

Additional Interested Party Submission concerning Conduct: Exclusive dealing notification N95607

1. We refer to the submission lodged on 25 November 2011.
2. The Commission has invited a further submission addressing the competition concerns which arise from the proposal. This letter outlines those concerns.
3. As set out in the initial submission, the effect of the notification is to mandate the use of Cabrini's inhouse pathology and medical imaging services.
4. There are limited bases for exceptions. They are, however, exceptions which can only be invoked in specific circumstances and which impose an evidentiary obligation on the referring medical practitioner to prove the conditions for the use of the exception. Accordingly, in substance, the proposed notification is essentially compelling the use of the onsite pathology and medical imaging services.
5. The notification is premised on the basis that it will lead to increased referrals to and revenues for Cabrini's pathology and medical imaging services. In other words, it expressly contemplates forcing referring medical practitioners to change the decision they would make in a competitive environment for the financial benefit of Cabrini.
6. The competitive effect of the proposed conduct needs to be considered not only in the context of its impact for this particular hospital, but the competitive flow on consequences if this notification is allowed to stand. This is because there is no basis in the notification or otherwise which would enable Cabrini to be distinguished from other private sector hospitals with vertically integrated pathology and medical imaging services.
7. The express rationale for the notification is to enable Cabrini to maintain its financial position (page 7 of the notification). It is therefore accepted that the conduct will enhance both the revenue and return earned by Cabrini, compared with the position which would exist if Cabrini continued to face full competition in the supply of these services. A similar proposition could be put forward by other vertically integrated hospital and pathology and/or imaging providers on the same basis. It is for this reason that the competitive implications of the conduct need to be considered both in terms of the competitive impact of the specific volumes involved at Cabrini Hospital and also in terms of the conduct which is likely to have to be permitted if this notification is allowed to stand.
8. In our submission, the competitive consequence of allowing the notification to stand is that it will favour vertically integrated providers who have hospital operations because it makes it more difficult for other providers to win that business. The Commission should be reluctant to permit any conduct which materially affects competition on the merits.
9. From the information contained in the notification, it can be seen that two of the four largest providers of pathology services (Healthscope and St John of God) are vertically integrated hospital and pathology networks. The logic for which Cabrini argues applies equally to these hospitals. St John of God is, like Cabrini, run on a not for profit basis. However, as submitted earlier, that is not of itself a reason for differential considerations in the context of public benefits. It is submitted that, if successful, the logic in the application would be likely to have implications for a range of private hospitals, and notifications are likely to be made by other vertically integrated private hospitals.
10. If hospital work were to be inaccessible to independent providers except in limited circumstances, it would become much more difficult for independent providers to gain scale. As

the Commission is aware from its previous decisions in this industry¹, there are significant scale advantages in these services.

11. Private hospital work is an important source of work within the pathology industry. Within Victoria it represents approximately 6-10% of all Patient Episode Initiations (PEI) for all pathology services covered by Medicare.
12. Pathology services provided within hospitals are generally more complex than those provided through collection centres. They therefore have a higher average fee than that which applies to work coming from collection centres. A detailed analysis has not been undertaken but the average fee for in-hospital pathology services can be more than 50% higher than the average fee for other pathology referrals. As a consequence of this, in-hospital work for private hospitals probably accounts for 9-15% of Medicare pathology services on a revenue basis.
13. In addition, in-patients will tend to have more tests per patient than is the case for other pathology referrals. The same is also true of medical imaging services.
14. The current position is that in-hospital providers compete with other non-vertically integrated providers of pathology and medical imaging services who service the hospitals and compete on quality, service and price.
15. Private hospital pathology fees are generally not confined to Medicare fee rebates and there is active price competition in the provision of these services, including through "no gap" agreements with private hospitals.
16. Hospital located providers have natural advantages because of their location. This provides three tiers of benefits.
 - (a) being located on the premises provides a natural locational advantage for in-patient referrals;
 - (b) the in-house provider has an advantage for out-patient work connected to the hospital; and
 - (c) as a referring medical practitioner comes to know a pathology provider through the in-hospital relationship, it increases the likelihood of that pathology provider being considered for referral work unrelated to the hospital.
17. If third party pathology providers are restricted in their ability to compete with incumbent providers, as proposed in the notification, the incumbency benefits will flow through to each of the three tiers identified above, making it more difficult for non-vertically integrated providers to compete, not just for hospital work, but more generally. Currently, competition is active with a significant proportion of work actually conducted by an external provider. The proportion varies widely depending on particular features of the hospital.
18. Furthermore, it is not just actual competition which is important, it is also the competitive threat that third party providers impose on the incumbent provider, that drive prices down and quality of

¹ Public Competition Assessment Healthscope Limited - proposed acquisition of Symbion Health Limited's pathology, medical centre and imaging businesses (para 93).

service up. The notification, if allowed to stand, would significantly limit the scope for third party providers to constrain incumbents in the way they currently do.

19. We hope this submission assists in your consideration of the notified conduct.