



Statement of Issues

20 July 2023

Australian Clinical Labs Limited – proposed acquisition of Healius Limited

Purpose

1. Australian Clinical Labs Limited (**ACL**) proposes to acquire Healius Limited (**Healius**).
2. This Statement of Issues:
 - gives the Australian Competition and Consumer Commission's (**ACCC**) preliminary views on competition issues arising from the proposed acquisition
 - identifies areas of further inquiry
 - invites interested parties to submit comments and information to assist our assessment of the issues.
3. Statements of Issues do not refer to confidential information provided by the parties or other market participants and therefore may not fully articulate the ACCC's preliminary position.

Overview of ACCC's preliminary views

4. In considering the proposed acquisition, the ACCC applies the legal test set out in section 50 of the *Competition and Consumer Act 2010* (the **CCA**). In general terms, section 50 prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in any market.
5. The ACCC divides its preliminary views into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to raise concerns'. In this Statement of Issues there are three 'issues of concern' and one 'issue that may raise concerns'.

Issue of concern – unilateral effects in community pathology services

6. The ACCC's preliminary view is that the proposed acquisition would lead to a substantial lessening of competition in the market or markets for community pathology services.
7. The transaction would result in a significant increase in concentration in already concentrated markets for the supply of community pathology services. New entry or expansion on a scale sufficient to prevent a substantial lessening of competition appears unlikely.
8. The ACCC is concerned that the merged entity would have the ability to increase prices and/or reduce service quality.

Issue of concern – coordinated conduct in community pathology services

9. The ACCC's preliminary view is that the proposed acquisition would lead to a substantial lessening of competition via an increased risk of coordinated conduct in community pathology services, particularly between the merged entity and Sonic.
10. The ACCC is particularly concerned that this increased risk of coordinated conduct may result in an increase in private billing for pathology services.

Issue of concern – public pathology services in Victoria

11. The ACCC's preliminary view is that the proposed acquisition would lead to a substantial lessening of competition in the supply of public pathology services in Victoria.
12. The proposed acquisition would combine the two most active competitors in the supply of pathology services to public hospitals in Victoria. In some regional areas of Victoria, the proposed acquisition may combine the only active competitors for these services.
13. The ACCC is concerned that the merged entity would have the ability to increase prices and/or reduce service quality.

Issue that may raise concerns – veterinary pathology services in Victoria and South Australia

14. The ACCC's preliminary view is that the proposed acquisition may lead to a substantial lessening of competition in veterinary pathology services in Victoria and South Australia.
15. The proposed acquisition would lead to the combination of two important competitors in already concentrated markets for the supply of veterinary pathology services in Victoria and South Australia.

Making a submission

16. The ACCC invites submissions from interested parties by 5pm on 10 August 2023. Responses may be emailed to mergers@acc.gov.au with the title: *Submission re: ACL-Healius - attention Debbie Ravalli*. If you would like to

discuss the matter with ACCC staff or have any questions about this Statement of Issues, please contact Debbie Ravalli on (07) 3811 9268.

17. The ACCC anticipates making a final decision on 12 October 2023, however, this timeline can change. To keep up with possible timing changes and to find relevant documents, interested parties should visit the Mergers Register on the ACCC's website at www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews.

Confidentiality of submissions

18. The ACCC will not publish submissions regarding the proposed acquisition. We will not disclose submissions to third parties (except our advisors/consultants) unless compelled by law (for example, under freedom of information legislation or during court proceedings) or in accordance with s155AAA of the CCA. Where the ACCC is required to disclose confidential information, the ACCC will notify you in advance where possible so that you may have an opportunity to be heard. Therefore, please identify any confidential information that is provided to the ACCC. Our [Informal Merger Review Process Guidelines](#) contain more information on confidentiality.

About ACCC 'Statements of Issues'

19. A Statement of Issues is not a final decision about a proposed acquisition. A Statement of Issues outlines the ACCC's preliminary views and identifies further lines of inquiry.
20. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

The parties

The acquirer: ACL

21. ACL is an ASX-listed Australian provider of pathology services (ASX:ACL). ACL provides human pathology services to out-patients, in-patients (of public and private hospitals), and commercial and government customers.
22. ACL primarily provides human pathology services through its wholly owned subsidiary Clinical Labs Pty Ltd. As at March 2023, ACL operated Approved Collection Centres (**ACCs**) and National Association of Testing Authorities (**NATA**) accredited laboratories Australia-wide (except Tasmania). See **Table 1** for the number of ACCs and laboratories per state/territory.
23. ACL provides veterinary pathology services in South Australia and Victoria through its Gribbles Veterinary brand.
24. ACL operates 31 SunDoctors skin cancer clinics in New South Wales, Queensland, Victoria and South Australia through Southern Sun Clinics Pty Ltd.

The target: Healius

25. Healius, which traded as Primary Health Care Limited until November 2018, is an ASX-listed Australian provider of pathology services and diagnostic imaging services (ASX:HLS). Healius provides pathology services to out-patients and in-patients (of private and public hospitals), and commercial and government customers.
26. As at March 2023, Healius provided human pathology services through Specialist Diagnostic Services Pty Ltd operating under various brands in all Australian states and territories. Its brands include Laverty Pathology (New South Wales and Australian Capital Territory), Dorevitch Pathology (Victoria), QML Pathology (Queensland), Abbott Pathology (South Australia), Western Diagnostic Pathology (Western Australia and Northern Territory) and TML Pathology (Tasmania). See **Table 1** for the number of ACCs and laboratories in each state/territory.
27. Healius also provides veterinary pathology services through its Vetpath (Western Australia and Northern Territory), Vetnostics (New South Wales and Australian Capital Territory), QML Vetnostics (Queensland), TML Vetnostics (Tasmania) and Australian Specialised Animal Pathology Laboratory (South Australia and Victoria) brands.
28. On 2 May 2023, Healius completed a binding agreement to sell its day hospital business (Montserrat Day Hospitals) to Nexus Hospitals.

Table 1: ACL and Healius ACCs and laboratories per state/territory¹

State	ACCs		NATA accredited laboratories	
	ACL	Healius	ACL	Healius
NSW/ACT	447	732	11	26
VIC	470	533	28	29
QLD	73	534	2	26
SA	153	32	26	1
WA	172	205	7	10
NT	14	18	1	2
TAS	-	22	-	2

¹ Data for this table was collected from Department of Human Services, [Approved Collection Centres for Pathology Services](#), DHS, Canberra, 2023 on 19 April 2023.

Industry background

Pathology testing

29. Pathology is the branch of clinical medicine concerned with studying the nature, diagnosis and causes of diseases. Pathology testing involves the analysis of medical samples, for example blood cell counts, which are collected from patients.
30. Pathology testing can be divided into the following four broad categories and relevant sub-specialties:
- biochemistry (chemical pathology, immunology and infertility and pregnancy tests)
 - haematology
 - microbiology
 - histopathology and cytopathology (sometimes referred to as histology and cytology).
31. Testing for different sub-specialities is automated to varying degrees. Biochemistry and haematology tend to be more highly automated and generate the highest pathology test volumes. Consequently, there are significant economies of scale associated with performing these tests. Histology and cytology tend to require greater manual preparation of samples, analysis, and interpretation of test results.

Pathology collection

32. Pathology samples are collected from patients via various channels, including at:
- ACCs, or pathology collection centres staffed by a pathology provider
 - collection bins in medical practices, specialist practices or other allied health facilities such as aged care and nursing homes (**'collection bins'**), where a pathology provider can collect referred samples
 - hospitals.
33. The ACCC is not aware of any full-service providers solely using collection bins. ACCs can be 'co-located' at medical practices (by sub-leasing part of a medical practice) or 'standalone' at an independent site.

Pathology funding

34. Most pathology testing is funded in one or more of the following ways:
- **Commonwealth government** – the Commonwealth Government funds most pathology tests through Medicare rebates on a fee-for-service basis, in some cases supplemented by out-of-pocket expenses paid by patients (see further below). The rate at which a pathology test is covered under Medicare rebates is set by the Commonwealth Government under the Medicare Benefits Schedule (**MBS**).
 - **Health funds** – for private in-patients with private health insurance, a private health fund will cover some or all of any 'gap' (see further below) for

privately billed patients. For this purpose, private health funds seek to enter into Medical Provider Purchase Agreements (**MPPAs**) with pathology providers.

- **State governments** – the pathology expenses of public in-patients at public hospitals are generally covered by a state-based funding system covering all services provided during a hospital stay.
35. The mechanism for billing pathology tests, except for public in-patients covered by a state-based funding system, is described below.
 36. A pathology provider can choose whether to receive only the applicable MBS rebates for services it provides (**'bulk bill'**) or to impose an additional charge to patients, known as an 'out of pocket' expense or 'gap' (**'privately bill'**). This decision is influenced by a range of factors, including whether the patient is a concession card holder, the preference of the doctor as expressed on the referral form, the billing policy of competing pathology providers and the complexity of the test. Pricing is implemented through the billing policy of each pathology provider.
 37. When a pathology provider chooses to bulk bill its patients, the pathology provider obtains payment directly from the Commonwealth Government. The result is that the services are effectively free to the patient and the pathology provider is exposed to minimal credit risk.
 38. The ACCC understands private billing is common in private hospital settings but is uncommon in out-patient settings.
 39. The ACCC understands that pathology providers face the following difficulties privately billing for out-patient services:
 - **Explicit informed consent:** At the point of collection, the number of laboratory tests that need to be run on a patient sample to satisfy a doctor's referral may be unknown. It may be difficult to ascertain the full cost owed by patients until testing has been undertaken. As pathology providers must obtain explicit informed consent from patients when billing, they are not authorised to charge for an unspecified amount.
 - **Episode coning:** In some circumstances where a medical practitioner refers numerous tests in a single patient visit (or patient episode), an algorithm is applied by Medicare to only furnish payment for the three highest fee items as determined by the MBS rate (also known as 'episode coning'). From the outset it may be difficult for pathology providers to accurately determine how episode coning may apply for some patients when the billing algorithm is applied by Medicare.
 - **Patients seeking MBS rate for eligible items:** Where a pathology provider renders a patient with an invoice for the full cost of a pathology test (which may include a testing fee and additional co-payment), the patient may still apply to Medicare to obtain a rebate for eligible tests based on the MBS rate. When an invoice is received, patients can either pay a pathology provider in full and subsequently apply for the MBS rate with Medicare or

make a claim directly to Medicare and receive a cheque for the MBS rate.² Alternatively, the patient may choose not to pay the invoice, in which case the provider may incur further costs to recover the debt. In this instance Medicare may elect to pay the MBS rate to the pathology provider,³ however this involves the pathology provider foregoing any additional out-of-pocket expenses charged to patients.

40. In private in-patient settings, private health insurers may enter an MPPA with pathology providers. This ensures that a private health insurer's customers are not privately billed. If a patient does not have private health insurance, or their private health insurer does not have an MPPA with a pathology provider, then the patient is directly billed for the cost of the pathology test.
41. Some pathology tests are not covered by Medicare, for example pathology tests connected with elective cosmetic surgery and some genetic/DNA tests.⁴ In this instance, patients are directly billed for the full cost of a pathology test.
42. A pathology provider may obtain substantially greater revenue if it privately bills patients, who must then pay out-of-pocket expenses. There is some credit risk associated with invoicing and seeking payment from out-patients relative to seeking payment directly from Medicare, as it relies on the patient paying the out-of-pocket expense and may also require the patient to pass on the applicable Medicare rebate to the pathology provider.⁵ The ACCC has previously found that the size of the out-of-pocket expense is generally set at a level that is sufficient to mitigate this risk.
43. In this Statement of Issues, references to 'price increases' should be read as including both or either of:
 - the introduction of private billing for pathology services that would otherwise be bulk billed
 - an increase in the gap for privately billed pathology services.

Referrals

44. A patient must obtain a referral from a medical practitioner for a pathology test. Pathology providers provide branded referral forms to medical practitioners, which patients then take to an ACC.
45. The medical practitioner may express a preference on the referral form for the patient either to be bulk billed or privately billed. A pathology provider can only bulk bill if that has been requested by a medical practitioner. Despite a request to bulk bill, the pathology provider can choose to disregard that request and bill the patient on a private basis.

² In this scenario, any additional out-of-pocket expense above the MBS rate would still have to be paid for by the patient.

³ The ACCC understands that, after a period of 90 days from the date of an eligible invoice, the Chief Executive of Medicare may elect to pay the MBS rate for an eligible test direct to the pathology provider.

⁴ Services Australia, [Pathology services for health professionals](#), Department of Human Services, accessed 28 June 2023.

⁵ There is relatively little credit risk involved with privately billing insured in-patients who are covered by health insurance.

46. Since 11 December 2010, patients have been free to take these forms to any pathology provider, regardless of the branding on the form.⁶ Patients generally opt for the pathology provider listed on the form. The ACCC understands that the number of 'foreign' request reforms received by pathology providers is low.

The proposed transaction

47. On 20 March 2023, ACL made an off-market takeover offer for Healius offering 0.74 ACL shares for every 1 Healius share (**the Offer**).
48. Also on 20 March 2023, Healius advised its shareholders to take no action in relation to the Offer.
49. On 29 March, Healius made an application to the Takeovers Panel, submitting that (among other things) ACL's Bidder's Statement is misleading (including by omission) and inadequate in several respects and as a result:
- the Offer is not taking place, or will not take place, in an efficient, competitive and informed market
 - Healius shareholders are not being given enough information to enable them to assess the merits of the Offer
 - the Bidder's Statement contravenes s636(1)(m) and 670A(1) of the Corporations Act.
50. Following receipt of the application by Healius, ACL provided the Takeovers Panel with a draft Replacement Bidder's Statement (**RBS**) containing revised disclosures. On 17 April 2023, the Takeovers Panel declined to conduct proceedings.
51. The offer period expires on 29 September 2023.

Other industry participants

Commercial pathology providers

52. Sonic Healthcare Limited (**Sonic**) (ASX:SHL) is a prominent commercial pathology provider operating in all states and territories. Sonic provides pathology and radiology services in Australia and overseas. It also offers medical centre management services through subsidiary company Independent Practitioners Network, and healthcare software development services through subsidiary company Precedence Healthcare.
53. 4Cyte Pathology Pty Ltd (**4Cyte**) is a commercial pathology provider with ACCs in New South Wales, Victoria and Queensland. 4Cyte commenced operations in 2018. Market feedback has suggested 4Cyte grew significantly across New South Wales, Victoria and Queensland as a result of its prominent role in securing State government contracts for conducting rapid antigen tests during the COVID-19 pandemic.

⁶ An exception is where a particular pathology provider is specified by the referring medical practitioner on clinical grounds.

54. There are also other commercial pathology providers with single-state offerings. These include Medihealth Pathology Pty Ltd (New South Wales), Saturn Pathology Pty Ltd (Western Australia) and Austech Medical Laboratories (Trading for KSPC Pty Ltd) (New South Wales).
55. There are also niche providers with limited ACC networks and/or that operate laboratories which focus on providing specific pathology services. This includes rapid antigen testing for COVID-19 (including walk-in sites and temporary sites at airports), and corporate/government testing for employees.

Not-for-profit pathology providers

56. There are several not-for-profit pathology providers. Some are owned by hospital operators and may not offer their services to all market participants.
57. The ACCC also understands not-for-profit providers may be more likely to operate in narrower geographic areas, including metro areas, typically around hospitals to which they are attached. Where a not-for-profit provider is affiliated with a particular hospital (such as St Vincent's Pathology primarily servicing St Vincent's Hospitals), these providers usually maintain ACC locations within a small geographic radius of the affiliated hospital.

Public pathology providers

58. South Australia, Australian Capital Territory, Northern Territory, Tasmania, Western Australia, Queensland and New South Wales have publicly funded pathology services that are required to service, under state health regulation, the clinical pathology testing needs of their respective public hospital systems state-wide.
59. These public pathology providers are required to provide the full range of pathology services on 24-7 basis, including complex tests. They are also able to accept pathology samples from a variety of sources including out-patients and private in-patients. Some public pathology providers maintain ACCs in the general community, usually in the area surrounding the public hospitals they service.
60. In Victoria, there are public pathology providers that are associated with a specific public hospital provider (Monash Health Pathology, Austin Pathology, Eastern Health, Alfred Pathology Services, Northern Pathology Victoria, and Melbourne Health). These providers operate at a smaller scale than the state-wide public pathology providers in other states.
61. Victoria has a high proportion of public pathology services that have been outsourced to commercial pathology providers. Market feedback suggests this has occurred due to historical policy settings favouring deregulation of pathology services in public hospitals.

Competition in the supply of pathology services

62. The ACCC has previously found that competition between pathology providers may be manifested in one or more of the following ways, which has been confirmed in recent market feedback:

- **Bulk billing levels:** The proportion of patients being bulk billed, which depends on a pathology provider's billing policy.
- **Prices to privately billed patients:** The amount of the gap set by pathology providers for privately billed patients.
- **Health funds:** The rates negotiated under MPPAs between pathology providers and private health funds. These rates are reflected in insurance premiums.
- **Service levels:** Pathology providers must comply with minimum standards imposed by the National Association of Testing Authorities (**NATA**), the authority for accrediting laboratories in Australia. Nevertheless, pathology providers compete on several other service-related aspects, such as turnaround times, the number and convenience of ACC locations, opening hours of ACCs, range of tests and customer service.

Veterinary pathology providers

63. There is demand for veterinary pathology services across Australia. The ACCC understands that there is overlap between the provision of veterinary pathology services by ACL and Healius in Victoria and South Australia with the following providers:
- IDEXX (which operates nationally)
 - ACE Laboratories (Victoria)
 - Animal Referral Hospital Essendon (Victoria)
 - Geelong Veterinary Hospital (Victoria)
 - Regional Laboratory Services (Victoria)
 - Independent Veterinary Pathology (Victoria).
64. Some veterinary pathology providers are funded through universities, including the Asia Pacific Centre for Animal Health (University of Melbourne), GreenCross Vet / U-Vet (University of Melbourne) and Veterinary Diagnostic Laboratory (Charles Sturt University, Adelaide).
65. Several government-funded veterinary pathology laboratories also operate in Victoria, including the AgriBio Centre laboratory in Epsom (operated as a joint venture between La Trobe University and the Victorian Government's Department of Jobs, Skills, Industries and Regions) and the Australian Centre for Disease Preparedness (operated by the CSIRO).

Future with and without the acquisition

66. In assessing a proposed acquisition under section 50 of the CCA, the ACCC considers the effects of the acquisition by comparing the likely future state of competition if the acquisition proceeds (the 'with' position) to the likely future state of competition if the acquisition does not proceed (the 'without' position) to determine whether the proposed acquisition is likely to substantially lessen competition in any relevant market.

67. The ACCC considers that the likely future competitive environment absent the proposed transaction would be the status quo. That is, Healius would continue to operate as an independent and effective competitor to ACL in relevant markets.

Previous ACCC decisions

68. The foundation for ACL's current business was Healthscope's former pathology businesses, acquired in 2015 by private equity firm Capital Crescent.

2016 Primary acquisition of pathology assets operated by Healthscope (Queensland) (litigation not commenced, following divestment undertakings)

69. On 16 June 2016, the ACCC announced that it had very significant competition concerns with Primary Health Care Limited's (**Primary**) completed, unnotified acquisition of pathology assets operated by Healthscope Limited (**Healthscope**) in Queensland (**Primary/Healthscope acquisition**). The ACCC considered a Queensland-based market for the supply of community pathology services. The ACCC also considered, alternatively, separate markets for Brisbane, the Gold Coast and Sunshine Coast, where Healthscope provided strong competitive constraint.
70. The ACCC's investigation indicated that Healthscope was an important constraint preventing Primary and the next nearest competitor, Sonic Healthcare Limited (**Sonic**), from increasing prices or decreasing service quality in the relevant markets.
71. The ACCC did not commence proceedings because Primary gave an undertaking to divest the assets it had acquired and to transfer relevant personnel to an approved purchaser, and Healthscope undertook to divest certain pathology assets that it had retained to the same purchaser.

2013 Sonic / Healthscope merger (Australian Capital Territory/Southern tablelands) (not opposed)

72. On 31 January 2013, the ACCC announced its decision to not oppose Sonic Healthcare's proposed acquisition of the pathology business of Healthscope Limited in the Australian Capital Territory and Southern Tablelands (New South Wales) area.
73. The ACCC concluded that the proposed acquisition was not likely to substantially lessen competition, given that:
- Sonic would continue to be constrained by Primary and the public provider, ACT Pathology
 - ACT Pathology had a significant presence and a policy to always bulk bill
 - Primary could expand its presence in the Australian Capital Territory if Sonic were to substantially increase price or reduce service levels
 - Healthscope did not appear likely to impose a strong competitive constraint in this area in the future absent the proposed acquisition.

2012 Sonic / Healthscope merger (partially opposed)

74. On 11 October 2012, the ACCC partially opposed the proposed merger between Sonic Healthcare Limited and Healthscope Limited (**Sonic/Healthscope merger**) for the supply of community pathology services in Queensland and Western Australia.
75. The ACCC noted that the merger would result in the removal of significant competitive constraint in the Queensland market that was not likely to be replicated by any existing or new pathology provider post-acquisition. The ACCC considered that the events surrounding a change of billing policy by Sonic Healthcare Limited in 2009 were a strong indication of the level of inter-dependence of the billing policies of the pathology providers. The ACCC therefore opposed the proposed acquisition of Healthscope's Queensland pathology business.
76. The ACCC concluded that, although the proposed acquisition was likely to remove a significant player in Western Australia, it was not likely to substantially lessen competition in the Western Australian market as:
- several pathology providers would remain in the Western Australian market that would continue to provide a comparable level of competition.
 - although Healthscope appeared to be a strong competitor, the competitive constraint offered by Healthscope and likely to be offered by Healthscope in the future absent the proposed acquisition, did not appear to be significantly different or superior to that of other competitors in the Western Australian market.

2013 IDEXX acquisition of veterinary pathology assets of Healthscope (New South Wales, Australian Capital Territory and Queensland) (not opposed)

77. On 25 January 2013, the ACCC announced that it would not oppose IDEXX Laboratories Pty Limited's proposed acquisition of the veterinary pathology assets of Healthscope Limited in New South Wales, the Australian Capital Territory, and Queensland.
78. The ACCC concluded that the proposed acquisition was unlikely to substantially lessen competition in the relevant markets because:
- Healthscope (trading as Gribbles at the time) did not appear to impose a strong competitive constraint on other veterinary pathology providers in the relevant markets in the future absent the proposed acquisition
 - other competitive constraints on IDEXX would remain post-acquisition, including Primary Health Care (now trading under Healius 'Vetnostics'), smaller specialised laboratories, and some potential new entry.

Market definition

79. The ACCC's starting point for considering which markets will be affected by the proposed acquisition is to identify the areas of overlap between the products actually or potentially supplied by the merger parties. The ACCC then considers other actual or potential suppliers of those products, as well as what other

products constitute sufficiently close substitutes to provide a significant source of constraint on the merged entity.

80. Noting the overlaps between the parties and for the purposes of this SOI, the ACCC is considering the following possible markets:
- the supply of community pathology services in separate state-based markets in all states and territories (except in Tasmania, where ACL does not operate)
 - the supply of public pathology services in Victoria
 - the supply of veterinary pathology services in separate state-based markets in Victoria and South Australia.

Community and public pathology services

Product dimension

81. Pathology services consist of several integrated services, including collecting pathology samples, transporting them to a laboratory, processing (testing) the samples, generating and delivering reports, and discussing with the referring medical practitioner where necessary.
82. Since these activities are integrated and the ACCC is not aware of companies active in only one component,⁷ the ACCC considers it appropriate to regard them as forming part of an overall product of providing pathology services.
83. There are three key sources of demand for pathology services:
- out-patients referred by general practitioners and specialists
 - private in-patients at public and private hospitals
 - public in-patients at public hospitals.
84. Pathology services provided to the first two sources of demand attract an MBS rebate. The ACCC has historically considered them together as 'community pathology'.
85. There are some distinctions between out-patient and private-in patient settings, despite both being eligible for the MBS rebate. The ACCC is considering whether it may be appropriate to further segment community pathology services between out-patient and private in-patient services.
86. Some private hospital clinical settings, including emergency and intensive care, require rapid turnaround times for tests to be processed. Consequently, some private hospitals require a separate laboratory to be established within their premises. There may also be a need for a broader range of tests, including esoteric tests (such as skin cancer-related tests) to be collected and processed.

⁷ The ACCC recognises that there is some scope for third parties such as courier companies to be engaged to provide transportation. However, this does not appear to occur on any material scale.

87. The ACCC understands that this higher standard of testing, in terms of turnaround times, volume and breadth of testing, is also a requirement of pathology testing in public hospitals.
88. Pathology services provided to public in-patients are covered by a state-based funding system and are described as ‘public hospital pathology’. Public hospital pathology services are generally:
- carried out in-house by a state-wide public pathology provider or
 - undertaken by public pathology providers or commercial pathology providers who have been appointed on a long-term contract.
89. Public in-patients are not contestable to pathology providers operating outside of these arrangements.
90. The ACCC’s view is that the supply of pathology services to public in-patients does not fall within the supply of community pathology services. However, the ACCC considers that:
- public pathology providers should be included as actual or potential competitors in relation to the supply of community pathology services to out-patients (as most public pathology providers offer out-patient services or have the potential to do so).
 - commercial pathology providers with sufficient capabilities should be included as actual or potential competitors in relation to the supply of public in-patient pathology services in Victoria.
91. Pathology providers also compete to provide corporate and government pathology services. While some corporate customers might require or prefer to engage a pathology provider with a national presence, market inquiries have indicated that a national presence is not usually required.
92. In addition, in some specialised areas of testing, pathology providers may compete with a range of potential suppliers that are not active in the wider community pathology markets. Nonetheless, at this stage the ACCC is considering corporate and government pathology services as part of the same market as community pathology services.

Geographic dimension

93. The ACCC is still considering the appropriate geographic dimension of the relevant markets.
94. On the consumer side, patients are unlikely to travel further than necessary to seek pathology testing. Hospital in-patients may be unlikely to travel at all. The supply of pathology services therefore has local dimensions.
95. Despite these local dimensions, to the extent market structures are similar across geographies, it may be appropriate to apply state or regional markets. For the purposes of this SOI, the ACCC has applied state-based markets. However, it may ultimately be more appropriate to apply regional or local markets on a case-by-case basis.

96. On the supply side, market inquiries have indicated that where a sample is tested depends on a range of factors, including the type of test and the acuity of the clinical setting. Laboratories are typically located close to population centres and specimens are generally tested in the same state or territory in which they are collected. It is often necessary for a pathology specimen to be tested within hours of being collected from a patient.
97. The ACCC is aware of exceptions to this. For example, specimens collected on the north coast of New South Wales may be tested in Brisbane. High volume tests are often transported to large central laboratories. In regional areas, samples are more likely to be sent much further afield if there is insufficient demand to support a local laboratory.
98. For the purposes of this SOI, the ACCC is considering the following geographic dimensions to the relevant markets:
 - regional markets currently defined as each state and territory in Australia (except Tasmania, where ACL does not currently compete) for the supply of community pathology services
 - the state of Victoria for the supply of pathology services to public hospitals and public health services.

Veterinary pathology services

99. The ACCC has previously considered that there are state-based markets for the provision of veterinary pathology services for all types of animals, including companion animals and livestock.
100. Veterinary pathology services are provided to veterinarians who treat companion or production animals. They are distinct from human pathology services, with specialist veterinary pathologists and no government funding arrangements.
101. ACL provides veterinary pathology services in South Australia and Victoria, whilst Healius provides veterinary pathology services in all states and territories. Market feedback indicated veterinary pathology services are distinct from human pathology services.

The ACCC invites comments from market participants on its preliminary views about the definition of the relevant market(s). Market participants may wish to comment on:

- whether out-patient and private in-patient services should be considered together as part of community pathology services
- whether narrow or broad geographic markets are applicable for community pathology services
- the extent to which geographic differences (including between metropolitan and regional areas) for the provision of community pathology are consistent in all relevant states and territories
- product and geographic dimensions of veterinary pathology services in Victoria and South Australia, including whether there are distinctions between pathology services between livestock and companion animals.

Issue of concern: Substantial lessening of competition in state-based markets for community pathology services (all states and territories except Tasmania)

102. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition in the supply of community pathology services in all states and territories (except Tasmania, where ACL does not operate).

103. As outlined in the following sections, this is because:

- the transaction would significantly increase concentration in already concentrated markets for the supply of community pathology services
- ACL and Healius are close competitors in the supply of these services
- competitive constraints from existing suppliers vary, but few have the same scale and breadth of operations as the merger parties
- new entry or expansion is unlikely to replace competitive tension lost through the proposed acquisition
- there is potential for anti-competitive effects, including price and non-price.

Significant change to structural conditions for competition

104. The supply of community pathology services is concentrated in every state and territory in which the parties overlap (all states and territories except Tasmania). The proposed acquisition would significantly increase concentration in all relevant markets.

105. There has been a trend of consolidation over the past decade via acquisitions. Market participants noted that ACL, Healius and Sonic have made acquisitions over the past decade, including:

- ACL's acquisition of Medlab Pathology in 2021
- ACL's acquisitions of not-for-profit pathology provider St John of God Pathology and Perth Pathology in 2016
- Sonic's acquisition of Healthscope's pathology businesses in Queensland, Western Australia, and the Australian Capital Territory in 2013.

106. The ACCC has calculated market share estimates for the supply of community pathology services in each relevant state or territory. To do so, the ACCC has used publicly available data identifying ACCs for each accredited pathology provider as of 19 April 2023.⁸

107. The number of ACCs reflects a pathology provider's collection capacity for out-patients. This metric does not include collection bins or private in-patient

⁸ Medicare publishes statistics relating to the number of ACCs owned by each pathology provider – see Department of Human Services, [Approved Collection Centres for Pathology Services](#), DHS, Canberra, 2023. This data is updated on a regular basis by the Department of Human Services. There is likely to be some variance in the total number of ACCs per state or territory between the sample date and publication of this Statement of Issues. Notwithstanding this, data collected as at 19 April 2023 is representative of ACL and Healius' presence in each state and territory as ACC numbers do not change significantly over short periods of time.

services. Market participants have indicated revenues and volumes (i.e., confidential information) are likely to be more accurate metrics for estimating market shares. Nevertheless, the ACCC is using ACC numbers in this Statement of Issues in order to give an approximate indication of market shares in community pathology services without disclosing confidential information.

108. The market share estimates below indicate the merged entity would become the largest provider of community pathology services in New South Wales and Australian Capital Territory (combined), Victoria, Queensland, Western Australia, South Australia and the Northern Territory. Sonic would be the second largest provider in these jurisdictions.
109. The market share of each remaining competitor is substantially less than the market shares of the merged entity or Sonic. Post-acquisition, the merged entity and Sonic between them would account for more than 75 per cent market share in all relevant jurisdictions.
110. Using these figures, HHI⁹ estimates show pre-acquisition values of more than 2,000 and increases of at least 400 in all states and territories in which ACL and Healius overlap.

Table 2.1: Market share estimates for New South Wales and the Australian Capital Territory by ACC (19 April 2023)

ACT/NSW		
Competitor	No. of ACCs	Share of ACCs
ACL	447	19.2%
Healius	732	31.5%
Combined	1179	50.7%
Sonic	739	31.8%
4Cyte	178	7.7%
NSW Health Pathology	163	7.0%
Sydpath / St Vincent's Pathology	29	1.2%
Medihealth Pathology	21	0.9%
ACT Pathology	7	0.3%
Austech Medical Labs	6	0.3%
Austin Pathology	2	0.1%
Total	2324	100.0%

⁹ Please refer to page 35 of the ACCC's [Merger Guidelines](#) for discussion of the Herfindahl-Hirschman Index (HHI).

Table 2.2: Market share estimates for Victoria by ACC (19 April 2023)

VIC		
Competitor	No. of ACCs	Share of ACCs
ACL	470	25.5%
Healius	533	29.0%
Combined	1003	54.5%
Sonic	402	21.8%
4Cyte	311	16.9%
Sydney / St Vincent's Pathology	67	3.6%
Austin Pathology	23	1.3%
Monash Health Pathology	18	1.0%
Eastern Health	5	0.3%
Northern Pathology Victoria	5	0.3%
Alfred Pathology Services	4	0.2%
Melbourne Health	2	0.1%
Total	1840	100.0%

Table 2.3: Market share estimates for Queensland by ACC (19 April 2023)

QLD		
Competitor	No. of ACCs	Share of ACCs
ACL	73	5.4%
Healius	534	39.6%
Combined	607	45.0%
Sonic	437	32.4%
4Cyte	230	17.0%
Pathology Queensland	38	2.8%
Mater Pathology	37	2.7%
Total	1349	100.0%

Table 2.4: Market share estimates for Western Australia by ACC (19 April 2023)

WA		
Competitor	No. of ACCs	Share of ACCs
ACL	172	25.6%
Healius	205	30.5%
Combined	377	56.0%
Sonic	217	32.2%
PathWest	78	11.6%
Saturn Pathology	1	0.1%
Total	673	100.0%

Table 2.5: Market share estimates for South Australia by ACC (19 April 2023)

SA		
Competitor	No. of ACCs	Share of ACCs
ACL	153	32.9%
Healius	32	6.9%
Combined	185	39.8%
Sonic	164	35.3%
SA Pathology	116	24.9%
Total	465	100.0%

Table 2.6: Market share estimates for Northern Territory by ACC (19 April 2023)

NT		
Competitor	No. of ACCs	Share of ACCs
ACL	14	31.1%
Healius	18	40.0%
Combined	32	71.1%
Sonic	7	15.6%
Territory Pathology	6	13.3%
Grand Total	45	100.0%

ACL and Healius compete closely with one another

111. ACL and Healius appear to be close competitors in the supply of community pathology services in the states and territories in which they overlap. This is because they have established:

- wide coverage of their ACCs

- wide coverage of their courier networks
 - a full range of pathology testing capability
 - networks of laboratories, including in regional centres
 - widespread recognition of their subsidiary brands
 - extensive relationships with referring medical practitioners.
112. Market participants have submitted that ACL and Healius compete closely for ACC sites and lose sites to one another each year.
113. Both ACL and Healius have the expertise and scale to provide pathology services to private in-patients and will often compete for tender processes to secure contracts with private hospitals. The ACCC has heard that ACL and Healius compete strongly for private hospital tenders.
114. Whilst ACL and Healius are close competitors, the extent to which they compete may vary between each state or territory. Some market participants consider Healius less competitive in SA, where it has a smaller share of ACCs than either ACL or Sonic. By contrast, some market participants viewed ACL as being less competitive in QLD, where it maintains a smaller share of ACCs than Healius, Sonic and 4Cyte.

Competitive constraint from alternative providers

Alternative commercial pathology providers

115. There are alternative commercial pathology providers that operate in individual states, with a small network of ACCs. However, the only comparable commercial competitors to ACL and Healius, given their scale and scope, are Sonic and to a lesser extent 4Cyte.
116. Based on current share of ACCs, Sonic maintains a comparable market share to the merger parties, in every relevant state and territory except the Northern Territory, where ACL and Healius maintain more than twice as many ACCs as Sonic.
117. Post-merger, Sonic would be the next largest provider, but it would account for a significantly smaller share of the market, particularly in New South Wales/Australian Capital Territory (combined), Victoria and Western Australia. 4Cyte only operates in New South Wales, Queensland and Victoria. On average, Sonic only maintains between 7-17% share of ACCs in these jurisdictions.
118. Considering the above, the merged entity would face a limited competitive constraint from alternative commercial pathology providers post-merger.
119. Whilst some market participants viewed Sonic as a relatively strong competitor, others considered that it has been focused on overseas operations and has been less aggressive in terms of expanding its ACC footprint in Australia (including in rural and regional areas).

Niche, not-for-profit and public pathology providers

120. The ACCC's preliminary view is that niche, not-for-profit and public pathology providers are unlikely to impose a significant competitive constraint on the

merged entity. They lack the extensive ACC footprint, broad service offering, and substantial economies of scale to viably replicate the closeness of competition between ACL and Healius.

121. Public pathology services face higher cost structures and are weaker competitors to ACL or Healius. These higher cost structures are a result of operating in service areas where profits are marginal or negative and performing certain high-cost, complex tests (some of which are referred by commercial providers).
122. Public providers also receive smaller MBS payments than private providers for the same services such that they may have less capacity to compete for ACC opportunities.

Competitive constraint in relation to private in-patient services

123. In relation to private in-patient services, market feedback has indicated that ACL, Healius and Sonic are currently the only providers of private in-patient services. The ACCC understands that in some regional areas ACL and Healius are the only competitors, so would face limited competitive constraints if the proposed transaction proceeds.
124. Additionally, smaller providers do not have sufficient scale, infrastructure, and reputation to supply private in-patient services. The ACCC also understands that 4Cyte does not currently compete for private in-patient services.

Barriers to entry or expansion and likelihood of new entry

125. The ACCC is considering whether new entry or expansion would be likely, timely and sufficient to prevent a substantial lessening of competition that might otherwise result from the proposed acquisition.

Barriers to entry or expansion

126. The ACCC's preliminary view is that there are significant barriers to new entry and expansion, which is consistent with previous consideration of this industry.
127. The ACCC has identified the following key obstacles to pathology providers establishing or expanding their market share:

- *Access to referrals*

- 1) Incumbent firms hold an advantage over new entrants by maintaining a strong flow of pathology referrals.

New entrants may need to expend significant time and effort over a substantial period to establish a positive reputation with referring medical practitioners. By contrast, incumbent firms seeking to expand may leverage their existing relationships with medical practitioners to increase their pathology referral flows. Brand and reputation, including with respect to timeliness, accuracy and reliability of results, are important to medical practitioners.

Providers can then leverage these relationships with medical practitioners to assist with securing co-located ACCs at GP practices (discussed further below).

- 2) Whilst some practitioners may be willing to switch ACC provider when offered a higher rental fee, there may be costs associated with switching between pathology providers. These could include uncertainty in the quality of service provided by an alternative pathology provider, and familiarity with a pathology provider's IT or reporting systems.
 - 3) Referrals can also be a pathway to securing pathology tests from collection bins in allied health facilities such as nursing and aged care homes. New entrants would find it difficult to establish referral pathways with these facilities given existing commercial relationships and uncertainty around quality of service.
- *Availability of suitable locations*
 - 1) A new entrant faces significant challenges establishing a footprint of profitable ACCs. The ACCC has previously found that most of the ACCs opened following deregulation in 2010 were 'defensive' or designed to support an existing referral base rather than capture additional volume.
 - 2) ACCs co-located with GP practices, particularly large GP practices, are the most profitable as they generate the greatest throughput. Key reasons for this include that some patients will take a pathology test immediately before or after a medical appointment at the GP clinic; and that GPs at such practices typically use the branded referral forms of the on-site pathology provider, and their patients then typically attend an ACC of that pathology provider. At present, the availability of profitable ACC locations is dependent on the growth of new medical practices or a change in provider at existing practices. The ACCC also understands that many desirable locations have been 'locked up' in long-term leases.
 - 3) Barriers to establishing ACCs that are not co-located in medical practices are lower. However, market participants have indicated that such ACCs typically generate significantly fewer referrals, and insufficient testing volumes to support significant new entry.
 - *Economies of scale*
 - 1) The ACCC understands that pathology services carry significant fixed overheads. This is particularly the case with respect to laboratories.
 - 2) The ACCC understands ACL and Healius have expanded their referral base gradually over time to reach their current scale. A new entrant may be deterred by the risk of not reaching a minimum competitive scale in a reasonable timeframe to offset sunk costs associated with entering.

Likelihood of new entry or expansion

128. For the reasons identified above, the ACCC considers the likelihood of profitable incremental new entry or expansion is low.
129. Thus far in its review, the ACCC has identified few examples of new entry in recent years. The largest new entrant is 4Cyte, which commenced operations in 2018 in New South Wales and has expanded into Victoria and Queensland. At

present, 4Cyte provides services in out-patient settings, it does not offer services to in-patients. 4Cyte is smaller than each of ACL and Healius in the states it operates, except for Queensland where it has a larger presence than ACL. Post-acquisition, 4Cyte would be significantly smaller than the merged entity in all states where it operates.

130. Market feedback suggests 4Cyte's entry and growth resulted from a unique combination of circumstances – including increased demand for pathology services during the COVID-19 pandemic. 4Cyte appears unlikely to continue growing at the same rate and its entry and expansion appears unlikely to be replicated by others.
131. Other new entrants in recent years include Saturn Pathology (operating only in Western Australia) and Medihealth (operating only in New South Wales).
132. While market participants noted some pathology providers expanded during the pandemic, they also considered such providers have generally returned, or are returning, to their pre-COVID market position.

ACCC considering likely effects of the proposed acquisition on relevant markets

133. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition, with the potential for price and non-price effects.

Price effects for out-patients

134. The ACCC considers that the strong market position of the merged entity would provide it with the ability to unilaterally increase prices for out-patients. Price increases could include the increased application of private billing which could occur initially at specific locations/in specific regions, or for individual tests.
135. As mentioned above at paragraph 24, the MBS rate for bulk billed pathology tests is covered by the Commonwealth Government. Most pathology tests are covered by the MBS rate. Pathology providers have the choice of maintaining bulk billing policies or privately billing.
136. In 2009, the Commonwealth Government introduced a Bulk Billing Incentive (BBI), a payment to pathology providers (and other medical practitioners) for bulk billing MBS-eligible services. The BBI is paid for relevant services provided that an additional out-of-pocket fee is not charged to patients. The ACCC understands that the BBI rate may be amended by the Government.
137. Therefore, there are strong incentives for bulk billing. The majority of out-patient tests are bulk billed at present. To be profitable, private billing must be at such a level that it covers the lack of a BBI, additional risks associated with billing patients privately (such as the risk of non-payment by patients) and volumes lost to competitors which retain a bulk billing policy.
138. Nevertheless, the ACCC is concerned that increased market consolidation resulting from the proposed acquisition would make private billing more viable. The merged firm would represent a significant share of ACCs and testing capacity, such that it can expect to lose fewer tests to competitors than would be the case absent the acquisition. This may give rise to scenarios in which the merged firm may profitably engage in private billing in certain regions,

particularly those where there are fewer competitors or where the merged firm would potentially face less competitive constraint.

139. The ACCC notes market participants have identified an alternative means of increasing 'price'. This would involve the introduction of membership fees or establishing a 'gold card' system granting patients priority service at ACCs. These alternative means of increasing prices could avoid some of the practical challenges with private billing identified at paragraph 29.
140. The ACCC also notes that there may be a circumstance in which private billing by incumbent firms pressures the Commonwealth Government to increase funding under the MBS rate or BBI, to ensure public access to bulk billed services. This is an alternative means of increasing price and may become more likely if the merged firm has an increased ability to introduce private billing.
141. The proposed merger may also see price effects for medical practices with co-located ACC sites. With reduced competitive tension post-acquisition, the merged entity would likely have an ability to offer lower rental payments for suitable ACC locations.

Price effects for private in-patients

142. Reduced competitive tension for private in-patient services could lead to price effects through increased prevalence and cost of private billing to patients and reduced rental payments to hospitals.
143. Unlike out-patient services, private in-patients are often charged co-payments with a balance covered by a 'gap' payment depending on the level of private health insurance held by a patient. The ACCC understands private hospitals consider the extent of private billing when selecting pathology provider. It therefore appears likely that the proposed merger would lead to increases in private billing.

Non-price effects for out-patients

144. Some market participants have expressed the view that, as Commonwealth Government funding mechanisms have effectively signalled a 'market price' for pathology testing, firms tend to compete strongly on non-price factors.
145. The ACCC is concerned that non-price aspects of competition, including quality or service, may decline post-acquisition. Market participants have identified the following non-price factors as important to patients and doctors in community pathology services:
 - turnaround times
 - accuracy
 - ACC staff levels and patient wait times
 - ACC opening hours
 - convenience / availability of ACCs in a local area.
146. The ACCC notes there may be differences in non-price effects between regional and metro areas. Market participants have identified concerns that ACCs would

be consolidated in rural and regional areas. Consolidation appears less likely in metropolitan areas where barriers to establishing new ACCs may be lower.

Non-price effects for in-patients

147. The ACCC is also concerned about potential decreases in services for private hospitals. Market feedback suggests that the post-merger entity could leverage its market position to obtain more favourable terms in lease agreements with private hospitals or decrease service quality to private in-patients (such as by decreasing staffing levels at on-site laboratories or limiting collection frequency for non-urgent testing).

Efficiencies

148. In its initial Takeover Offer, ACL suggests the transaction would result in up to \$95 million in cost synergies through laboratory consolidation and logistics optimisation, procurement benefits and back-office consolidation.¹⁰
149. To the extent efficiencies are likely, the ACCC is considering whether the benefits are likely to be passed on to consumers through lower prices or improved services. This is unlikely to occur unless the savings are variable cost savings and there is sufficient competition post-acquisition to compel the merged entity to pass a significant portion of those savings through.
150. The ACCC has heard concerns that laboratory and logistics consolidation may in fact lead to reductions in service quality, such as increased turnaround times.

ACCC's preliminary views

151. In summary, the ACCC is concerned that the proposed acquisition appears likely to substantially lessen competition in the provision of community pathology services in the states and territories in which the parties overlap. ACL and Healius appear to compete closely with one another and the market is unlikely to self-correct via significant new entry or expansion. There is potential for price and non-price effects from such a significant reduction in competition.

The ACCC invites comments from market participants on its concerns in relation to reduced competition in community pathology services. Market participants may wish to comment on the following:

- the extent of competitive constraint imposed on ACL and Healius by other pathology providers, including Sonic and 4Cyte
- the significance of 'collection bins' to competition for out-patient pathology services
- the likelihood of new entry or expansion, given the need for new firms to reach a minimum competitive scale and the incremental, gradual nature of expansion
- for existing competitors, what factors inform whether you enter or expand into a new region

¹⁰Australian Clinical Labs Ltd, [Investor Presentation – Takeover Offer of Healius](#), 20 March 2023.

- any recent examples (e.g., from the last 5 to 7 years) of how pathology providers have introduced private billing in out-patient settings, including which tests, regions and time periods it applied to
- any examples of acquisitions of pathology providers leading to increases in price or reductions in service/quality for private in-patient services.

Issue of concern: Increased likelihood of coordinated outcomes in community pathology services

152. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition in the supply of community pathology services through an increased likelihood of coordinated conduct. The acquisition would lead to a significant structural change in market conditions, which may increase the potential for coordinated market outcomes.
153. The ACCC has previously examined changes in billing policy by Sonic in 2009 to privately bill a greater proportion of patients, which was subsequently reversed in early 2010.¹¹ The ACCC considers that previous contemplation of private billing as indicative of potential commercial opportunities that the merged firm may consider post-acquisition.
154. Post-acquisition, the merged entity and Sonic would be the two largest pathology providers in with at least 75% market share between them (using ACC numbers as a proxy). The ACCC is concerned this may enhance the ability for these providers to coordinate their market offerings.
155. The ACCC has heard strong concerns from market participants that such coordination may be likely. Citing the previous attempt by Sonic to increase prices in 2009, market participants submitted that if the merged entity were to introduce co-payments or otherwise raise prices, Sonic would be likely to accommodate them.
156. The ACCC is considering whether market conditions in community pathology services are conducive to coordinated market outcomes. Relevant factors include:
- The merged entity and Sonic would together account for a significant proportion of pathology services in each state and territory. Patients may have few alternatives, particularly in rural and regional areas.
 - Pricing and service levels are somewhat observable between competitors, at least to the extent of whether providers are bulk billing. Pathology providers are likely to rapidly become aware of changes to bulk billing practices through industry contacts.
 - Post-acquisition, the merged entity and Sonic would overlap in every state and territory and would have significant regional and local overlaps as well. They would also overlap with respect to all, or substantially all, types of

¹¹ See PCA, Sonic / Healthscope 2013: <https://www.accc.gov.au/system/files/public-registers/documents/MER13%2B7337.pdf>.

pathology tests. This may provide the merged entity and Sonic with opportunities to coordinate and/or retaliate against each other.

- As discussed above, significant new entry or expansion appears unlikely. The threat of new entry may not be sufficient to competitively constrain the merged entity and Sonic on any coordinated conduct.

The ACCC invites comments from market participants on its concerns in relation to the potential for increased coordination in community pathology services. Market participants may wish to comment on the following:

- whether, and if so how, the proposed acquisition increases the likelihood of coordinated competitive outcomes in community pathology
- whether competitors, such as 4Cyte, could rapidly expand in response to reductions in bulk-billing
- any examples of competitors coordinating conduct in the supply of community pathology, for example by instituting price increases or reductions in service at approximately the same time.

Issue of concern: Reduced competition in the supply of pathology services to public hospitals/public health services in Victoria

157. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition in the supply of pathology to public hospitals and public health services in Victoria.

158. ACL and Healius are the most significant private pathology providers competing to service public hospitals and public health services in Victoria. Following the proposed acquisition, the merged entity would face limited competition in the supply of pathology services to public hospitals and public health services in Victoria.

ACL and Healius compete closely for public hospital services in Victoria

159. In Victoria, a substantial portion of public pathology is outsourced through competitive tenders.

160. Not all pathology providers possess the necessary scale and infrastructure to meet the service requirements of public hospitals. ACL and Healius are two of three providers with this capability, alongside Sonic.

161. The ACCC understands that ACL and Healius have historically competed for public hospital tenders and have often been the only providers to do so. Feedback suggests this is particularly the case for regional areas of Victoria. Market participants submitted that Sonic usually does not compete for public hospital contracts.

Barriers to entry or expansion and likelihood of new entry

162. The ACCC considers that the barriers to entry or expansion for pathology services in public hospitals to be high, noting the following factors:

- *Scale and breadth of services*

- 1) Public hospitals require a full suite of pathology testing, including esoteric tests. Operating theatres also require tight turnaround times for collection results. In addition, hospitals require regular collection of pathology samples to accompany ward rounds. A new entrant would likely need to invest significant sunk costs to ensure they can operate and staff a laboratory onsite and can draw on a broader network to offer the breadth of testing required by hospitals.

- *Reputation*

- 1) Noting the time-critical nature of pathology testing in hospital environments, existing firms would have a reputation, developed over time, to ensure high confidence ratings in their testing procedures. A new entrant would have difficulty in overcoming perceptions of reliability and consistency from known providers such as ACL and Healius.

163. Market participants have indicated that Sonic and 4Cyte do not compete significantly, or at all in 4Cyte's case, for public hospital contracts in Victoria. This particularly applies to regional areas of Victoria. It appears unlikely that 4Cyte would have sufficient scale to service the breadth and volume of testing required in public hospital settings, nor would they have the existing reputation for quality in hospital settings to convincingly tender for public hospital contracts.

164. The ACCC understands Sonic may not have a significant presence in some regional areas of Victoria and consequently may face significant hurdles to competing in these areas. The competitive constraint from these providers may therefore differ between metropolitan and regional areas. The ACCC is considering these regional differences further.

165. The potential entry of public pathology providers is discussed below.

Entry or expansion by public pathology providers, and potential countervailing power of the Victorian Government

166. There are public pathology providers operating in Victoria that are often tied to public hospital providers. For example, Austin Pathology predominantly services the Austin Hospital in Victoria.

167. The ACCC understands that, historically, these providers have been:

- unlikely to assume contracts requiring the operation of laboratories in other hospitals
- likely to provide collection services to public hospitals in the region around the base hospital.

168. As a result, the current competitive constraints imposed by public pathology providers differs between metropolitan and regional areas of Victoria.

169. The ACCC is considering whether the Victorian Government has countervailing power with respect to public in-patient pathology services. Some public pathology services are in-sourced to public providers. The ACCC has heard that some contracts with commercial providers have been in-sourced in recent years.

170. The ACCC understands there are several public hospitals and public health services in Victoria operating largely independently of one another. For at least some of these entities, in-sourcing may not be an option in the short to medium term.

Possible effects for public hospitals

171. Post-acquisition, the merged entity may be able to charge more and offer less for its services to public hospitals in Victoria. The ACCC has heard that pathology providers typically charge on a per test basis. Services focus significantly on turnaround times and accuracy. These factors are negotiated as part of competitive tenders.

The ACCC invites comments from market participants on its concerns in relation to reduced competition for public in-patient services in Victoria, post-merger. Market participants may wish to comment on:

- whether the threat of in-sourcing is likely to significantly constrain the merged firm in bidding for tenders for out-patient services
- the likelihood of new entry or expansion by other providers (such as Sonic, 4Cyte and public providers) into the supply of public in-patient services in Victoria.

Issue that may raise concerns: Reduced competition in separate state-based markets for the supply of veterinary pathology services in Victoria and South Australia

172. The ACCC's preliminary view is that the proposed acquisition may substantially lessen competition in the supply of veterinary pathology services in separate state markets for Victoria and South Australia.

Barriers to entry

173. The ACCC's preliminary view is that there may be significant barriers to entry for the provision of veterinary pathology services, including:

- *Establishing referral networks*
 - 1) Veterinary pathology services are referred by veterinarians or other buyers of veterinary pathology services. The ACCC understands that new entrants would find it difficult to surmount existing commercial relationships that incumbent firms have developed with veterinarians.
- *Economies of scale*
 - 1) Veterinary pathology requires sunk costs in establishing a laboratory capable of processing a wide variety of pathology specimens (including across different animal species). There are additional costs in hiring laboratory staff with the expertise to process and analyse a wide variety of pathology specimens.
 - 2) The ACCC's preliminary assessment is that, as per community pathology services, new entrants would need to reach a minimum competitive scale to offset the sunk costs in establishing

operations, and that expansion via referral networks often occurs in a gradual and incremental manner.

Availability of alternative providers

174. Market participants have submitted that the supply of veterinary pathology services is concentrated, often citing IDEXX, ACL and Healius as the key competitors. IDEXX is consistently cited as a dominant competitor.
175. Given the increase in market concentration in the South Australian and Victorian veterinary pathology services post-acquisition, competition concerns may arise in these markets if the merged entity is not constrained by alternative providers post-acquisition.
176. The ACCC is considering the level of competitive constraint that government-funded laboratories and university-based laboratories impose on ACL and Healius.
177. There are also smaller private veterinary pathology providers. The ACCC is considering the competitive constraint from these pathology providers and their ability to expand in the event of price increases or reductions in service levels.

The ACCC invites comments from market participants on its concerns in relation to reduced competition for the provision of veterinary pathology services across each state and/or territory in Australia. The ACCC is interested in the following:

- identifying all competitors in the supply of vet pathology services in Victoria and South Australia, along with their estimated share of supply in each state
- the extent of barriers to entry and expansion, including the extent of barriers for human pathology providers entering the supply of veterinary pathology
- the extent to which vet pathology providers compete across state boundaries.

ACCC's future steps

178. The ACCC invites submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter. Submissions should be emailed to mergers@acc.gov.au by no later than 10 August 2023.
179. The ACCC will finalise its view on this matter after it considers submissions invited by this Statement of Issues.
180. The ACCC intends to publicly announce its final view by 12 October 2023. However, the anticipated timeline may change in line with the *Informal Merger Review Process Guidelines*. A Public Competition Assessment explaining the ACCC's final view may be published following the ACCC's public announcement.