

**By email**

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MATTER NO. 403-5638  
DATE 24 April 2020

Commerce Commission

**Elanco / Bayer: Divestment of sheep ectoparasiticide and canine otitis products in New Zealand**

**1. Introduction**

- 1.1 This letter refers to the proposed acquisition by Elanco Animal Health Inc. (**Elanco**) of the global animal health division of Bayer AG (**Bayer Animal Health** or **BAH**) (collectively the **Parties**) (the **Proposed Transaction**) which is currently the subject of an application for clearance to the Commerce Commission (the **Commission**).
- 1.2 At the date of this letter, we understand the Commission is not satisfied that the Proposed Transaction is unlikely to give rise to competition issues in relation to (a) external parasiticides for use in sheep and (b) otitis treatments for dogs. The Parties do not consider that the Proposed Transaction gives rise to competition concerns, but in the interests of ensuring completion of the global Proposed Transaction in a timely fashion the Parties are prepared to divest certain products in the sheep ectoparasiticide market segment (**Flystrike Treatment Products**) and canine otitis market segment (**Canine Otitis Product**) (together, the **Products**). The draft Divestment Deed is attached as **Annex 1**.
- 1.3 This letter sets out details of the Products, explains why divestment of the Products addresses the Commission's preliminary concerns, and sets out the arrangements for transition of the Products to an Approved Purchaser (as defined in the Divestment Deed).
- 1.4 Elanco has entered into an agreement with Dechra Pharmaceuticals PLC (**Dechra**), pursuant to which Elanco's Canine Otitis Product Osurnia will be divested to Dechra (the **Dechra Agreement**). For the avoidance of any doubt, the obligations under the Divestment Deed that are described in this letter will only apply to the Otitis Divestment Assets (as defined in section 2.2 below) if the Dechra Agreement has not completed by 11:59pm on the date the Proposed Transaction completes.

**2. The Products to be divested**

2.1 The Products are set out in the table below.

<b>Bayer product / brand and active ingredient</b>	<b>Active and label indication</b>	<b>ACVM registration number</b>
<b>Flystrike Treatment Products</b>		
Maggo (propramphos)	Treatment of flystrike; prevention of re-strike as a docking medication	A005679
Zapp Encore (triflumuron, imidacloprid)	Treatment and prevention of flystrike; treatment and prevention of lice	A010400
<b>Canine Otitis Product</b>		
Osrurnia (terbinafine, florfenicol)	Treatment of otitis externa in dogs	A011416

2.2 To address the Commission’s concerns, the Divestment package will comprise the assets and rights associated with the Flystrike Treatment Products (the **Parasiticide Divestment Assets**) and the assets and rights associated with the Canine Otitis Products (the **Otitis Divestment Assets**) as set out in at clause 1.1(m) and (n) of the Divestment Deed (together the **Divestment Assets**). Broadly speaking, these are intellectual property rights, product technology information, customer records, relevant contractual rights (e.g. relating to manufacture and supply of the Products), and agricultural compounds and veterinary medicines (**ACVM**) product registrations with the Ministry for Primary Industries (**MPI**).

**3. Divestment of the Products removes the possibility of competition concerns arising**

3.1 Divestment of the Products to an Approved Purchaser will remedy any concern in relation to products for the treatment of external parasites in sheep and otitis in dogs.

*External parasites in sheep*

- (a) We understand the Commission’s current concerns in this market segment relate primarily to products indicated for sheep flystrike treatment. Divestment of the Flystrike Treatment Products would remove entirely the overlap between the Parties for sheep flystrike treatment arising from the Proposed Transaction. In other words, Elanco would effectively not be acquiring any sheep flystrike treatment products from Bayer. In addition, Zapp Encore is indicated for the prevention of flystrike, but is predominantly used for the control of lice. To the extent that the NZCC has any preliminary concerns related to lice, then the divestment of Zapp Encore addresses these.
- (b) The combined share of the Parties in the segment for sheep ectoparasiticides is estimated to be ~[REDACTED]%, with an increment of ~[REDACTED]%. The combined share of the Flystrike Treatment Products is ~[REDACTED]%, and so the divestment removes the majority of the increment.
- (c) ~[REDACTED]% market share would give a new entrant a significant presence in the market, and allow it to provide an effective constraint on the merged entity and avoid any competition issues that the Commission currently believes might otherwise arise.

- (d) Alternatively, if one of the existing smaller players on the market were to acquire the Flystrike Treatment Products, this would further strengthen the constraint currently imposed by such player and allow it to compete even more effectively with the merged entity.
- (e) The effective market share gain to Elanco from the underlying transaction would be only ~[REDACTED]%, from just one product, Seraphos. Seraphos is one of many flystrike and lice prevention products on the market, and is not indicated for flystrike treatment. It is also indicated for treatment against keds and ticks in sheep; Elanco does not have products indicated for use against these parasites. Accordingly, the Parties submit no competition concerns would arise from Elanco acquiring Seraphos.
- (f) In relation to Maggo, Elanco notes that this contains an organophosphate, propetamphos, as its active ingredient. While the use of organophosphates as a parasiticide is less prevalent than it once was, Maggo continues to be an effective product for the treatment of flystrike (maggots). Indeed, Beef + Lamb New Zealand's guidance to farmers states that "propetamphos still has an important role to play in sheep lice control as a rotation partner to other effective saturation dip options".<sup>1</sup> Elanco also notes that the Bayer product that it will retain, Seraphos, also has propetamphos as its active ingredient. Accordingly, the divestment of Maggo and Zapp Encore should address any competition concerns currently held by the Commission, by materially reducing the overlap in the sheep ectoparasiticide market and removing the overlap in products indicated for sheep flystrike treatment.

*Otitis in dogs*

- (g) We understand the Commission's concern in canine otitis is that Bayer's pipeline product, Neptra, will be a close competitor of Osurnia. Divestment of Osurnia should therefore sufficiently address the Commission's concern in the Otitis market.
- (h) Elanco has only a ~[REDACTED]% share of the otitis market, and Osurnia makes up the majority of this with [REDACTED]%. As explained at paragraph 50 of the section 66 notice in relation to the Proposed Transaction, Elanco's remaining product, Surolan, will not compete closely with Neptra: Neptra only needs to be applied once, whereas Surolan requires several applications over a number of weeks. Furthermore, [REDACTED].

**4. Composition of the Divestment Assets**

- 4.1 The Divestment will include the key assets relating to the Flystrike Treatment Products and, if applicable, the Canine Otitis Product, as set out at clause 1.1(m) and (n) of the Divestment Deed.
- 4.2 The Divestment Assets will include all relevant supply contracts, intellectual property, and other information necessary to enable the Approved Purchaser to operate a successful and highly competitive supply operation for the Products in New Zealand.
- 4.3 The separation of the Divestment Assets within the Divestment Period is achievable. Elanco has recent experience undertaking structural separations through its de-merger from Eli Lilly, and BAH has experience in the transfer of ownership of animal health products. As the Commission is aware, BAH [REDACTED].

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<sup>1</sup> Beef and Lamb New Zealand 'Managing flystrike and lice: a practical guide for farmers' (2019) <https://beeflambnz.com/knowledge-hub/PDF/managing-flystrike-and-lice> at page 12.

- 4.4 To ensure the Divestment Assets include all information and assets required to ensure the Products will be commercially viable for supply by the Approved Purchaser, the package includes:
- (a) the ACVM registrations for the Products;
  - (b) the right to use the Products' brands in New Zealand on the terms of the Trade Mark and Intellectual Property Licences associated with the Products;
  - (c) the assignment of contracts in relation to the manufacture and supply of the Products in New Zealand;
  - (d) if required, a contract for the supply of propetamphos (the active ingredient in Maggo) on the same terms as those received by Bayer/Elanco; and
  - (e) if required by an Approved Purchaser, the assignment of all customer contracts in relation to the Products in New Zealand.
- 4.5 In relation to manufacturing of the Products:
- (a) Zapp Encore is currently manufactured by [REDACTED] and the active ingredients (imidacloprid and triflumuron) are sourced from [REDACTED]. Clause 7.3 of the Divestment Deed contemplates that [REDACTED], to an Approved Purchaser to enable it to continue to sell this Product while it sources alternate manufacturing and supply arrangements.
  - (b) Maggo is manufactured [REDACTED]. The active ingredient (propetamphos) is manufactured by [REDACTED]. The Approved Purchaser could continue to have the product manufactured by [REDACTED].
  - (c) Osurnia is manufactured by [REDACTED]. Its active ingredients are manufactured by [REDACTED]. These contracts (and others) associated with the manufacture of Osurnia are being divested to Dechra, as mentioned above.
- 4.6 In order to ensure the reputation and goodwill in the Products is unaffected in the period leading up to actual divestment, as set out at section 5 of the Divestment Deed, Elanco has undertaken during the Divestment period:
- (a) to preserve the reputation, goodwill, economic viability, marketability and competitiveness of the Products; and
  - (b) not to carry out any act that could have a significant adverse impact on the competitiveness of the Products.

## 5. **Asset risk**

- 5.1 The timeframe for Divestment will be [REDACTED] months, as set out in the Deed. For the reasons set out above, the competitive effectiveness of the Divestment Assets will not deteriorate during the Divestment Period.
- 5.2 In any event, Elanco has included hold-separate obligations and ring-fencing provisions in the Divestment Deed (at sections 6 and 7). Under these provisions, Elanco agrees to:
- (a) appoint a person to manage the Divestment Assets separately from the rest of Elanco's business (**Divestment Manager**), who will be required to maximise the value and viability of the Divestment Assets on a standalone basis, and report to an Elanco division sufficiently removed from day to day decision-making and the Commission;

- (b) implement all measures necessary to ensure to the extent possible that that none of Elanco's employees, contractors, agents or advisers obtain any business secrets, know-how, commercial information, or any other information of a confidential or proprietary nature relating to the Products, other than what is strictly necessary to progress the divestment (including to maintain the ongoing viability of the Divestment Assets) or comply with other legal obligations;
- (c) ensure that that any competitively sensitive information relating to the Divestment Assets is accessible only by employees that have signed a confidentiality undertaking (to the extent possible without compromising the viability of the Divestment Assets); and
- (d) ensure that any employee that receives commercially sensitive information in relation to the Divestment Assets will be subject to a confidentiality undertaking.

**6. Purchaser approval**

- 6.1 Consistent with previous divestment undertakings accepted by the Commission in relation to previous transactions, Elanco has undertaken to satisfy the Commission that any proposed purchaser of the Divestment Assets:
- (a) is not associated with Elanco or any of its affiliates;
  - (b) has the financial resources, proven expertise and incentive to viably operate and develop the Divestment Assets in competition with Elanco in the relevant market(s);
  - (c) is not likely to create competition concerns that would result in a contravention of section 47(1) of the Commerce Act 1986; and
  - (d) is not likely to give rise to a risk that the implementation of the Divestment will be unduly delayed, and must, in particular, reasonably be expected to obtain all necessary approvals from the relevant authorities for the acquisition of the Divestment Assets.
- 6.2 As the Commission is aware Elanco has entered into an agreement to sell the global rights to manufacture and market Osumnia to Dechra. This agreement is conditional upon the Proposed Transaction completing, and the transaction is subject to regulatory approvals including from the Commission. The Commission is currently considering a section 66 application for clearance in relation to this divestment.
- 6.3 Dechra is not associated with Elanco or any of its affiliates. It is an in-market participant, currently selling two otitis products in New Zealand, and has the financial resources, proven expertise and incentive to viably operate and develop Osumnia as part of its otitis product portfolio. Finally, for the reasons outlined in the section 66 application lodged by Dechra on 24 March 2020, the acquisition by Dechra does not give rise to competition concerns.

**Bell Gully**

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**Annex 1 – Draft Divestment Deed**