



Public Competition Assessment

16 November 2007

Proposed merger of BUPA Australia Pty Ltd and MBF Australia Limited

Introduction

1. On 7 November 2007, the Australian Competition and Consumer Commission (**ACCC**) announced its decision not to oppose the proposed merger of BUPA Australia Pty Ltd (**BUPA**) and MBF Australia Limited (**MBF**) (**proposed merger**). The ACCC was of the view that the proposed merger would be unlikely to have the effect of substantially lessening competition in any relevant market in contravention of section 50 of the *Trade Practices Act 1974* (the **Act**).
2. The ACCC formed its view on the basis of the information provided by the merger parties and information arising from extensive market inquiries. This Public Competition Assessment outlines the basis on which the ACCC has reached its decision on the proposed merger, subject to confidentiality considerations.

Public Competition Assessment

3. To provide an enhanced level of transparency and procedural fairness in its decision making process, the ACCC issues a Public Competition Assessment for all transaction proposals where:
 - a merger is opposed;
 - a merger is subject to enforceable undertakings;
 - the merger parties seek such disclosure; or
 - a merger is approved but raises important issues that the ACCC considers should be made public.
4. This Public Competition Assessment has been issued because the proposed merger is considered to raise issues of interest to the public.
5. By issuing Public Competition Assessments, the ACCC aims to provide the public with a better understanding of the ACCC's analysis of various markets and the associated merger and competition issues. It also alerts the public to the circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change, because of developments.

6. Each Public Competition Assessment is specific to the particular transaction under review by the ACCC. While some transaction proposals may involve the same or related markets, it should not be assumed that the analysis and decision outlined in one Public Competition Assessment will be conclusive of the ACCC's view in respect of other transaction proposals, as each matter will be considered on its own merits.
7. Many of the ACCC's decisions will involve consideration of both non-confidential and confidential information provided by the merger parties and market participants. In order to maintain the confidentiality of particular information, Public Competition Assessments do not contain any confidential information or its sources. While the ACCC aims to provide an appropriately detailed explanation of the basis for the ACCC decision, maintaining confidentiality will be the ACCC's paramount concern. Accordingly, a Public Competition Assessment may not definitively explain the analysis of all issues.

Merger parties

The acquirer: BUPA Australia Pty Ltd

8. BUPA is a registered provider of private health insurance (**PHI**), covering over one million Australians. BUPA forms part of the worldwide health and care specialist organisation, British United Provident Association (**BUPA Group**).
9. The main activities of the BUPA Group include:
 - supplying PHI in Australia, Asia, the Middle East, Spain and the United Kingdom;
 - owner-operator of aged care homes in the United Kingdom and Spain, and proposed owner-operator of aged care homes in Australia and New Zealand¹; and
 - operating hospitals in the United Kingdom and operating hospitals and clinics in Spain.
10. In Australia, BUPA provides PHI under the business name *HBA* in all states and territories except South Australia and the Northern Territory where it operates under the *Mutual Community* business name. BUPA is the largest PHI provider in South Australia and the second largest PHI provider in Victoria.

The target: MBF Australia Limited

11. MBF is Australia's largest, non-government private health insurer with nearly two million policyholders across Australia. MBF's core business is the supply of

¹ On 3 October 2007, BUPA announced that it had entered into an agreement to acquire the controlling interest in the DCA Agedcare Group from DIAC Holdings NV, subject to regulatory approval; www.bupa.com.au, press release of 3 October 2007, *BUPA Acquires Leading Care Home Businesses in Australia and New Zealand*.

PHI. MBF has a presence in every Australian state and territory, and is the second largest PHI provider in New South Wales, Queensland, Tasmania and the Northern Territory. MBF is the third largest PHI provider in South Australia.

12. On 17 August 2007, MBF announced its intention to demutualise and list on the Australian Securities Exchange.² The ACCC notes recent press comment that MBF may be considering demutualisation as well as BUPA's proposal to merge.
13. MBF forms part of the MBF Group which comprises the following businesses:
 - MBF Health (comprising MBF and MBF Alliances)³;
 - MBF Travel;
 - MBF Life (life insurance business);
 - MBF ClearView Retirement Solutions (financial services business); and
 - in2life (health and lifestyle management business).⁴

Industry Background

14. The main participants in the PHI industry are PHI providers, hospital operators, doctors and consumers (PHI customers and patients). The PHI industry is different from most industries in that although patients use the hospital service, it is generally their doctors who determine where they will be treated and their PHI provider pays for most, if not all, of the in-hospital services. PHI providers directly negotiate with private hospitals for the provision of services to their members when and if they are required.
15. Providers of PHI offer consumers insurance cover for hospitals services (**Hospital Cover**) and ancillary services (**Ancillary Cover**). Consumers can choose to purchase Hospital Cover and Ancillary Cover separately or together and can hold Hospital Cover and Ancillary Cover with different PHI providers. PHI providers typically offer different levels of cover to meet the needs of different consumers. The range of PHI products which a PHI provider may offer to consumers (including specific features of certain PHI products) is subject to regulation. Changes to PHI premiums can only be made annually and are subject to approval by the Minister for Health and Ageing.
16. Additionally, the regulatory principle of Community Rating requires that each customer who holds a particular policy type with a particular PHI provider in a particular membership category will, in each state, pay the same premium.⁵

² MBF press release, *MBF's plan to demutualise and list on the Australian Securities Exchange*, 17 August 2007, available at: www.mbf.com.au.

³ References to MBF in this Public Competition Assessment include MBF Alliances.

⁴ In2life provides a range of discounts for health and lifestyle related services such as fitness, weight loss and disease management programs. The program also provides ancillary health services such as dental, optical and physiotherapy and is integrated with MBF PHI products.

17. A PHI provider must be registered in accordance with the *Private Health Insurance Act 2007 (PHI Act)* to supply PHI products to Australian consumers. There are currently 37 registered PHI providers in Australia, 24 of which are open to the general public (**Open Membership Fund**) and 13 operate on a restricted membership basis. The PHI industry is generally concentrated with the seven largest PHI providers⁶ having a large share of PHI policies nationally. BUPA and MBF are Open Membership Funds.

Timing

18. On 31 August 2007, BUPA announced its interest in merging with MBF. The following table outlines the timeline of key events in this matter.

Date	Event
31 August 2007	ACCC commenced review under the Merger Review Process Guidelines. Market inquiries commenced.
20 September 2007	Closing date for submissions from interested parties.
11 October 2007	ACCC requested further information from BUPA. ACCC timeline suspended.
25 October 2007	ACCC received further information from BUPA. ACCC's timeline recommenced. Former proposed date of 31 October 2007 for announcement of ACCC's findings amended to 7 November 2007 to allow for consideration of further information received from BUPA.
7 November 2007	Announcement of ACCC decision.

Areas of overlap

19. BUPA and MBF are both registered PHI providers which supply PHI to consumers in every Australian state and territory.

Market inquiries

20. The ACCC conducted extensive market inquiries in relation to potential competition issues with a range of industry participants, including competitors, private hospital groups, industry bodies, regulatory and government bodies, and other market participants. Market inquiries identified the following areas of interest:
- competition for the supply of PHI to consumers, particularly in South Australia; and

⁵ The policy objective of Community Rating is to prevent PHI providers from price discriminating on the basis of age, health status etc. Exceptions apply for loadings for Lifetime Health Cover and the limited range of permitted discounting measures.

⁶ Medibank, MBF, BUPA, HCF, HBF, NIB and Australian Unity.

- competition for the acquisition of private hospital services by PHI providers in relevant geographic regions, including South Australia.

Market Definition

21. The ACCC considered the relevant markets for the assessment of the proposed merger were:
- state/territory based markets for the supply of PHI to consumers (**PHI consumer markets**); and
 - local, regional or state/territory based markets for the acquisition of services from private hospitals by PHI providers (**PHI hospitals markets**).

PHI consumer markets

22. In delineating the relevant product market the ACCC considered whether Medicare is a close demand-side substitute product for PHI. Medicare is a government funded⁷ scheme which provides free, or subsidised treatment for certain medical services. Under the Medicare system Australian citizens treated as public patients, in a public hospital are entitled to free in-hospital treatment. The ACCC was of the view that, while some consumers do switch between Medicare and PHI, policies such as the Medicare Levy Surcharge and Lifetime Health Cover⁸ are likely to (and, indeed, are designed to) minimise the number of switching consumers. Accordingly, the ACCC considered that Medicare was unlikely to pose a significant constraint on PHI products, and therefore fell outside the relevant product market.
23. In the geographic market, the ACCC considered that while consumers may be able to switch to PHI providers in other states in Australia in response to a PHI price rise, there are several state-based factors which impact on the ability of PHI providers to adopt a wholly national approach to supplying PHI to consumers, and historical/legacy factors which suggest that the relevant geographic area is state/territory-based. Such factors include:
- risk equalisation liabilities which are calculated on a state/territory basis;
 - varying costs of medical specialist services per state;
 - varying costs of private hospital services per state;
 - distinctly different market shares of PHI providers in each state/territory;

⁷ Medicare is jointly funded by the Australian Government and state and territory governments and is administered by state and territory health departments.

⁸ Under Lifetime Health Cover, PHI providers may charge different premiums based on the age of each new customer when they first take out Hospital Cover with a PHI provider. Customers who take out Hospital Cover early in life will be charged lower premiums throughout their life, relative to people who take out Hospital Cover later. Specifically, for each year a person remains uninsured after the age of 31, there is a penalty increase of 2% on top of the general premium. See <http://www.privatehealth.com.au/lhc.htm>

- difficulties PHI providers have in gaining significant market share outside of their 'home' states;
- the tendency for a state-based approach to marketing by PHI providers; and
- the use by some PHI providers of different brand names in different states.

PHI hospital markets

24. The ACCC considered the relevant product market with respect to private hospital services is the market(s) for the acquisition of the right for consumers to be supplied with private hospital services on specific terms (including price).
25. The ACCC defined local, or regional geographic markets for the acquisition of services from private hospitals for two reasons. First, consumers (on whose behalf PHI providers negotiate with private hospitals) prefer to attend hospitals close to where they reside. Second, the negotiating position of a PHI provider with a private hospital depends primarily on the number of members in a hospital's area of operation.

Supply of PHI to consumers

26. In analysing the potential impact of the proposed merger on competition in PHI consumer markets, the ACCC had regard to whether:
 - BUPA would have market power in the supply of PHI to South Australia as a result of the proposed merger; and
 - BUPA would have an increased ability to raise rival PHI providers' costs in South Australia by being able to be more selective in contracting with private hospitals in that state as a result of the proposed merger.

BUPA's stronger position in South Australia

27. Some market participants raised concerns that post merger BUPA would have market power in the South Australian PHI consumer market due to the removal of a significant competitive constraint in MBF, BUPA's significant market share and high barriers to entry into PHI consumer markets.
28. The ACCC's inquiries indicated that while the proposed merger would result in the removal of a significant competitive constraint in South Australia in circumstances where barriers to entry and expansion are likely to continue to be high, competition from existing PHI providers in South Australia would be likely to continue to constrain BUPA post merger.

29. The ACCC's inquiries indicated that there are alternative PHI providers in South Australia which supply comparable PHI products, for a comparable price and which are successfully competing with BUPA to acquire PHI consumers in that state. In particular, the ACCC's inquiries indicated that in South Australia BUPA is likely to continue to face strong competition from Australia's largest PHI provider, Medibank. The ACCC also identified that mid sized PHI provider, Health-Partners, is likely to be an effective competitor to BUPA post merger.
30. The ACCC's inquiries found that a key area of competition between PHI providers is the supply of PHI to consumers who are purchasing PHI for the first time, as distinct from existing PHI consumers. The ACCC found that smaller PHI providers in South Australia are competing more effectively in this regard than their market shares may indicate.
31. The ACCC concluded that competition from rival PHI providers in South Australia would be likely to continue to constrain BUPA post merger.

Selective contracting

32. Some concerns were raised by market participants that BUPA would have a stronger position in the South Australian PHI consumer market post merger, and as a result, would have a greater ability to increase rival PHI providers' costs by being more selective in contracting with private hospitals in South Australia, and subsequently may result in a substantial lessening of competition in the relevant market.
33. Some market participants were concerned that larger PHI providers have shown an increasing trend of not contracting with private hospitals which specialise in providing 'high cost' services such as psychiatric, rehabilitative and orthopaedic treatment, with the potential effect of increasing costs to rival PHI providers. Market participants indicated that PHI consumers affected by a PHI provider being 'out of contract' with particular hospitals have an incentive to switch PHI providers to avoid paying a gap for services rendered at the hospital. In addition PHI providers to whom these 'high cost' consumers transfer are compelled by legislation to accept the relevant consumers.
34. Some market participants were concerned that the cost base of the PHI provider from whom the relevant consumers switched would decrease as the result of losing 'high cost customers' and correspondingly, the cost base of the PHI providers who acquire the relevant consumers would increase.

35. Information obtained during the ACCC's inquiries indicated that the ability to selectively contract with private hospitals is unlikely to be determined by market share, such that a PHI provider with a large or smaller market share may be in the position to selectively contract. Additionally factors such as the operation of the risk equalisation scheme⁹, the effect of selective contracting on the value proposition of a PHI provider's products over time¹⁰ and the potential impact on a PHI provider's brand from engaging in selective contracting¹¹ would be likely to act as disincentives for BUPA to engage in selective contracting post merger.
36. Market inquiries also indicated that community rating provisions in the PHI Act would be likely to limit the ability of a PHI provider from targeting 'high cost' consumers through its actions, or inactions.
37. Additionally, consultation with private hospital groups, relevant regulatory bodies and rival PHI providers indicated that selective contracting with lower cost hospitals is not a common feature in negotiations between PHI providers and private hospitals, and the limited examples of attempts to selectively contract in the past have not led to a general practice of selective contracting. In particular, the ACCC noted that in recent years BUPA has maintained a consistently high number of contracts with private hospitals in South Australia, including psychiatric, rehabilitative and orthopaedic facilities.
38. The ACCC concluded that there is insufficient evidence to support the proposition that BUPA's stronger position in the South Australian PHI consumer market post merger would provide it with an increased ability to raise rivals' costs by selectively contracting with private hospitals in South Australia to a greater extent. Consequently, the ACCC considered it is unlikely the proposed merger would result in a substantial lessening of competition in this regard.

⁹ The risk equalisation scheme compensates PHI providers for a substantial proportion of the costs associated with having 'high risk/high cost' consumers as a part of a PHI provider's membership base. There would therefore be limited incentives to seek to increase the cost base of a rival PHI provider through selective contracting.

¹⁰ The ACCC's inquiries indicated that there is demand from consumers for broad hospital coverage in PHI Hospital Cover products to the extent that it would not make commercial sense for a PHI provider to significantly limit the number of private hospitals with which it has contracts.

¹¹ The ACCC's inquiries indicated that PHI products are 'high trust' products and PHI consumers therefore tend to gravitate to PHI providers which have a stable and trustworthy reputation. Market participants indicated that selective contracting could impact negatively on a PHI provider's reputation as perceived by consumers.

Acquisition of private hospital services

39. The ACCC considered:
- whether the proposed merger would be likely to result in BUPA having market power with respect to the acquisition of services from private hospitals; and
 - the impact of any exercise of that market power on the supply of private hospital services in South Australia, and the supply of PHI in South Australia.
40. Some market participants raised concerns that BUPA's stronger position in South Australia post merger would place it in a better position to secure lower reimbursement rates and/or terms and conditions with private hospitals, which would increase costs to such hospitals. In particular, market participants indicated that BUPA would have an increased ability to secure such rates and/or terms and conditions with private hospitals which derive a significant proportion of their revenue from payments made by both BUPA and MBF.
41. The ACCC's inquiries indicated that BUPA would be likely to be constrained in its acquisition of services from private hospitals in South Australia by both the bargaining power of private hospitals in South Australia and the presence of competing PHI providers.
42. The ACCC's inquiries indicated that a large proportion of private hospitals in South Australia would be likely to have bargaining power in negotiations with BUPA due to being part of a private hospital group, consumer demand for their services, or because they are the only private hospital in a remote geographic location. The ACCC's inquiries also indicated that if BUPA were to seek to secure lower reimbursement rates and/or terms and conditions with private hospitals in South Australia which significantly increased costs to such hospitals, and which resulted in a proportion of such hospitals reducing their services or service quality, this may impact on the value proposition of BUPA's products. The ACCC's inquiries indicated that this impact may encourage PHI consumers to switch to rival PHI providers. As noted above, there would be alternative PHI providers to which South Australian consumers could switch in these circumstances post merger.
43. The ACCC concluded that the proposed merger would not be likely to substantially lessen competition with respect to the acquisition of private hospital services in South Australia.

Conclusion

44. On the basis of the above, the ACCC formed the view that the proposed merger of BUPA and MBF would not be likely to result in a substantial lessening of competition in any relevant market in contravention of section 50 of the Act.