [ ] per year for other (non equipment) capital expenditure.

175. This capital expenditure is currently planned to occur over a four year period which would coincide with full site consolidation in year five.

176. The Commission considers that this expenditure is likely to be an accurate estimate of the level of capital expenditure required to achieve full site consolidation. Therefore, the Commission has concluded that the capital expenditure is a cost to the merged entity with a NPV over the next 5 years of [ ] million.

Potential for increased investment

177. The Applicants have submitted that the Acquisition will increase the ability and incentive of the Applicants to invest in facilities which will allow for a broader range and better quality of services. The Applicants further submit that since 2008, neither of the hospitals has carried out significant capital investment, and both in fact have deferred business as usual capital investment.

178. The Applicants state that this lack of investment means that neither hospital is operating to the standard of comparable private hospitals in New Zealand. As an example, the Applicants cite [

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179. The Applicants assert that by creating a single, profitable private hospital facility in Palmerston North, they would be able to engage in significant investment in new technology and facilities, including investment in High Dependency (HDU) and/or Intensive Care (ICU) facilities, digital theatres and high tech imaging. The Applicants suggest that by investing in such facilities, the merged entity would be able to offer a broader range of procedures, which would attract more surgeons to the region.

180. The Commission considers that levels of actual capital expenditure for both Aorangi and Southern Cross since 2008 have been below what they both had budgeted for. The Commission also considers that in the factual, the merged entity would be better placed to make a coherent business case for new investment.

181. However, the Commission notes that [

]. Without the competitive pressures applied by a competitor, the merged entity may face decreased incentives to invest in new technology.

182. The Commission considers that the merged entity would have greater ability to invest in new technology and facilities than the Applicants would in the counterfactual, due to the acquisition creating a single private hospital venture. While the Commission is unable to quantify the value of this potential benefit, it does consider that some weight should be attached to the potential for the joint venture to invest in new technology as this potential would not exist to the same extent in the counterfactual.

BALANCING OF BENEFITS AND DETRIMENTS

183. The determination of the Application involves a balancing of the public benefits and detriments which will, or will be likely to result, from the Acquisition. Only when there is a net positive public benefit can the Commission be satisfied that the Acquisition should be permitted, and that it should grant an authorisation for the Acquisition.

184. Tables 4 and 5 summarise the Commission's quantitative assessment of the likely detriments and benefits arising from the Acquisition.

Table 4: Summary of detriments

Category	Evaluation	Likely NPV
Allocative efficiency	[ ]	[ ]
Productive efficiency	[ ]	[ ]
Dynamic efficiency	Nil	Nil
Total of quantified detriments		**$1.55 million**

Note: A 10% discount rate was used in these calculations

Table 5: Summary of benefits

Category	Evaluation	Likely NPV
Cost savings	Over 5 years, cost savings increase to [ ]	[ ]
Alternative use of premises	One off benefit	[ ]
Capital expenditure on land and buildings	One off cost	[ ]
Increased investment	Not quantifiable	
Total of quantified benefits		**$3.13 million**

Note: A 10% discount rate was used in these calculations

185. The estimate of the likely net present value of detriments over five years of $1.55 million and benefits of $3.13 million. Accordingly, the benefits are sufficient to outweigh the detriments.

186. The quantitative assessment outlined above demonstrates that the benefits accruing from this acquisition outweigh the likely detriments. Further, the Commission considers that its qualitative judgement supports this assessment, particularly when non quantifiable benefits such as the potential for increased investment are taken into account.

DETERMINATION

187. Having regard to all the circumstances, the Commission's view is that it is satisfied that the benefits to the public would outweigh the loss of competition arising from the Acquisition. Therefore, the Commission is satisfied that the Acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted.

188. Therefore, the Commission grants an authorisation for the Acquisition pursuant to section 67(3)(b) of the Commerce Act 1986.

Dated this 28th day of July 2011.

.....
Dr Mark Berry
Chair