Public Version
ISSN NO. 0114-2720
J5784

COMMERCE COMMISSION

Decision No. 496

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

PFIZER LABORATORIES LIMITED

and

PHARMACIA LIMITED

The Commission:	M J Belgrave D Curtin D Bates QC
Summary of Application:	Pfizer Laboratories Limited has sought clearance to acquire the business assets of Pharmacia Limited.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give **clearance** for the proposed acquisition.
Date of Determination:	3 April 2003

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THE PROPOSAL

1. On 17 March 2003, Pfizer Laboratories Limited ("Pfizer NZ") gave notice, pursuant to s 66(1) of the Commerce Act 1986 (the Act), seeking clearance for its proposed acquisition of Pharmacia Limited ("Pharmacia NZ"). This is part of an international merger, whereby Pfizer Inc is to acquire Pharmacia Corporation in a stock-for-stock transaction.
2. The acquisition in NZ is subject to divestment of the business relating to Cue-Mate, pursuant to formal undertakings in that respect under section 69A.
3. On 3 April 2003, the Applicant varied its application for clearance by including an amended divestment undertaking. The divestment undertaking is attached as Appendix One.
4. Section 69A of the Commerce Act 1986 states:

> Commission may accept undertakings –
>
> (1) In giving a clearance or granting an authorisation under section 66 or section 67 of this Act, the Commission may accept a written undertaking given by or on behalf of the person who gave notice under section 66(1) or section 67(1) of this Act as the case may be, to dispose of assets or shares specified in the undertaking.
>
> (2) The Commission shall not accept an undertaking in relation to the giving of a clearance or the granting of an authorisation under section 66 or section 67 of the Act, other than an undertaking given under subsection (1) of this section.
>
> (3) An undertaking given to the Commission under subsection (1) of this section is deemed to form part of the clearance given or the authorisation granted in relation to the acquisition to which the undertaking relates.

5. The Commission is satisfied that the Undertaking has been given by, or on behalf of, the Applicant in this case, and that it relates to the disposal of assets or shares. Accordingly the Commission is able to accept the Undertaking in accordance with section 69A(1). The Undertaking forms part of the Application considered below.

THE PROCEDURES

6. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension was agreed to by the Commission and the Applicant until 3 April 2003.
7. The Applicant sought confidentiality for specific aspects of its application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
8. The Commission's determination is based on an investigation conducted by staff.
9. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.[1]

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[1] Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

THE PARTIES

Pfizer

10. Pfizer Inc is a publicly held corporation listed on the New York Stock Exchange with its headquarters in New York City. Pfizer Inc has a presence in 89 countries and Pfizer products are available in more than 150 countries. Revenue for Pfizer Inc in 2001 was US$32.3 billion. Research and development expenses for 2001 were US$4.8 billion.

11. The principal activities of Pfizer in NZ, are the distribution and marketing of a range of pharmaceutical, consumer and animal health products.

Pharmacia

12. Pharmacia Corporation is listed on the New York and Stockholm Stock Exchanges and has its corporate headquarters in the United States of America. It operates in more than 60 countries with approximately 59,000 employees worldwide. Pharmacia's sales revenue for 2001 was US$13.8 billion. Pharmacia's annual pharmaceutical research and development budget is over US$2 billion.

13. Pharmacia NZ is an overseas company registered in NZ and is a wholly owned subsidiary of Pharmacia Corporation. The principal activities of Pharmacia in NZ are the distribution and marketing of pharmaceutical and animal health products.

OTHER RELEVANT PARTIES-ANIMAL HEALTH

Schering-Plough

14. Schering-Plough is a worldwide, research-based pharmaceutical company. It has a global animal health business, a human health business as well as consumer brands for foot care, over-the-counter and sun care products.

Stockguard

15. Stockguard Laboratories (NZ) Ltd ("Stockguard") is a private New Zealand company that specialises in the development and manufacture of veterinary products. Stockguard is the only manufacturer of veterinary antibiotic products in New Zealand.

Intervet

16. Intervet is one of the world's leading companies in the animal health market.

Ethical Agents

17. Ethical Agents Ltd markets and distributes a wide selection of animal health products. It holds sole agencies for 27 international companies plus they have their own range of products.

OTHER RELEVANT PARTIES-HUMAN HEALTH

Eli Lilly

18. Eli Lilly is a major player in the pharmaceutical industry. The company employs more than 41,000 people worldwide and markets its medicines in 158 countries.

Abbott Laboratories

19. Abbott Laboratories is a pharmaceutical company that distributes products in 130 countries world-wide.

GlaxoSmithKline

20. GlaxoSmithKline ("GSK") is a world-wide research-based pharmaceutical company. GSK leads in four major therapeutic areas: anti-infectives; central nervous system; respiratory; and gastro-intestinal/metabolic. The company also has a consumer healthcare portfolio comprising of over-the-counter medicines, oral care products and nutritional healthcare drinks.

INDUSTRY BACKGROUND

ANIMAL HEALTH

21. Animal healthcare products are manufactured by pharmaceutical companies. Animal healthcare products are supplied either directly to larger veterinary clinics, or through wholesalers. There are around 450 veterinary clinics in NZ. The two main wholesalers in NZ are Southern Veterinary Supplies, which supplies products from over 200 companies, and National Veterinary Supplies, which has branches in Auckland, Palmerston North, Christchurch servicing over 500 vet clinics.

Cattle Breeding

22. Cattle breeding products are used to manage a dairy cow's reproductive cycle and ultimately to increase the number of days the cow is able to be milked. Products are used for two main purposes:-

- To treat non cycling/anoestrus cows. These are cows that fail to begin cycling by themselves and cannot become pregnant again.

- To synchronise oestrus in cycling cows, namely, to regulate the animal's fertility process so that all dairy cows can breed at the same time in a short space of time.

Antibiotics

23. Animal antibiotics are used both for food animals and pets to treat diseases of bacterial, mycoplasmal or fungal origin. This sector consists of a number of products that are used to treat different diseases. The product used will depend on the bacteria, the route of

administration (injectable product or oral administration), the active ingredient required, the vet's preference and the track record of the product.

24. The most common type of disease in dairy cows is mastitis. Mastitis is a condition, which involves the inflammation of the mammary gland caused by specific disease producing micro organisms which gain entrance via the teat openings.

25. The most common type of mastitis treatments are intramammary treatments which are tubes designed for infusion into individual cow quarters via the teat and canal. Different intramammary products are used to treat dry and lactating cows. Different intramammary products also exist for treatment of the various strains of the disease.

26. Respiratory diseases and foot rot tend to be treated with injection based animal antibiotics. These products are mostly used as multidose vials and are injected either intramuscularly or subcutaneously.

27. Companion animal antibiotics are available as tablets for oral administration.

Regulatory environment

28. Animal antibiotics and cattle breeding products are sold under a prescription animal remedy licence and can only be used, following, a veterinary consultation. The farmer will approach the vet and the vet prescribes the drug. The vets deal either directly with the pharmaceutical companies or with the wholesalers.

29. The Agricultural Compounds and Veterinary Medicines Group (ACVMG) is responsible for the regulatory control of agricultural compounds (veterinary medicines/plant compounds), and their importation, manufacture, sale and use on behalf of the New Zealand Food Safety Authority under the Agricultural Compounds and Veterinary Medicines Act 1997.

HUMAN HEALTH

30. The majority of human health pharmaceutical products in NZ are sourced from pharmaceutical manufacturers/suppliers which are usually large international companies. The supplier undertakes the distribution of pharmaceuticals itself, or in some instances, it will appoint a company to distribute its product.

31. Pharmaceutical products are generally divided into two categories, prescription and Over The Counter ("OTC"). The demand for prescription pharmaceuticals is driven by what general practitioners ("GPs") prescribe patients. On the other hand, many OTC pharmaceuticals can be sold directly to consumers without the need for a prescription, by retail pharmacies, supermarkets and some consumer good stores.

Erectile Dysfunction

32. Erectile dysfunction products are used for the treatment of male impotence. Most men experience erectile dysfunction at some point in their lives, usually by age 40. Some men experience chronic, complete erectile dysfunction (impotence), and others achieve partial

or brief erections. Frequent erectile dysfunction can cause emotional and relationship problems, and often leads to diminished self-esteem. It has many causes, most of which are treatable, and is not an inevitable consequence of aging.

Motion Sickness

33. Motion sickness occurs when the body is subjected to accelerations of movement in different directions or under conditions where visual contact with the actual outside horizon is lost. Symptoms generally consist of dizziness, fatigue, and nausea which may progress to vomiting. Motion sickness drugs do not require a prescription and can be purchased over the counter at any pharmacy.

Regulatory Environment

34. Regulatory Pharmaceutical Management Agency Limited ("PHARMAC") is a Crown Agency set up in 1993 as a limited liability not-for-profit company, owned by the Health Funding Authority (HFA), to manage New Zealand's Pharmaceutical Schedule. The Pharmaceutical Schedule is a list of subsidised prescription drugs and related products available in New Zealand.

35. Medsafe, a business unit of the Ministry of Health (MOH), is the authority responsible for the regulation of therapeutic products in New Zealand. Medsafe administers the Medicines Act 1981 and Regulations 1984, and parts of the Misuse of Drugs Act 1975 and Regulations 1977. Medsafe carries out its functions by applying a framework of controls designed to ensure that the therapeutic products available in New Zealand are those that can be expected to have greater benefits than risks if used appropriately.

MARKET DEFINITION

36. The Act defines a **market** as:

> *. . . a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.*

37. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip* test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

38. It is substitutability at competitive market prices which is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.

39. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:

    - the goods or services supplied and purchased (the product dimension);
    - the level in the production or distribution chain (the functional level);
    - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
    - the temporal dimension of the market, if relevant (the timeframe).

40. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.

41. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

Product Dimension

42. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

43. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[2] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

Demand-side substitution

44. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

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[2] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive". See also *News Limited v Australian Rugby Football League Limited & Ors* (1996) ATPR at 41,687, where Burchett J stated: "Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation." Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

45. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a ssnip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a ssnip would be profitable.

46. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers. In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.

Supply-side substitution

47. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.

Undifferentiated/Differentiated Products

48. In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.

49. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission will consider defining additional relevant markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas. In other cases, the primary focus may switch to the extent to which a business acquisition eliminates competition between the products brought together by the acquisition.

50. Pharmacia and Pfizer have a large number of products in both the animal and human health markets. Analysis has focussed on those product areas where the merged entity has an aggregation or would have a potential aggregation. The areas considered are:

- The supply of cattle breeding devices;
- The supply of animal antibiotics;
- The supply of companion animal oral antibiotics;
- The treatment of erectile dysfunction;
- The treatment of motion sickness;
- The treatment of urinary incontinence;
- The supply of sleepaids.

Animal Health

Cattle Breeding

51. Pfizer's cattle breeding device is called Cue-Mate. Pharmacia has a brand called CIDR. Both these products are intra-vaginal devices used in dairy cows. Both CIDR and Cue-Mate are used in conjunction with oestradiol benzoate.

52. Market investigations have found that there is limited demand side substitutability, between intra-vaginal devices and injectable products. This is because they contain different hormones which are used for different purposes.

53. Intra-vaginal devices contain the hormone progesterone which is used to treat 'non-cycling cows'. Injectable products contain the hormone prostaglandin which is used with or without a progesterone intra-vaginal device (depending on the cow's condition) to synchronise oestrus in 'cycling cows'. This has been confirmed by market investigations. Further, in the merger between AKZO Nobel and Hoechst Roussel Vet[3], the European Commission found that the different types of hormones used to regulate an animal's fertility process were separate product markets.

54. On the supply side there appears to be limited substitutability. Market investigations suggest that any new product used to treat 'non-cycling cows' would need to contain the progesterone hormone and would need to be a proven product that is easy to use, particularly when farmers have a large herd of cows that need to be treated. Industry participants estimated that the farmer's average herd size is between 200-450 cows of which 25% could be 'non-cycling'. A new entrant would need to invest in R&D in designing a new product, obtain regulatory approval, and gain access to appropriate manufacturing facilities.

55. The Commission's investigation suggests that the relevant market is the supply of progesterone cattle breeding devices.

Animal Antibiotics

56. In the supply of intramammary mastitis treatments, Pfizer has three products used for lactating cows and three products used for dry cows. Pharmacia has three lactating products and one dry cow product.

57. In the treatment of mastitis, separate product markets can be considered for intramammary treatments for dry cows and lactating cows. There is no demand side substitutability between these products. This has been confirmed by the Commission's market investigations.

58. In the merger between AKZO Nobel and Hoechst Roussel Vet[4], the European Commission noted that in the supply of animal antibiotics "products based on different anti-infective compounds are not demand-side substitutable and the active substance used appears therefore to be the relevant criterion to define the relevant markets for dry cow

[3] CASE No.COMP/M.1681
[4] CASE No. COMP/M.1681

products and lactating products respectively". In that merger, the main categories of active substances considered were sulphanomides, penicillins, cephalosporins, tetracyclines, macrolides, quinolones, aminoglycosides, phenicals and fluoroquinolones.

59. In the current merger, the same categories of active substances were considered as an initial approach. In the supply of lactating intramammary treatments, different products contain different active substances, although most products contained some form of penicillin. Further, each product may contain more than one active substance. There is likely to be different degrees of substitutability between the different active substances. For instance, the vets contacted were content with the choice of lactating intramammaries available suggesting some substitutability.

60. For the purposes of this acquisition, the relevant markets can be considered to be:

- The supply of lactating intramammary treatments;
- The supply of dry cow intramammary treatments.

Companion Animal Oral Antibiotics

61. There is a minor aggregation in the supply of companion animal oral antibiotics. Pfizer has three products and Pharmacia has one. The merged entity's combined market share is [ ] (increment is [ ]). There are four other competitors Intervet, Virbac, Bayer and Merial, all of which are major international companies. This aggregation is not considered further as it is unlikely to lead to a substantial lessening of competition.

Human Health

62. Pharmaceutical products are used for the treatment of human illnesses and diseases. The European Commission analyses pharmaceutical markets using the "Anatomical Therapeutic Chemical" (ATC) classification system, which subdivides medicines into different therapeutic classes.

63. The ATC system is hierarchical and has 16 categories (A,B,C,D etc.) each with up to four levels. The first level (ATC1) is the most general and the fourth level (ATC4) the most detailed. The third level (ATC3) allows medicines to be grouped in terms of their therapeutic indications e.g. their intended use and can therefore be used as an operational market definition. These groups of products generally have the same therapeutic indication and cannot be substituted by products belonging to other ATC3 classes.

64. In the Glaxo Wellcome Plc/SmithKline Beecham Plc merger[5] the Commission said that the "ATC classification affords an appropriate initial approach to defining product markets". However, the Commission also noted that "there may be instances where broader or narrower classifications are necessary, dependent upon the particular circumstances of the pharmaceuticals and the condition requiring treatment".

[5] Decision No.398

Erectile Dysfunction

65. In the proposed merger, there is an aggregation in the treatment of erectile dysfunction. [ ] The Applicant has stated that the products currently available in NZ have an ATC classification of G4B3.

66. Pfizer sells the well known brand Viagra, which is a product available in tablet form. Viagra operates as a PDE-5 inhibitor and enables men with erectile dysfunction to respond to sexual stimulation, by increasing the blood flow to the penis.

67. Pharmacia owns Caverject, which is applied by injection into the penis prior to sexual intercourse. Due to the nature of application, the first injections must be given at the physician's office by medically trained personnel.

68. The Applicant states that Viagra does not compete with Caverject. Market investigations have found that sales of Caverject are very small. It is primarily a last resort to cater for the residual demand arising from patients where Viagra and other oral PED5 inhibitors are contra-indicated. In particular there is a special category of patients (such as spinal injury and post operative prostate cancer patients in some instances) for whom Caverject has no substitute. As a result the demand for Caverject may be more inelastic.

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69. Market investigations suggest that Viagra is not a substitute for Caverject. [ ].

70. On the other hand, Pharmacia has two erectile dysfunction products in the late stage of development. Therefore, there is a potential aggregation in the supply of G4B3 erectile dysfunction products. However, this aggregation is being removed. As a result of concerns expressed by the European Commission, Pharmacia proposes to transfer/divest their two erectile dysfunction products in development worldwide. Pharmacia will transfer the rights to develop and commercialise the apomorphine hydrochloride nasal spray for human sexual dysfunction to Nastech Pharmaceutical Company Inc. ("Nastech") and will provide financial and technical assistance to Nastech to preserve the viability of the project. In addition, Pharmacia will divest the rights to develop and commercialise the selective agonist for the dopamine D2 receptor for the treatment of human sexual dysfunction.

71. Since Viagra is not a substitute for Caverject and there is no further potential aggregation, the Commission does not need to consider any further issues that arise in this area.

Motion Sickness

72. Pfizer has a product called Marzine and Pharmacia has a product called Dramamine. Both these products are available in tablet form and have the same ATC classification (A4A9).

73. Other motion sickness products are Sea Legs (Boots), Avomine (Aventis) and Scopoderm (Novartis) which is a patch.

74. Market investigations have found that the most popular product sold is Sea Legs (supplied by Boots), as it is a proven product that works well. Market enquiries also

found that pharmacists were reluctant to sell Pfizer's product Marzine as it was prone to abuse, even though they considered it to be a substitutable product.

75. Motion sickness can be also treated with herbal remedies. The main products are Travel Calm Ginger (Blackmores) and Trip Ease (Miers Labs). The Commission's investigation found that these products are substitutable with pharmaceutical products. The pharmacists contacted stated that it depended upon the individual's preference and that herbal remedies were popular with pregnant ladies and children.

76. Most pharmacies stock several products enabling consumers to choose products based on the pharmacist's recommendation and their own individual preference. Some consumers and pharmacists may be loyal to a product that they know will work. Therefore, reactions to increases in price will ultimately vary between individual consumers.

77. For the purposes of the current merger, the relevant market can be considered to be the treatment of motion sickness.

Urinary Incontinence

78. In the current merger there could have been a potential aggregation in the treatment of urinary incontinence. Pharmacia is currently marketing Detrusitol in NZ. Pfizer was in [ ] development of a competing product, Darifenacin. However as a result of the European Commission's concerns in Europe, Pfizer has agreed to divest Darifenacin. Therefore, there is no potential aggregation and the Commission does not need to consider any further issues that arise in this area.

Sleepaids

79. In the proposed merger, there is a minor aggregation in the supply of sleepaids. The merged entity would have a combined market share of [ ]. This aggregation is not considered further as the increment is [ ] and there are numerous other suppliers with products in the same ATC classification, namely N5B1. There is unlikely to be a substantial lessening of competition in this market.

Geographic Extent

80. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.

81. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.

82. Where transport costs are high relative to the final value of a product, a narrower geographic market is more likely to be appropriate. Where product perishability and other similar practical considerations limit the distance that a product may be transported, this may limit the geographic extent of the market. The timeliness of delivery from alternative geographic sources is similarly relevant.

83. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

84. The Commerce Act defines a market to be a "market in New Zealand". However, in many markets New Zealand buyers purchase products from both domestic and from overseas suppliers. Where imported products are close substitutes for domestic products, the overseas suppliers will be part of the relevant market. In such circumstances the Commission, in order to comply with the wording of the Act, is likely to define a national market and then, as discussed later in the competition analysis, to consider the extent to which overseas suppliers exercise a competitive constraint on the participants in the domestic market.

85. In the supply of animal healthcare products and human healthcare products, the relevant geographic market can be considered to be national. The sale of these products is influenced by NZ administrative procedures with NZ registration and approval requirements. In particular, NZ has different levels of reimbursement for pharmaceutical products. Further, in the Glaxo Wellcome/SmithKline Beecham merger a national market was considered.

Functional Level

86. The production, distribution and sale of a product typically occurs through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[6] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

[6] *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: "If we ask what functional divisions are appropriate in any market definition exercise, the answer, …, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market."

87. In NZ, the merging parties' activities overlap in the distribution and marketing of pharmaceutical and veterinary products. Both parties import finished products from their manufacturing facilities overseas. All research is conducted off-shore.

Conclusion on Market Definition

88. The Commission concludes that the relevant markets are:

- The national supply of progesterone cattle breeding devices;
- The national supply of lactating intramammary treatments;
- The national supply of dry cow intramammary treatments;
- The national supply of ATC level-4 G4B3 Erectile Dysfunction products;
- The national supply of motion sickness products.

COMPETITION ANALYSIS

Substantially Lessening Competition

89. Section 47 of the Act prohibits particular business acquisitions. It provides that:

> A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

90. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[7] What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.[8]

91. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[9]

92. While the Act defines the words "substantial" and "lessening" individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
- the nature and extent of the contemplated lessening; and
- whether the contemplated lessening is substantial.[10]

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[7] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).

[8] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [ ] 1 All ER 289.

[9] For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

[10] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [ ] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [ ] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

93. In interpreting the phrase "substantially lessening competition", the Commission will take into account the explanatory memorandum to the Commerce Amendment Bill (No 2). The memorandum notes that:

> Two of the 3 key prohibitions are strengthened to bring New Zealand into line with Australian competition law, which will facilitate a more economic approach to defining anti-competitive behaviour.

and, in relation to s47:

> This proposed new threshold is the same as the threshold for these types of acquisitions in section 50 of the Trade Practices Act 1974 (Australia).

94. For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent, since they are the two sides of the same coin. Hence, it uses the two terms interchangeably. Thus, in considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

95. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

96. The Commission will continue to use a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

97. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed.[11]

98. The Applicant claims that, internationally, there is increasing concentration in the pharmaceutical industry as well as a desire to provide a wider range of products and to become more competitive manufacturers and distributors. In response to these trends, the

[11] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

Applicant wishes to acquire Pharmacia, stating that the parties' product portfolios are complementary. The Applicant states that this merger would reduce the cost of producing products as research and development costs are escalating and that only large companies can support these costs to ensure a continued flow of product. There is no indication that Pharmacia would cease trading or attempt to find another purchaser if the acquisition did not take place and every indication that Pharmacia Corporation would continue to trade internationally as a pharmaceutical company.

99. Therefore for the purposes of the investigation the Commission believes the relevant counterfactual to be the status quo.

Potential Sources of Market Power

100. Two types of market situation conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.

101. In undifferentiated product markets, where buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition, a business acquisition may have the potential to substantially lessen competition when the combined entity has acquired a market share below that required for dominance. This is especially likely in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one year time frame.[12] The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.

102. In differentiated products markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics as well as of price, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a "chain of substitutes", where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes.

103. The supply-side characteristics of differentiated products markets are important, as the potential market power of the combined entity may be offset by the actions of rivals. However, rivals may not be able to offer a competitive constraint where they are unable either to re-position their products closer to that of the combined entity to replace the lost localised competition, or to strengthen the promotion of existing products. A further possible constraint would be lost if it were not possible for new products to be added through new entry.

[12] See, for example, Roger D Blair and Amanda K Esquibel, "The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power" (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

Conclusion – Competition Analysis Principles

104. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. In the present case the counterfactual is considered to be the status quo. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.

105. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity.

ANALYSIS OF EXISTING COMPETITION

Introduction

106. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

107. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.

108. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[13]

[13] For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

109. In determining market shares, the Commission will take into account, as appropriate, the existing participants (including 'near entrants'), inter-firm relationships, and the level of imports. This is followed by a specification of the Commission's 'safe harbours', an estimation of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

Existing Participants

110. There are several competitors in the animal health and human health markets. The primary participants are listed in the parties section above.

Safe Harbours

111. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

112. As noted below, market shares by themselves are insufficient to establish whether competition in a market has been lessened. Other relevant issues are discussed in later sections.

Market Shares

113. On the basis of the preceding discussion, the Commission proposes to use sales data as the primary measure of market share and concentration.

Cattle Breeding Devices

Table 1:
Market Shares for Progesterone Cattle Breeding Devices

Company	Product	Sales in $	Market share
Pharmacia	CIDR	[ ]	[ ]
Pfizer	CUE-MATE	[ ]	[ ]
Combined		**[ ]**	**[ ]**
Stockguard	PRID	[ ]	[ ]
Total		[ ]	[ ]

Source: Data obtained from Commission investigations

114. Post merger, the parties would have a monopoly product in the supply of progesterone cattle breeding devices. In 2002, the merged entity had a combined market share of [ ] (increment [ ]). The only other competitor is Stockguard's product PRID, which has a market share of [ ].

115. In the circumstances of this case, this aggregation raises competition concerns for the Commission for the following reasons.

- There appears to be limited competition from PRID as it a very difficult product to use. [ ] all but one of the vets contacted said that they had never used PRID. [ ]. Further, a previous competitor, [ ].

- There would be a loss of competition between Cue-Mate and CIDR. The two products are similar as they are both intra-vaginal devices containing the same hormone, used for the same purpose, with similar prices. Despite having some product differentiation, market enquiries have found that vets consider these products to be substitutable, although they tend to have a preference for one or the other. Further, Cue-Mate entered in 1999 and market enquiries found that it was able to gain a market share of around [ ].

116. The lack of competitive constraint from existing competitors suggests that the merged entity would have the scope to exercise unilateral market power by raising prices by 5%. It is also possible that the merged entity could leverage its market power into related markets, namely in the supply of injectable prostaglandins.

Lactating Intramammaries

117. In the supply of lactating intramammary treatments, the Applicant estimates that the merged entity would have a combined market share of [ ]. The Commission has

collected market share information from the Applicant and its competitors. The Commission's estimates of market shares are outlined in the table below.

Table 2:
Market Shares for Lactating Intramammary Treatments

COMPANY	PRODUCT	SALES $	MARKET SHARE %
Pfizer	Clavulox LC	[ ]	[ ]
	Mastalone	[ ]	[ ]
	Orbenin LA	[ ]	[ ]
Pfizer Total		**[ ]**	**[ ]**
Pharmacia	Special Formula 17900 Forte V	[ ]	[ ]
	Pirsue	[ ]	[ ]
	Lilcocin Forte S	[ ]	[ ]
Pharmacia Total		**[ ]**	**[ ]**
Combined entity		**[ ]**	**[ ]**
Stockguard	Strepcin HP MC	[ ]	[ ]
	Intracillin 1000 MC	[ ]	[ ]
	Adpen	[ ]	[ ]
	Penacillin 100	[ ]	[ ]
Stockguard Total		**[ ]**	**[ ]**
Virbac	Cloxagel 200 MC	[ ]	[ ]
	Gallimycin 36	[ ]	[ ]
	Rilexine 200 LC	[ ]	[ ]
Virbac Total		**[ ]**	**[ ]**
Ethical Agents Ltd	Dicloman MC	[ ]	[ ]
	Terrexine	[ ]	[ ]
Ethical Agents Total		**[ ]**	**[ ]**
Boehringer Ingelheim	Ubro Yellow	**[ ]**	**[ ]**
Schering-Plough	Streptopen HP	[ ]	[ ]
	Spectrazol MC	[ ]	[ ]
	Streptopen MC	[ ]	[ ]
	Penalone	[ ]	[ ]
Schering-Plough Total		**[ ]**	**[ ]**
Intervet	Nafpenzal	**[ ]**	**[ ]**
Norbrook	Lactaclox	**[ ]**	**[ ]**
Parnell	Kefamast LC	**[ ]**	**[ ]**
TOTAL		**[ ]**	**[ ]**

Source: Data obtained from Commission investigations

118. Table 2 shows that, based on data obtained from Commission investigations, the merged entity would have a market share of [ ] increment ([ ]). Post merger, the three firm concentration ratio is [ ].

119. The combined entity's market share in the supply of lactating intramammary treatments falls outside the Commission's safe harbours. However there are several suppliers of lactating intramammary treatments, most of which are major international companies. In addition, most of the companies supply more than one lactating intramammary treatment. For instance, Schering Plough has four products and Stockguard, Virbac, Ethical Agents each have two products.

120. Some vets said that they purchased a product range and preferred a one stop shop, whilst other vets purchased individual products based on efficiency and proven track record. On the whole, industry participants were content with the choice of suppliers and raised no concerns.

121. In conclusion, the Commission considers that the merged entity would be constrained by current competition from several other suppliers and would therefore not have unilateral market power in the supply of lactating intramammary treatments.

Dry Cow Intramammaries

122. In the supply of dry cow intramammary treatments there is a minor aggregation. The combined market share is [ ], with the increment being [ ]. This aggregation is unlikely to lead to a substantial lessening of competition as there are several other suppliers, most of which are major international companies. This aggregation is not considered further.

Motion Sickness

Table 3:
Market Share for Motion sickness products

Company	Sales $	Markets Share
Pfizer	[ ]	[ ]
Pharmacia	[ ]	[ ]
Combined	**[ ]**	**[ ]**
Boots	[ ]	[ ]
Novartis	[ ]	[ ]
Aventis	[ ]	[ ]
Blackmores	[ ]	[ ]
Miers Labs	[ ]	[ ]
TOTAL	[ ]	100%

Source: Applicant

123. Table 3 shows that in the treatment of motion sickness, the parties would have a combined market share of [ ] (increment [ ]). Post merger, the three firm concentration ratio is [ ].

124. The combined entity's market share in the supply of motion sickness products falls outside the Commission's safe harbours. However the increment is [ ] and there are six other suppliers of motion sickness products, the main competitor being Boots with a market share of [ ]. Market investigations found that some pharmacies are reluctant to

sell Pfizer's product as it is prone to abuse. Further, most pharmacies stocked several motion sickness products, providing the consumer with choice.

125. In conclusion, the Commission believes that the merged entity would be constrained by current competition and would therefore not have unilateral market power in the supply of motion sickness products.

Conclusions – Unilateral Market Power

126. The Commission considers that the merged entity would not be constrained by existing competitors in the supply of progesterone cattle breeding devices.

127. However, the Commission considers that the scope for the exercise of unilateral market power would not be enhanced by the acquisition, in the following markets:

- The national supply of lactating intramammamary treatments;
- The national supply of dry cow intramammary treatments;
- The national supply of motion sickness products.

CONSTRAINTS FROM MARKET ENTRY

Introduction

128. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.

129. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.

130. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.

Barriers to Entry

131. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

132. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader 'entry conditions' that apply, and then go on to evaluate which of those constitute entry barriers.

133. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.

134. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity and others in the market.

Cattle Breeding Devices

135. In the supply of progesterone cattle breeding devices, market investigations have found that any new competitor would need to enter with a proven product, with the hormone progesterone, that is easy to use. A new entrant would need to invest in R&D in designing a new product, obtain patents and regulatory approval as well as gain access to manufacturing facilities.

136. The Commission believes any new product would need to be an effective substitute for Cue-Mate and CIDR. This is because of the seasonal nature of the sales and the hesitancy of vets and farmers to substitute away from effective and easy to use products, with a proven track record. For example, [

]. It has also been suggested that some added value, possibly a cost advantage as experienced in the case of Cue-Mate's successful entry, would be needed before any significant degree of switching would take place.

137. In addition, an industry participant has suggested that the research and development costs involved in producing a new product would be large and would be at least $0.5-1 million. In the case of Cue-Mate, R&D costs in product design would have been [ ].

138. Industry patents would also constrain the development, entry and success of any new product. Developing a new product design to compete with CIDR and Cue-Mate, both in terms of efficacy and ease of use, without infringing their patents, could be a long, complicated and potentially unsuccessful task.

139. Entrants also face a significant regulatory barrier in introducing new products. As a device used to deliver a drug to a food bearing animal, the products must be registered under the Agricultural Compounds and Veterinary Medicines Act 1997. The time and cost involved in the registration process varies on a case by case basis.

140. Access to raw materials, manufacturing facilities and distribution channels are relatively easy and do not act as a significant barrier to entry.

141. In conclusion, the Commission believes that barriers to entry are high in the supply of progesterone cattle breeding devices.

Lactating Intramammaries

142. The Applicant has submitted that approximately three product entries per year have been made over the last three years. They also suggest that all of the active ingredients used respectively by the various manufacturers are off patent and that the technology is very simple.

143. As a product used on a food bearing cow, registration is required under the Agricultural and Veterinary Compounds Act 1997. New products also require approval from the Environment Risk Management Authority under the Hazardous Substances and New Organisms Act 1996. The length and cost of registration seems to differ with the individual product with a standard time for registration varying between 12-18 months. The cost of the process is fairly insubstantial, being in the vicinity of $5000-10,000.

144. It has been submitted by the applicant that the introduction of a generic drug into the New Zealand market may be even easier. Generic registration applications still require information to be submitted on safety, quality and efficacy, but it can be submitted in an abridged application.

145. Research and development costs will vary according to the existing infrastructure of the entering firm. If a company is already involved in the provision of animal healthcare products significant economies of scale may be possible.

146. Testing of the product would also have to be undertaken both in terms of safety and efficacy. Industry participants have indicated that the costs are not significant and can be carried out reasonably quickly, especially if familiar with the exact requirements of the regulators.

147. Branding of products may act as a further barrier to entry into this market to a certain degree. Farmers and veterinarians have indicated that they are loyal to particular brands if they are proven to work and have expressed that they would rather pay seven dollars for a product that they know will work rather than five dollars for a product that may work.

148. Access to raw materials and distribution channels is relatively easy and does not act as a barrier to entry.

149. In conclusion, the Commission considers barriers to entry to be low, in the supply of lactating intramammary treatments.

Motion Sickness

150. Medicines for the treatment of motion sickness must be registered with Medsafe under the Medicines Act 1981. However, herbal remedies which do not contain prescription, restricted or pharmacy only medicines do not need to be registered.

151. It has been indicated that the registration process normally takes between 12 and 18 months to complete at a cost of merely a few thousand dollars. The preparation of the application dossier, however, can be a lengthy and involved process and could cost in excess of $20,000. Industry participants did not consider this cost to be financially demanding with reference to the value of the end product.

152. It has also been suggested that entry would be likely to come from an international pharmaceutical company, who would already have an existing infrastructure in terms of pharmaceutical development and marketing. This would avoid the large sunk costs involved with any de novo entry.

153. Patents also act as a barrier for potential new entrants. The discovery of a compound that is used to treat a particular condition is patentable for a period of 20 years. This prevents generic reproduction at least in the short term.

154. In conclusion, the Commission believes that barriers to entry are moderate in the supply of motion sickness products.

The "LET" Test

155. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

Likelihood of Entry

156. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

157. In general, it is the pre-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

Extent of Entry

158. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

159. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that "toe-hold" position may be difficult because of the presence of mobility barriers, which may hinder firm's efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the 'extent' of entry.

Timeliness of Entry

160. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

161. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

Cattle Breeding Devices

162. The Commission believes that entry is more likely from firms that are already actively involved in the animal healthcare market than de novo entry.

163. The Commission has learned of [ ] companies that intend to enter the market [ ].

164. The Commission believes that although some difficulties may be faced in terms of intellectual property issues and registration the other barriers to entry are not so high so as to insulate against entry. As such, some constraint on the merged entity could be present from the likelihood of entry into the market.

165. However, the extent of entry of these [ ] products is questionable. [ ]

166. The developers of [ ] have indicated that they are targeting [ ].

167. Market investigations suggested that the time required to introduce a new product, if reasonably acquainted with the industry, would be roughly four years from start to finish. Regulatory requirements, patent issues and technological hurdles, however, may slow the process down considerably with the Commission learning of [ ].

168. The Commission believes that de novo entry would take considerably longer than the Commissions two year threshold, even if done well, yet evidence of two products on the verge of entering within the next 12 months leads to a conclusion that entry is timely.

169. In conclusion, the Commission considers entry would be likely and timely however not to an extent that would act as a material constraint on the merged entity.

Lactating Intramammaries

170. It is the view of the Commission that the introduction of a new lactating intramammary for the treatment of mastitis would not be particularly difficult. The introduction of a generic antibiotic, it is suggested, would be even easier. Further the Commission has learned of [

].

171. The question of the extent of any new entry would vary on a case by case basis. Veterinarians and farmers may exhibit some resistance in terms of switching brands. A product that can prove itself in terms of safety and efficacy may be able to grow its market share and if competitive in terms of price may be more widely accepted.

172. The Commission believes that there are no significant capacity constraints or mobility barriers that would suggest entry could not be sufficient in extent.

173. A generic copy of an existing lactating intramammary could enter the market relatively quickly. Generic reproduction decreases the need for significant investment in research and development expediting the process.

174. Pharmaceutical companies also normally employ independent contractors to handle the intricacies of the registration process which increases the efficiency of the entire process.

175. The Commission considers that entry is likely, would be sufficient in extent and would be timely in the supply of lactating intramammary treatments.

Motion sickness

176. The Commission knows of no products on the verge of entering this market. However, in light of the discussion above concerning constraints from market entry, barriers to entry are low enough for the Commission to conclude that entry is likely, if the merged entity were to raise prices post acquisition.

177. Branding and brand loyalty may, to some degree, affect the ability for a new entrant to displace the reputation and market share of participants such as Sea Legs (Boots). Many consumers may also be reluctant to experiment with unfamiliar products particularly if a company was to enter with a herbal remedy. On the other hand, many consumers prefer herbal remedies to engineered medicines, particularly if they are to be used on children.

178. The success of a new entrant, in the area of OTC medicines, may also be highly dependent on the accompanying marketing campaign. Although the cost of such a campaign may indicate the presence of a further barrier to entry there is nothing to suggest that, if done well, new entry could not be achieved to a sufficient extent to constrain the merged entity.

179. Further a new entrant with a herbal alternative could bypass the registration requirements and also the patent issues to a large degree. There appears to be nothing to

stop companies producing a similar herbal variation of an existing product. This entirely expedites the entry process and it is the view of the Commission that entry could be achieved within a period of two years.

180. The Commission concludes that entry is likely, would be sufficient in extent and would be timely in the supply of motion sickness products.

Conclusion on Barriers to Entry

181. In the supply of progesterone cattle breeding devices, barriers to entry are not low enough to constrain the merged entity. Entry is considered likely and timely however not to an extent that would act as a material constraint on the merged entity.

182. In the supply of lactating intramammary treatments and the supply of motion sickness products, the Commission concludes that the barriers to entry are low enough to act as some constraint on the merged entity. Further the Commission believes that, both in terms of lactating intramammary treatments and motion sickness products, entry is likely, would be sufficient in extent and would be timely.

Scope for the Exercise of Coordinated Market Power

Introduction

183. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

184. In broad terms, successful coordination can be thought of as requiring two ingredients: 'collusion' and 'discipline'. 'Collusion' involves the firms individually coming to a mutually profitable expectation or agreement over coordination; 'discipline' requires that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

185. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

Collusion

186. "Collusion" involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.

187. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column in Table 2. The significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'collusion'; a high proportion of 'no' responses the reverse.

Cattle Breeding Devices

TABLE 4
Testing the Potential for 'Collusion' in the progesterone cattle breeding device market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes
Undifferentiated product	No
New entry slow	De novo entry is slow
Lack of fringe competitors	Yes
Price inelastic demand curve	Variable, tending towards inelastic
Industry's poor competition record	No
Presence of excess capacity	Yes
Presence of industry associations/fora	No

188. The merged entity will, post acquisition, have a significant market share of [ ]. As concluded above, the merged entity would not be constrained by the existing competitor Stockguard.

189. Despite the prime facie existence of excess capacity, high seller concentration, de novo entry being slow, and reasonably inelastic demand, any form of co-ordinated market power seems unlikely due to the lack of competitors exacerbated by product differentiation (in terms of fringe competitors).

190. The market share that the merged entity will hold post acquisition makes it difficult to anticipate any mutual advantage obtainable from any collusive arrangement. As such the Commission believes that the potential for the exercise of co-ordinated market power is low and that it is unnecessary to discuss the potential for discipline.

Lactating Intramammaries

TABLE 5
Testing the Potential for 'Collusion' in the lactating intramammary market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	No
Undifferentiated product	Variable
New entry slow	No
Lack of fringe competitors	No
Price inelastic demand curve	Variable - tending towards inelastic
Industry's poor competition record	No
Presence of excess capacity	Variable – potentially yes
Presence of industry associations/fora	No

191. The above assessment of the relevant structural and behavioural conditions in the supply of lactating intramammary treatments suggests that the market is not particularly likely to be susceptible to collusion, even after the acquisition. Low barriers to entry and the strength of existing competition suggests that the potential to co-ordinate would be significantly undermined.

192. The Commission is therefore satisfied that the potential for collusion in the lactating intramammary market is low. Accordingly the Commission considers it unnecessary to determine the potential for discipline in these markets.

Motion Sickness

TABLE 6
Testing the Potential for 'Collusion' in the motion sickness market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	No
Undifferentiated product	Partially
New entry slow	No
Lack of fringe competitors	No
Price inelastic demand curve	Partially tending towards elastic
Industry's poor competition record	No
Presence of excess capacity	Yes
Presence of industry associations/fora	No

193. Although the degree of differentiation within the market is questionable the Commission believes that the potential for the exercise of coordinated market power is not increased after the acquisition due to the other factors listed within Table 6. The strength of existing competition also undermines the ability to collude.

194. The Commission is therefore satisfied that the potential for collusion in the motion sickness market is low. Accordingly the Commission considers it unnecessary to determine the potential for discipline in these markets.

Conclusions – Co-ordinated Market Power

195. The Commission considers that the scope for the exercise of co-ordinated market power would not be enhanced in the following markets:

- The national supply of progesterone cattle breeding devices;
- The national supply of lactating intramammary treatments;
- The national supply of motion sickness products.

OTHER COMPETITION FACTORS

Elimination of a Vigorous and Effective Competitor

196. Sometimes an industry contains a firm that is in some way non-typical, or has different characteristics, or is an innovator, or is regarded as a maverick. The independent or less predictable behaviour of such a firm may be an important source of competition in the market, and may undermine efforts by other firms to engage in coordination. Such a firm need not be large to have an impact on competition out of proportion to its relative market size. Should it become the target of a business acquisition, the resulting elimination of a vigorous and effective competitor could have the effect of substantially lessening competition in the market (especially if there are barriers preventing the entry of new, effective competitors).

197. While Pharmacia actively competes for customers in the market, it is not markedly different from any other firm in that respect. The Commission does not consider Pharmacia to be a maverick or non-typical competitor.

Constraint from Buyers or Suppliers

198. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

199. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission will consider

whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

200. The Applicant has made no submissions regarding the ability for consumers and or GP's to exercise any degree of countervailing power in relation to animal healthcare and human healthcare products.

Cattle Breeding Devices

201. In the supply of progesterone cattle breeding devices, there is limited countervailing power. Industry participants stated that the value of cattle breeding devices far outweighs their cost and as such, demand is reasonably inelastic, particularly in the short term. Market enquiries found that around 50-90% of farmers in NZ used these cattle breeding devices.

202. The non-existence of substitutable products also limits the exercise of any buyer power. The CIDR and Cue-Mate products, in holding almost the entire market, have a considerable reputation both in terms of quality and efficacy. The third player in the market, PRID, is viewed by market participants, as an inferior product due to the cumbersome nature of its use.

203. Wholesalers do not have the ability to exercise countervailing power. They are intermediaries and could be bypassed by the manufacturer supplying directly to the veterinarians if need be.

Lactating Intramammaries

204. The supply of lactating intramammaries is characterised by a degree of brand loyalty. Some farmers and veterinarians expressed reluctance to experiment with products with which they are not familiar. To that end, the demand for these products appears to be reasonably inelastic at least within a 5% price range. As such, price is not the sole driver of demand and it would be artificial to suggest that farmers and veterinarians hold any degree of countervailing power collectively.

205. It also appears that wholesalers have no real ability to constrain the merged entity. Demand is primarily driven by farmers in consultation with their veterinarians, wholesalers being mere intermediaries in the process. Although wholesalers increase efficiency in the distribution chain they could ultimately be bypassed by the manufacturers.

Motion Sickness

206. Individuals are unlikely to have countervailing power. Consumer choice is usually based on past experiences with particular products. It has been indicated, however, that consumers may be particularly influenced by the advice of the pharmacist with, in either case, price being quite secondary to the consideration.

207. As discussed above wholesalers appear to be purely intermediaries in the distribution process of the particular medicines.

Conclusion on Constraint from Buyers or Suppliers

208. The merged entity would not face any constraint from the threat of the exercise of any countervailing power in the following markets:

- The national supply of progesterone cattle breeding devices;
- The national supply of lactating intramammary treatments;
- The national supply of motion sickness products.

DIVESTMENT

209. In the supply of progesterone cattle breeding devices, the merger raises significant competition concerns. However Pfizer has offered a divestment undertaking that [ ] it will divest the Cue-Mate business [ ].

210. This divestment undertaking satisfies the Commission's concerns, as it removes any aggregation in the supply of progesterone cattle breeding devices.

OVERALL CONCLUSION

211. The Commission has considered the probable nature and extent of competition that would exist in the markets for:

- The national supply of progesterone cattle breeding devices;
- The national supply of lactating intramammary treatments.
- The national supply of motion sickness products.

212. The Commission considers that the appropriate counterfactual for comparison is the status quo.

213. The Commission has considered the nature and extent of the contemplated lessening. In the supply of progesterone cattle breeding devices, the supply of lactating intramammary treatments and the supply of motion sickness products the proposed acquisition would result in the merged entity obtaining a market share which falls outside the Commission's safe harbour guidelines.

214. The Commission has also considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:

- existing competition;
- potential competition from entry; and
- other competition factors.

215. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the national supply of progesterone cattle breeding devices, due to the divestment undertaking.

216. In the national supply of lactating intramammary treatments and the national supply of motion sickness products, the Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, as the merged entity would be constrained from existing competition and potential competition from entry.

DETERMINATION ON NOTICE OF CLEARANCE

182. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition of Pharmacia Limited ("Pharmacia NZ") by Pfizer Laboratories Limited.

Dated this 3rd day of April 2003

MJ Belgrave
Chair

APPENDIX ONE

DIVESTMENT UNDERTAKING PURSUANT TO SECTION 69A OF THE COMMERCE ACT 1986

This **Deed** is made on 26 March 2003

by

1. **Pfizer Laboratories Limited**, a duly incorporated company under the Companies Act 1993 having its registered office at Auckland, New Zealand ("Pfizer NZ") and

in favour of

2. **The Commerce Commission**, a body corporate established by section 8 of the Commerce Act 1986 ("Commission").

INTRODUCTION

A. On 17 March 2003, Pfizer NZ gave notice to the Commission pursuant to section 66(1) of the Commerce Act 1986 ("**Act**") seeking clearance for the proposed acquisition by Pfizer NZ of all the business assets in Pharmacia Limited Corporation ("**Clearance Application**"). This proposed acquisition forms part of an international agreement whereby Pfizer Inc is to acquire Pharmacia Corporation in a stock-for-stock transaction.

B. The Clearance Application included, under section 69A of the Act, an undertaking to divest certain assets, which is now set out herein in the form of this Deed.

COVENANTS

1. Pfizer NZ operates the CueMate business in New Zealand, being the distribution and marketing of the CueMate product. CueMate is a product which is used to treat "anoestrus" cows (cows that fail to begin cycling by themselves and so cannot become pregnant). It is inserted into the vagina of the cow and left there for several days to slowly release progesterone. The progesterone is contained in detachable pods, so that the main body of the CueMate product can be removed, cleaned and reused with a fresh pod.

2. Pfizer NZ undertakes to the Commission that, [ ], it shall unreservedly divest to a person not connected or associated with it the CueMate business in New Zealand.

3. Pfizer NZ will advise the Commission of the sale on completion.

4. Pfizer NZ confirms that in entering into the agreement recorded in this Deed it intends to create binding and enforceable legal obligations in relation to the Commission.

5. This Deed is governed by New Zealand law and the parties accept the exclusive jurisdiction of the New Zealand courts and any court which may hear appeals from those courts.

6. This Deed may be executed in any number of counterparts each of which is deemed to be an original, but all of which together are to constitute one instrument. It is acknowledged that this Deed may be executed by an exchange of facsimile copies and executing of this Deed by that means is valid and sufficient execution.

EXECUTED AS A DEED

PFIZER LABORATORIES LIMITED by:

Signature of director	Signature of director
Name of director	Name of director