

Determination

Elanco Animal Health Inc and Bayer AG’s animal health business [2020] NZCC 14

The Commission:	Sue Begg Elisabeth Welson Dr Derek Johnston
Summary of application:	An application from Elanco Animal Health Inc. seeking clearance to acquire up to 100% of the shares of four entities that currently comprise Bayer AG’s animal health business namely: Bayer Animal Health GmbH, KVP Pharma+Veterinär Produkte GmbH, Bayer (Sichuan) Animal Health Co., Limited, and Bayer HealthCare Animal Health Inc. and the business assets that form Bayer AG’s animal health business.
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission gives clearance to the proposed acquisition, subject to the divestment undertaking dated 8 July 2020 provided by Elanco Animal Health Inc under section 69A of the Commerce Act 1986.
Date of determination:	9 July 2020

Confidential material in this report has been removed. Its location in the document is denoted by [].

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Executive summary

- E1. On 9 July 2020, the Commerce Commission (the Commission) granted clearance to Elanco Animal Health Inc. (Elanco or the Applicant) to acquire Bayer AG's animal health business (the Proposed Acquisition), subject to a divestment undertaking requiring Elanco to divest the necessary assets and licenses for three products: Osurnia; Zapp Encore; and Maggo.
- E2. Elanco applied to the Commission for clearance to acquire Bayer AG's animal health business on 14 February 2020 as part of a global transaction. Elanco became a separate entity in 2019 when the Eli Lilly group of companies divested its animal health division. With Elanco now focused entirely on animal healthcare products, it sought to acquire the global animal health business of Bayer AG, a pharmaceutical and chemical conglomerate. The Proposed Acquisition would create one of the largest animal health businesses in the world.
- E3. In New Zealand, while Elanco and Bayer AG are two of the largest suppliers of animal healthcare products, there is relatively limited overlap in the product portfolios of the two suppliers. In making its decision, the Commission focused on the potential impact of the Proposed Acquisition on competition in three markets, namely the markets for the manufacture/importation and wholesale supply of products for:
- E3.1 the treatment of otitis in dogs;
 - E3.2 the prevention of external parasites on sheep; and
 - E3.3 the treatment of external parasites on sheep.
- E4. In each of these three markets, the Commission could not be satisfied that Elanco's acquisition of Bayer AG's animal health business would not result in a substantial lessening of competition.
- E5. The Commission considered that for products for the treatment of otitis in dogs Bayer AG would likely introduce a new otitis treatment called Neptra into New Zealand. This product would likely compete closely with Elanco's long acting otitis treatment, Osurnia and the Proposed Acquisition would remove this competition. The remaining competition from daily dose otitis treatments would not be sufficient to constrain the merged entity from increasing wholesale prices and/or reducing the quality of otitis treatment products. The merged entity would not be constrained by the threat of entry, and customers do not have countervailing power they could use to keep prices down.
- E6. The Commission considered the combination of Elanco and Bayer would likely allow the merged entity to profitably increase wholesale prices and/or reduce the quality of products for the prevention, and for the treatment, of external parasites on sheep in New Zealand. Post acquisition, customers would have limited alternatives to the merged entity and no countervailing power. As a result, in both these markets, the Commission considered that:

- E6.1 the Proposed Acquisition would end the existing competition between Elanco and Bayer AG's respective external parasite product ranges;
 - E6.2 the merged entity would have significant market share, with some of the most prominent and respected brands in New Zealand; and
 - E6.3 while the merged entity would face some constraints from Boehringer Ingelheim and other smaller suppliers of animal health products, the lost constraint would be substantial and it would not be replaced by the threat of expansion or entry.
- E7. To address the Commission's concerns in these three markets, Elanco offered to divest the necessary assets and licenses for one product brand in each market. The Commission assessed that, once completed, the divestment would result in sufficient additional competitive constraint on the merged entity to remedy the substantial lessening of competition in each of the relevant markets.
- E7.1 The divestment of Osumia would mean that customers would continue to have a number of alternative products for the treatment of otitis in dogs.
 - E7.2 The divestment of Zapp Encore and Maggo would remedy the competition harm from the combination of two of the most prominent suppliers in the markets for the supply of products for the prevention, and for the treatment, of external parasites on sheep.
- E8. There are some factors in each of these three markets that makes them vulnerable to coordination between the respective remaining suppliers. However, the Commission was satisfied that the Proposed Acquisition would not change this vulnerability such that a substantial lessening of competition through coordinated effects was likely in any of the relevant markets.
- E9. Accordingly, the Commission granted clearance to Elanco to acquire Bayer, subject to a divestment undertaking. To comply with the undertaking, Elanco will divest all the necessary assets and licenses to supply Osumia, Zapp Encore and Maggo in New Zealand and any purchaser will need to be approved by the Commission.

The proposed acquisition

1. On 14 February 2020, the Commerce Commission registered an application from Elanco seeking clearance to acquire up to 100% of the shares of four entities that currently comprise Bayer AG's animal health business (Bayer) namely: Bayer Animal Health GmbH, KVP Pharma+Veterinär Produkte GmbH, Bayer (Sichuan) Animal Health Co., Limited, and Bayer HealthCare Animal Health Inc. and the business assets that form Bayer. The clearance application relates to the Proposed Acquisition to the extent that it relates to/affects markets in New Zealand.
2. On 8 July 2020, the Commission received an undertaking from Elanco under section 69A of the Commerce Act 1986 (the Act). We consider that the undertaking to divest the assets associated with three products, namely Zapp Encore, Maggo and Osumnia, would result in sufficient additional competitive constraint on Elanco such that the likely substantial lessening of competition in the relevant markets identified by the Commission would be remedied. As with the clearance application, the undertaking only relates to assets that are affecting markets in New Zealand.

Our decision

3. With the acceptance of a divestment undertaking from Elanco, we are satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the relevant markets. Accordingly, we decided to give clearance to the Proposed Acquisition subject to Elanco's divestment undertaking.

Our framework

4. Our approach to analysing the competition effects of the merger is based on the principles set out in our Mergers and Acquisitions Guidelines (our guidelines).¹

The substantial lessening of competition test

5. As required by the Act, we assess mergers using the substantial lessening of competition test.
6. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).²
7. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price above the price that would exist in a

¹ Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2019).

² *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

competitive market (the 'competitive price'),³ or reduce non-price factors such as quality or service below competitive levels.⁴

When a lessening of competition is substantial

8. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.⁵ Some courts have used the word 'material' to describe a lessening of competition that is substantial.⁶
9. As set out in our guidelines, there is no bright line that separates a lessening of competition that is substantial from one which is not. What is substantial is a matter of judgement and depends on the facts of each case.⁷ Ultimately, we assess whether competition will be substantially lessened by asking whether consumers in the relevant market(s) are likely to be adversely affected in a material way.

When a substantial lessening of competition is likely

10. A substantial lessening of competition is 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility but does not mean that the effect needs to be more likely than not to occur.⁸

The clearance test

11. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.⁹ If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.
12. In *Woolworths* the Court held that "the existence of a 'doubt' corresponds to a failure to exclude a real chance of a substantial lessening of competition".¹⁰
13. The burden of proof lies with the Applicant to satisfy us on the balance of probabilities that the proposed merger is not likely to have the effect of substantially lessening competition.¹¹ The decision to grant or refuse a clearance is necessarily to be made on the basis of all the evidence.¹² We will sometimes have before us conflicting evidence from different market participants and must determine what weight to give the evidence of each party.¹³

³ Or below competitive levels in a merger between buyers.

⁴ *Mergers and Acquisitions Guidelines* above n1 at [2.21].

⁵ *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

⁶ *Woolworths & Ors v Commerce Commission* (HC) above n5 at [129].

⁷ *Mergers and Acquisitions Guidelines* above n1 at [2.23].

⁸ *Woolworths & Ors v Commerce Commission* (HC) above n5 at [111].

⁹ Section 66(3)(a) of the Commerce Act 1986.

¹⁰ *Commerce Commission v Woolworths Ltd* (CA) above n2 at [98].

¹¹ *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA) at [7] and *Commerce Commission v Woolworths Ltd* (CA) above n2 at [97].

¹² *Commerce Commission v Woolworths Ltd* (CA) above n2 at [101].

¹³ *Brambles New Zealand Ltd v Commerce Commission* (2003) 10 TCLR 868 at [64].

Key parties

The Applicant – Elanco

14. Elanco is a global animal healthcare company, based in the United States, that develops, manufactures and distributes healthcare treatments for a range of different companion animals (such as cats and dogs) and production animals (such as sheep and cattle). Elanco became a separate entity in 2019 when the Eli Lilly group of companies divested its animal health division to focus on human pharmaceuticals.
15. At present, Elanco does not develop or manufacture any products in New Zealand and most of its products are currently imported and distributed in New Zealand by a veterinary wholesaler, Provet NZ Pty Limited (Provet). Provet is responsible for distributing Elanco's products to veterinarians across New Zealand.

The Target – Bayer

16. Bayer AG is a global human and animal healthcare company that supplies a range of pharmaceuticals products, consumer healthcare products and animal healthcare products (via Bayer) as well as certain agro-chemicals.
17. Like Elanco, Bayer develops, manufactures and distributes healthcare treatments for a range of different companion and production animals. However, unlike Elanco, Bayer manufactures certain animal health products at its production facilities in Auckland which it supplies in New Zealand. Bayer distributes its products to end customers in New Zealand through:
 - 17.1 veterinary wholesalers (such as Provet and SVS Veterinary Supplies Limited); and
 - 17.2 retailers such as veterinarians (eg, VetEnt veterinary clinics), rural supply merchants (eg, PGG Wrightson and Farmlands) and pet stores (eg, Animates).

Other relevant parties

18. There are a number of global manufacturers who, like Elanco and Bayer, develop and supply a wide portfolio of both companion and production animal healthcare treatments. In New Zealand these manufacturers include:
 - 18.1 Boehringer Ingelheim Animal Health New Zealand Limited (Boehringer Ingelheim). Its portfolio includes Merial branded products;
 - 18.2 Zoetis New Zealand Limited (Zoetis), formerly the animal health business of Pfizer Inc; and
 - 18.3 MSD Animal Health, which is a division of Merck Sharp & Dohme (New Zealand) Limited (MSD). Its portfolio includes Schering-Plough branded products.
19. There are also a number of suppliers who develop and/or manufacture animal healthcare products but who have a more limited portfolio of treatments than the

manufacturers listed above. There is also a number of New Zealand based suppliers who distribute both patented and off-patent animal healthcare treatments. These suppliers include:

- 19.1 Alleva Animal Health Limited (Alleva);
- 19.2 Animal Health Direct Limited (AHD);
- 19.3 Ravensdown Limited (Ravensdown);
- 19.4 Donaghys Limited (Donaghys);
- 19.5 Jurox Limited (Jurox); and
- 19.6 Virbac New Zealand limited (Virbac).

Related acquisition involving Dechra

- 20. Dechra Veterinary Products NZ Limited (Dechra) primarily supplies a range of companion animal and equine treatments in New Zealand including a treatment for otitis in dogs.
- 21. Earlier this year, Dechra's parent company signed an agreement to acquire from Elanco the global rights to Osumnia, which is one of Elanco's two treatments for otitis in dogs.¹⁴ This agreement is conditional on regulatory approval in a number of jurisdictions including New Zealand. On 26 May 2020, we granted clearance to Dechra in relation to its proposed acquisition of the global rights to Osumnia from Elanco.¹⁵

Industry background

- 22. Elanco and Bayer are two large suppliers of animal healthcare products in New Zealand. The two areas in which Elanco and Bayer compete most closely in New Zealand are products for the treatment of otitis in dogs, and products for the prevention and the treatment of external parasites on sheep.

Treatments for otitis in dogs

- 23. Otitis is an inflammation of the external ear canal and is a common condition in dogs. It is not a disease in itself but rather a symptom of some other diseases, such as parasitic, bacterial or fungal infections. In New Zealand, products to treat otitis in dogs can only be provided with a veterinarian prescription.
- 24. Most products to treat otitis require an administration of a daily dose of treatment over a number of days. More recently, suppliers such as Elanco and Bayer have

¹⁴ Press release Elanco signs agreement with Dechra to divest Osumnia (6 January 2020).

¹⁵ Commerce Commission Media release Dechra granted clearance to acquire Osumnia from Elanco (27 May 2020).

introduced (or are in the process of introducing) longer acting treatments that only require one or two applications over a period of days.

Products for the treatment and prevention of external parasites on sheep

25. The two main external parasites that affect sheep in New Zealand are flies (causing flystrike) and lice. There are a variety of animal healthcare products that are commonly used to treat or prevent these two parasites.
26. All industry participants we interviewed emphasised to us that end customers (namely sheep farmers) want to prevent flystrike and/or lice from emerging in the first place. To this extent, farmers apply prevention products to provide protection to sheep over a period of time.
27. However, industry participants also advised that even the best prevention plans may not prevent outbreaks or infestations of flystrike or lice from developing. When there are outbreaks, farmers will administer a treatment product (often called a knockdown product) that can treat the outbreak quickly by instantly killing the parasites.¹⁶

Regulatory requirements for animal health products in New Zealand

28. Prior to any animal healthcare product being distributed in New Zealand, the supplier of the product has to complete two main steps: the necessary research and development; and obtain regulatory approval in accordance with the Agricultural Compounds and Veterinary Medicines Act 1997 (ACVM).¹⁷ Developing and then registering new animal healthcare products can be both lengthy and costly, although the cost and time it takes depends on how novel the product is and the extent to which similar products are already registered in New Zealand.¹⁸
29. Once a product is registered under the ACVM, it can be legally sold in New Zealand. How the product is sold to end customers depends on whether it can be purchased with or without a prescription.
 - 29.1 Products to treat otitis in dogs can only be used with a prescription and so they have to be purchased from a veterinary clinic under the guidance of the prescribing veterinarian.¹⁹

¹⁶ For example, see “Managing flystrike and lice- a practical guide” Sheep and Beef Cattle Veterinarians Branch of the New Zealand Veterinary Association and Beef + Lamb New Zealand (August 2019).

¹⁷ See <https://www.mpi.govt.nz/processing/agricultural-compounds-and-vet-medicines/acvm-overview/authorisation-of-acvm/>

¹⁸ While it may be possible to registered a product within two years, see Clearance application from Elanco (14 February 2020) and Commerce Commission interview with [] (14 May 2020), many industry participants consider it can take up to five to 10 years to develop and register a new and/or novel product for distribution in New Zealand. See Commerce Commission interview with [](20 February 2020); Commerce Commission interview with [] (17 March 2020) Commerce Commission interview with [](21 February 2020); and Commerce Commission interview with [](17 March 2020).

¹⁹ Although there may be cases where, once prescribed, an end-customer purchases the treatment from a different veterinarian or vet clinic.

- 29.2 Products to prevent and treat external parasites on sheep can be purchased over the counter without a prescription and so there are no regulatory limits on where the products can be purchased. End customers typically purchase such products from either a veterinarian or a rural supply merchant store such as PPG Wrightson or Farmlands.
30. When a product is sold, the relevant registrations under the ACVM for the product are included on the product label which also includes a list of indications that the product can be used for. For example, all registrations for products to treat and prevent external parasites on sheep include:
- 30.1 the type of parasite it will deter;
 - 30.2 whether it can be used to immediately treat the parasite and/or how long the prevention will typically last; and
 - 30.3 the type of wool on which it can be used.²⁰

The relevant markets

31. We define markets in the way that we consider best isolates the key competition issues that arise from a merger. In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products and services that fall outside the market, but which still impose some degree of competitive constraint on the merged entity.
32. Both Elanco and Bayer have large portfolios of animal healthcare products and, as a result, they currently overlap in a number of different product areas.
33. There are several areas of overlap that do not appear to raise any significant competition issues and so we have not considered these areas any further. This is because these are product areas where the merging parties are not close competitors and where the merged entity would be constrained by the presence of a number of existing competitors. For example, areas of overlap that do not appear to raise competition issues include products for the treatment of:
- 33.1 internal and external parasites in companion animals;
 - 33.2 internal parasites in sheep;
 - 33.3 liver fluke in cattle;
 - 33.4 coccidial conditions in poultry; and
 - 33.5 microbial conditions in ruminant animals.

²⁰ For example, some prevention and treatment products can only be used on sheep with coarse wool and cannot be used on sheep with long and/or merino wool.

34. However, there are three areas of overlap between Elanco and Bayer that raise potential competition issues and we discuss these areas further below. These are products for:
- 34.1 the treatment of otitis in dogs;
 - 34.2 the prevention of external parasites on sheep; and
 - 34.3 the treatment of external parasites on sheep.

Our assessment of the relevant product market – otitis treatments for dogs

35. In this section, we assess the appropriate boundaries of the relevant product market for products used to treat otitis in dogs.

The Applicant's view of the relevant product market - otitis treatments for dogs

36. Elanco submitted that there is a single product market for all the different types of products used to treat otitis in dogs.²¹ While there are daily dose and long acting products, Elanco (as well as Dechra) consider that all the different otitis products have similar characteristics.²²
37. To this extent, Elanco considers that the degree of closeness and desirability of the different products for treating otitis depends on the condition of the dog in question, and the veterinarian's view of the pet-owner's ability to administer the medication. For example:
- 37.1 some products contain alcohol and some veterinarians prefer not to use these because alcohol may cause additional irritation to a dog's ear canal;
 - 37.2 some products are in gel form and some veterinarians may prefer to use these over liquid drop formulations because drops can pool at the dog's ear drum instead of spreading evenly throughout the ear canal. Other products can be administered to the dog's ear with a small pump spray; and
 - 37.3 some products require multiple applications and, if not administered correctly, this can jeopardise the efficacy of the treatment.²³
38. In addition, Elanco noted that a single market for otitis treatments is consistent with the approach taken by the European Commission, which considered a separate product market for otitis.²⁴

²¹ Clearance application from Elanco (14 February 2020).

²² Clearance application from Elanco (14 February 2020); Clearance application from Dechra (26 March 2020).

²³ Clearance application from Elanco (14 February 2020).

²⁴ However, Elanco also notes that the European Commission did not conclude definitively on the scope of the market and left open segmentation by mode of administration. See European Commission, Lilly/Novartis Animal Health (2014/7228/EU).

The Commission's view of the product market

39. We are of the view that it is appropriate to assess the two types of products for the treatments for otitis – daily dose products and long acting products – in the same product market, given that both types of product have the same therapeutic indication and are regarded by veterinarians as alternatives for the treatment of otitis in dogs.
40. At present, Elanco supplies a daily dose product (Surolan) and a long acting treatment (Osurnia). Bayer recently registered its first otitis treatment, a new long acting product called Neptra, and this is expected to be available for sale in New Zealand shortly.²⁵ All other existing suppliers supply daily dose products.
41. Based on the feedback from industry participants, we consider that daily dose and long acting products for treating otitis are likely to be alternatives for one another because they have the same therapeutic indication, the treatment of otitis. For example, we understand that:
- 41.1 otitis treatments are broad spectrum products with the primary drivers of sales falling along a spectrum of indications (bacteria, fungi, yeast indications etc) as well as the length of action;²⁶ and
- 41.2 the choice of application (or application rate) depends on the symptoms and circumstances of the afflicted dog.²⁷
42. However, evidence from our investigation indicates that while daily dose products and long acting products are regarded as alternatives for the treatment of otitis in dogs, there is a degree of differentiation between them based on compliance by the owner to the recommended treatment plan, the individual symptoms and circumstances of the afflicted dog, and price.
- 42.1 We understand that if an otitis product is not administered correctly it could lead to long-term problems.²⁸ Therefore, the administering veterinarian will try to design a treatment plan that would be the most effective for the dog that is being treated. In some circumstances, a long acting product is ideal for some pet owners who find it difficult to comply with the administration of daily dose treatments over a period of time.²⁹

²⁵ Clearance application from Elanco (14 February 2020).

²⁶ Email from [] to the Commerce Commission (20 March 2020).

²⁷ Commerce Commission interview with [] (22 April 2020); Email from [] to the Commerce Commission (4 May 2020).

²⁸ Clearance application from Elanco (14 February 2020); Clearance application from Dechra (26 March 2020).

²⁹ Commerce Commission interview with [] (22 April 2020).

42.2 A price premium is typically attached to products that are more user friendly, and long acting products and pump products are more expensive than daily dose droplet products on a per dose basis.³⁰

43. As there are some differentiating factors between daily dose products and long acting products, we will consider any differences in the closeness of competition between daily dose and long acting products in the competitive effects section below.

Our assessment of the relevant product market – products for external parasites on sheep

44. Within the prevention and treatment markets some external parasite products will be closer substitutes and compete more vigorously with each other than with other products. In these types of markets, what matters is that we consider all relevant competitive constraints, and the extent of those constraints.
45. We consider it appropriate to assess external parasite treatment products used on sheep separately from prevention-only products, given the difference in indications and use and because only certain products are indicated for immediate treatment (or knockdown).
46. Elanco considers that products used to prevent and treat external parasites on sheep³¹ are differentiated products, which means that there is no bright line that separates particular products from others.³² We agree with the Applicant that many of the characteristics of these products are not sufficiently different to place them in discrete markets. Therefore, we do not consider it necessary to delineate products for use on external parasites on sheep by the following characteristics:
- 46.1 the pharmaceutical molecules or the active pharmaceutical ingredient (API) – the products for use on external parasites on sheep, currently supplied in New Zealand, contain a number of different APIs that fall into different chemical groups and/or chemical classes but all have similar purposes from the perspective of the end user (ie, sheep farmers). We understand that farmers can and do switch between different chemical groups and APIs, in part to avoid the parasite developing a resistance;
- 46.2 the parasite(s) that the products target – the products for use on external parasites on sheep are used to treat, prevent and control flystrike and lice. Narrowing our assessment to focus on products targeting one specific parasite does not impact on our competition assessment. Most suppliers currently supply a range of narrow (ie, flystrike only) and broad spectrum (ie, combination flystrike and lice) products and the competitive constraints on

³⁰ Commerce Commission interview with [](22 April 2020); Commerce Commission interview with [](20 May 2020).

³¹ The products for use on external parasites on sheep supplied by Elanco and Bayer (and all the other existing suppliers) are only registered and indicated for use on sheep and so cannot be used on other animals.

³² Clearance application from Elanco (14 February 2020).

the merged entity would be the same whether we look separately at combination products, fly-only products or lice-only products; and

- 46.3 the application method – there are two common application methods for products for use on external parasites on sheep with each method having certain advantages and disadvantages. The application methods are the jetting or saturation method (which involves saturating the sheep in a shower or bath with a dip wash), or the pour-on/spray-on method (which involves a low volume of product being applied by a hand-held applicator). Most suppliers supply their products in both application methods.
47. However, we do not agree with the Applicant that it would not be appropriate to define separate product markets based on the different therapeutic indications of treatment and prevention products for external parasites on sheep. We explain the reasons for this view below.

Products used for treatment appear to be in separate markets from those for prevention

48. We consider it appropriate to define separate product markets depending on whether a product is used to either prevent or treat external parasites on sheep.
49. The Applicant submitted that treatment products are combination products (with indications for prevention) and so there are no treatment-only products.³³ Because they are combination products, the Applicant considers that treatment products should be assessed together with prevention products as the pricing of treatment products would be constrained by prevention products. In particular, the Applicant noted that:
- 49.1 there are significantly more prevention-only products than combination treatment/prevention products and Elanco's combination products predominantly compete with prevention products;
- 49.2 sales of treatment products are dependent on ensuring they are priced competitively compared with numerous prevention products; and
- 49.3 the profitability of combination products is contingent on ensuring that they continue to be sold in substantial volumes to farmers seeking to prevent external parasites.³⁴
50. All external parasite products are indicated for prevention. However, we understand that, as per the ACVM indications, there are only a few external parasite products that can be used for the immediate treatment of flystrike or a lice infestation.³⁵

³³ Submission from Elanco to the Commerce Commission (31 March 2020).

³⁴ Submission from Elanco to the Commerce Commission (31 March 2020).

³⁵ "Managing flystrike and lice- a practical guide" Sheep and Beef Cattle Veterinarians Branch of the New Zealand Veterinary Association and Beef + Lamb New Zealand (August 2019).

51. Industry participants advised that treatment (or knockdown) products are used in a very different manner and have a different purpose than those products used as part of a prevention plan.³⁶ In general, treatment products will only be required when a farmer needs to urgently treat sheep that already have external parasites.
52. With different uses and purposes, we consider it appropriate to assess external parasite treatment products separately from prevention products. For example, it appears that a product only indicated for prevention would not be a close substitute when a farmer is requiring a treatment product. As such, if the price of treatment products increased then a farmer will not switch to a prevention-only product.
53. In addition, a number of industry participants advised us that the range of product options available for farmers is also different, with there being a larger number of prevention products (and suppliers).³⁷ One of the reasons for this is that some APIs used in prevention products are designed to regulate the growth of the parasite over its life cycle rather than to kill it immediately.³⁸ This suggests that, in the face of a price increase for treatment products, some suppliers producing certain prevention products may have a limited ability to easily switch to producing a treatment product using their existing resources.

Assessment on the product markets for external parasite products for sheep

54. For the purposes of assessing the Proposed Acquisition, we consider it appropriate to assess separate product markets for animal healthcare products indicated for:
- 54.1 the prevention of external parasites on sheep; and
- 54.2 the treatment of external parasites on sheep.

Our assessment of the relevant functional market

55. We consider that the relevant functional market for all relevant products is the manufacture/importation of products for supply at the wholesale level. While there are some arguments for narrowing some of the relevant markets further, we do not consider it necessary to delineate the wholesale market by particular customer groups and/or particular distribution channels to assess the impact of the Proposed Acquisition, as to do so would have no impact on our competition assessment.

Treatments for otitis in dogs

56. All existing treatments for otitis in dogs are prescription-only products that can only be supplied to the end customer by a veterinarian. As such, the relevant functional

³⁶ Commerce Commission interview with [] (28 February 2020); and Commerce Commission interview with [] (2 March 2020).

³⁷ Commerce Commission interview with [] (20 February 2020); Commerce Commission interview with [] (10 March 2020); Commerce Commission interview with [] (12 March 2020); and Commerce Commission interview with [] (13 March 2020).

³⁸ "Managing flystrike and lice- a practical guide" Sheep and Beef Cattle Veterinarians Branch of the New Zealand Veterinary Association and Beef + Lamb New Zealand (August 2019).

market is the manufacture/importation and wholesale supply to veterinarians of products for the treatment of otitis in dogs.

Products for the treatment and prevention of external parasite on sheep

57. Elanco and Bayer supply products for the prevention and the treatment of external parasites on sheep to two customer groups who supply to retail customers. The two groups are:
- 57.1 veterinarians; and
 - 57.2 rural supply merchant stores including firms such as Farmlands and PGG Wrightson.
58. The Applicant considers there is no basis to delineate any products supplied to any one particular wholesale customer group (or one particular distribution channel) because all products for use on external parasites on sheep can be purchased from any retailer without a prescription and neither Elanco nor Bayer favours any one retailer or distribution channel over another.³⁹
59. On the demand side, we received mixed evidence on the extent to which farmers switch their purchases of their preferred prevention and treatment products between veterinarians and the rural supply merchant stores.
- 59.1 Some farmers prefer to purchase all of their animal health products from their local vet.
 - 59.2 Other farmers had no issues switching their purchases between different retailers.
60. On the supply side, there are some suppliers who, unlike Elanco and Bayer, only distribute their products to veterinarians and some others who only distribute to rural supply merchant stores.
61. While there appear to be some differences in the conditions of wholesale supply to veterinarians and to rural supply merchant stores, these differences do not appear to be sufficient to place the different wholesale customer groups in separate markets.

Our assessment of the relevant geographic market

62. Elanco considers there is a national market for the manufacture/importation and wholesale supply of all the relevant products.⁴⁰
63. We consider that there are national markets for the treatment of otitis in dogs, for the prevention of external parasites on sheep and for the treatment of external parasites on sheep. All of these animal healthcare products are

³⁹ Clearance application from Elanco (14 February 2020).

⁴⁰ Clearance application from Elanco (14 February 2020).

manufactured/imported and then distributed nationwide and the competitive conditions at the wholesale level do not seem to differ by region.

Conclusion on the relevant markets

64. For the purposes of assessing the competition effects of the Proposed Acquisition, we consider the relevant markets to be the national market for the manufacture/importation and wholesale supply of products for:
- 64.1 the treatment of otitis in dogs (the otitis treatment market);
 - 64.2 the prevention of external parasites on sheep (the external parasite prevention market); and
 - 64.3 the treatment of external parasites on sheep (the external parasite treatment market).

How the acquisition could substantially lessen competition

65. We have considered whether the acquisition would be likely to substantially lessen competition by assessing the unilateral and coordinated effects of the Proposed Acquisition.
66. Unilateral effects arise when a firm merges with or acquires a competitor that would otherwise provide a significant competitive constraint. The Proposed Acquisition would likely have the effect of substantially lessening competition:
- 66.1 in the otitis treatment market, if it removed the closest alternative to the merged entity's products and allowed the merged entity to profitably increase the wholesale price and/or reduce the quality of its otitis treatment products; and
 - 66.2 in the external parasite prevention market and the external parasite treatment market, if it removed the close competition between the Elanco and Bayer brands and allowed the merged entity to profitably raise the wholesale price and/or reduce the quality of its prevention and treatment products.
67. Coordinated effects can occur when a merger or acquisition makes it significantly more likely that the remaining firms can collectively exercise market power to increase prices, restrict output or reduce quality. In this case, we tested whether each of the three relevant markets is vulnerable to coordination and then considered how the Proposed Acquisition might change the likelihood of coordination in each market.

With and without scenarios

68. Assessing whether a substantial lessening of competition is likely requires us to compare the likely state of competition if the Proposed Acquisition proceeds (the scenario with the merger, often referred to as the factual) with the likely state of

competition if it does not (the scenario without the merger, often referred to as the counterfactual) and to determine whether competition is likely to be substantially lessened by comparing those scenarios.

With the acquisition

69. With the acquisition, Elanco would acquire Bayer AG's animal health business. However, Elanco considers that the with-the-acquisition scenario does not include Elanco owning the assets, rights and liabilities relating to the supply of Osurnia, a treatment for otitis in dogs. This is because Elanco is in the process of selling Osurnia to entities related to Dechra.
70. On 26 May 2020, the Commission granted clearance to Dechra Pharmaceuticals PLC, Dechra Limited and Dechra Veterinary Products LLC to acquire the worldwide assets, rights and liabilities relating to the supply of Osurnia from Elanco, insofar as they relate to markets in New Zealand.⁴¹ However, at the time of this determination, this acquisition has not yet been completed. Accordingly, for the purposes of our assessment of the Proposed Acquisition, we have considered the with-the-acquisition scenario on the basis that Elanco would continue to own the necessary assets and licenses to supply Osurnia.

Without the acquisition

71. We consider the status quo would be the relevant counterfactual. As discussed below, this scenario would see Bayer introduce a new otitis treatment for dogs in New Zealand and Elanco and Bayer would continue to operate independently (albeit that Bayer AG would likely continue to seek an alternative purchaser of Bayer).

Competition assessment – the otitis treatment market

72. For the reasons set out below, we are not satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the otitis treatment market due to unilateral effects.
73. Bayer recently registered a new product, a long acting product called Neptra, which it expects to introduce into the market later this year. For customers who place a premium on convenience, Elanco's Osurnia and Bayer's Neptra are likely to be each other's closest alternatives, given they would be the only long acting products available in New Zealand.
74. Without the acquisition, Bayer's new long acting product (Neptra) and Elanco's long acting product (Osurnia) would likely exert significant competitive constraint on each other in the otitis treatment market. This competition would be lost as a result of the Proposed Acquisition.
75. We consider that the Proposed Acquisition is likely to raise significant unilateral effects concerns in the otitis treatment market.

⁴¹ Commerce Commission Media release Dechra granted clearance to acquire Osurnia from Elanco (27 May 2020).

- 75.1 Without the Proposed Acquisition the entry of Neptra would likely have constrained the price of Elanco's Osumnia and would be an additional source of constraint on daily dose products. This constraint would be lost with the Proposed Acquisition.
- 75.2 The remaining suppliers of daily dose otitis treatment products would not be able to replace all of the lost constraint between Elanco (Osumnia) and Bayer (Neptra), as the merged entity would be the only suppliers of long acting otitis treatment products in New Zealand.
- 75.3 The effect of the increase in market power post-acquisition in the otitis treatment market would likely result in the merged entity having the ability to profitably increase the wholesale prices of long acting otitis treatment products in New Zealand and put upward pressure on prices of daily dose treatments.
- 75.4 Post acquisition, Elanco would not be constrained by the threat of new entry.
- 75.5 Veterinarians, as the wholesale customers, are unlikely to have any countervailing power with which to discipline the merged entity.

The extent of constraint on the merged entity from existing competition

76. In this section, we assess the unilateral effects of the Proposed Acquisition including the extent of competition between Elanco and Bayer and the constraint that the merged entity would face from existing and potential competitors, and customers countervailing power.
77. Elanco considers that the Proposed Acquisition is unlikely to create any significant competition issues in the otitis treatment market, given the number of other existing suppliers.⁴² Table 1 shows the existing competitors and their estimated market shares in the otitis treatment market for 2019. As Bayer has not yet released its long acting product (Neptra), it had no sales in 2019.

⁴² Clearance application from Elanco (14 February 2020).

Table 1: Market share estimates for the otitis treatment market in 2019

Suppliers	Brand	Application	Sales (\$)	Share (%)
Elanco	Osurnia	long acting gel	[
	Surolan*	daily dose drops	[
Bayer	Neptra	long acting solution	0	0
Dechra	Canaural*	daily dose drops	[
	PMP	daily dose drops	[
Virbac	Easotic	daily dose pump	[
MSD	Otomax	daily dose drops	[
Troy Laboratories NZ Pty Limited	Dermotic	daily dose drops	[
Vetoquinol New Zealand Limited	Aurizon	daily dose drops	[
Total			[]	100

Source: Commission estimates based on Baron data (12 months to February 2020) and Dechra's application. *We understand that both Surolan and Canaural have encountered supply shocks which impacted on their sales in 2019.

78. Table 1 shows that Elanco, Dechra and Virbac are currently the largest suppliers in the market. However, once Neptra is introduced, Elanco and Bayer would be the only suppliers with a long acting product. As noted above, there is a degree of differentiation between daily dose products and long acting products for the treatment of otitis in dogs. In analysing the extent of existing competition between the parties, we have taken this differentiation into account when assessing the closeness of competition between the various otitis treatment products available in New Zealand.

Closeness of competition between Elanco and Bayer

79. Without the acquisition, Elanco (Osurnia) and Bayer (Neptra) would be the only suppliers with a long acting product in the otitis treatment market and are therefore likely to compete particularly closely. This competition would be lost as a result of the Proposed Acquisition.
80. While Bayer does not currently have a presence in the market, Neptra has a significant presence in overseas markets and Bayer anticipates gaining a [] presence in New Zealand, following Neptra's expected launch later this year. Table 2 shows Bayer's anticipated sales forecasts for Neptra in New Zealand.⁴³

⁴³ [] attached to an email from Simpson Grierson (acting for Bayer AG) to the Commerce Commission (9 March 2020).

[]

Table 2: Bayer's sales forecast for Neptra in New Zealand (NZD)

Bayer	Launch Year	Year 2	Year 3
Neptra (long acting)	[

Source: Bayer

81. Elanco's launch of its long acting product (Osurnia) has been relatively successful.⁴⁴ The availability of a long acting product was viewed by industry participants as a welcome relief to dogs and owners (especially where the dog is reluctant to receive a daily dose product) as a long acting product helps avoid a "daily battle" between the owner and dog.⁴⁵
82. In this respect, for customers who place a premium on convenience, Elanco's Osurnia and Bayer's Neptra are likely to be each other's closest alternatives as they would be the only long acting products available in New Zealand.⁴⁶
83. Neptra competes closely with Elanco's Osurnia in the United States, where both products have been available for some time.⁴⁷ Further, Dechra, which is proposing to acquire Osurnia, considers that Osurnia faces a strong constraint from Neptra in overseas markets.⁴⁸

Level of constraint from existing suppliers

84. Post-acquisition, all current competitors to Elanco would continue to provide daily dose products.
85. Virbac advised that its daily dose product, Easotic⁴⁹ [it is also easy to administer because the required daily dose is delivered via a pump, instead of droplets.
86. As indicated by Table 1, Dechra has a substantial market presence with its two daily dose droplet products, although this presence has been impacted by supply issues relating to Canaural.⁵⁰ Dechra would continue to compete closely with Elanco's daily dose product (Surolan) because Dechra's PMP product is a generic equivalent to Surolan.

⁴⁴ Commerce Commission interview with [](22 April 2020); and Commerce Commission interview with [](2 March 2020).

⁴⁵ Email from []to the Commerce Commission (4 May 2020).

⁴⁶ Clearance application from Elanco (14 February 2020). Clearance application from Dechra (26 March 2020).

⁴⁷ Clearance application from Elanco (14 February 2020). Clearance application from Dechra (26 March 2020).

⁴⁸ []attached to an email from DLA Piper (acting for Dechra) to the Commerce Commission (24 March 2020).

⁴⁹ []

⁵⁰ []].
Clearance application from Dechra (26 March 2020).

87. Similarly, daily dose droplet suppliers such as Vetoquinol (with Aurizon), Troy (with Dermotic) and MSD (with Otomax) would continue to provide some degree of constraint on Elanco post acquisition as they have equivalent products to Surolan.⁵¹ Elanco's Surolan would therefore continue to be constrained by existing suppliers of daily dose products.
88. As noted above, there is a price differential between daily dose products and long acting products, with a price premium charged to long acting products that are more user friendly.⁵² Given the difference in application (as well as price), we consider that individual daily dose droplet products likely provide a limited constraint on Elanco's Osumnia and Bayer's Neptra.
89. The likely constraint on Osumnia's price by Neptra would be lost with the Proposed Acquisition. It is therefore likely that the merged entity could profitably raise the price of both Osumnia and Neptra. With the merged entity being the only supplier with long acting products, any constraint imposed by long acting products on daily dose products would also be weakened as a result of the Proposed Acquisition.
90. Therefore, we cannot be satisfied that existing suppliers would be sufficient, either individually or combined, to constrain the merged entity for long acting products.

Other potential constraints

91. We consider that barriers to entry in this market are likely to be high because, as discussed in more detail below in relation to products for use on external parasites on sheep, developing and registering new animal healthcare products can take a very long time and is costly. We do not have any evidence that a potential supplier is in the advanced stages of developing a new otitis treatment. Therefore, the merged entity is unlikely to be constrained by the threat of potential entry. Accordingly, we do not consider that potential new entry is likely, or that it would occur in a timely manner that would be sufficient to constrain the merged entity.
92. Similarly, we do not consider that the merged entity would be constrained by any countervailing power held by its veterinarian customers. Given the time and cost it takes to register new products, we do not consider that sponsorship of new entry by a customer is likely. Further, we also do not have evidence that customers are able to exert substantial influence on negotiations in this market.

Coordinated effects in the otitis treatment market

93. We are satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition through coordinated effects in the otitis treatment market.

⁵¹ Email [] to the Commerce Commission (20 March 2020). Email from [] to the Commerce Commission (4 May 2020). Commerce Commission interview with [] (22 April 2020).

⁵² Commerce Commission interview with [] (22 April 2020); Commerce Commission interview with [] (20 May 2020); Email from [] to the Commerce Commission (25 May 2020).

94. There are some factors that could make the otitis treatment market vulnerable to coordination. However, the Proposed Acquisition does not change this vulnerability such that a substantial lessening of competition through coordinated effects is likely. In particular, the Proposed Acquisition would not increase market transparency. Further, the differentiated nature of otitis treatment products may also make it harder for firms to coordinate their behaviour and sustain that coordination.

Conclusion on competition effects in the otitis treatment market

95. We consider that the Proposed Acquisition is likely to raise significant unilateral concerns in the otitis treatment market as it would remove the likely significant constraint provided by Bayer's Neptra on the price of Elanco's Osurnia. The remaining suppliers of daily dose otitis treatment products would not be able to replace all of the lost future constraint between Elanco and Bayer, as the merged entity would be the only supplier of long acting otitis treatment products in New Zealand.
96. Post-acquisition, Elanco would unlikely be constrained by the threat of entry, or veterinarians' countervailing power (as the wholesale customers in the market).
97. Accordingly, we are not satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the otitis treatment market.

Competition assessment - products for use on external parasites on sheep

98. The Proposed Acquisition would combine two of the largest suppliers of products in both the external parasite prevention market and the external parasite treatment market. We have assessed the effects of the Proposed Acquisition in these two markets separately although, as we discuss further below, there are a number of similarities between the two markets.
99. In particular, we consider that Elanco and Bayer are currently significant competitors and constraints on each other in these two markets and this competition would be lost as a result of the Proposed Acquisition.
100. Post-acquisition, entry and expansion is unlikely to be sufficient in extent and/or timely enough to constrain the merged entity. In addition, customers are unlikely to have sufficient countervailing power to constrain the merged entity. In our view, by removing the existing rivalry between Elanco and Bayer, the Proposed Acquisition would be likely to give the merged entity the ability and/or incentive to:
- 100.1 raise the price of its products for the prevention and treatment of external parasites on sheep; and/or
- 100.2 reduce the quality or extent of innovation of its products for the prevention and treatment of external parasites on sheep.

101. Accordingly, for the reasons set out below we are not satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition through unilateral effects in the:

101.1 external parasite prevention market; and

101.2 external parasite treatment market.

102. We are satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition through coordinated effects in the external parasite prevention and treatment markets. We discuss the reasons for this conclusion below.

What the Applicant submitted – the products for external parasites on sheep

103. Elanco considers that the Proposed Acquisition would not raise any competition issues for any wholesale customer or distribution channel for any external parasite products used on sheep because Elanco's and Bayer's product ranges are largely complementary and do not compete closely with one another.⁵³ This is because:

103.1 Elanco's and Bayer's products have different chemical properties;

103.2 end customers need to regularly switch suppliers due to the need to prevent flies and lice from developing resistance to the products; and

103.3 given the need for continued switching, the merged entity would face competition from big brand competitors such as Boehringer Ingelheim and MSD, as well as generic suppliers such as Ravensdown, AHD, Donaghys and Alleva.

104. While accepting that the merged entity would have a high market share (in a market that includes all external parasite products for sheep), Elanco considers that the smaller existing suppliers are all well placed to be able to expand to constrain the merged entity.⁵⁴ For example, Elanco considers that:

104.1 MSD would be a significant constraint on the merged entity's ability to materially increase prices because all its products offer comparable protection against flystrike and lice when compared to the products currently supplied by Elanco and Bayer. MSD also has a large presence in Australia, which it could use to grow its New Zealand presence;

104.2 Jurox is ideally placed to expand, if incentivised by the actions of the merged entity. This is because Elanco's most popular product (Clik) is based on dicyclanil and Elanco and Jurox are the only two existing suppliers with dicyclanil-based products in New Zealand; and

⁵³ Clearance application from Elanco (14 February 2020).

⁵⁴ Submission from Elanco to the Commerce Commission (31 March 2020).

104.3 local suppliers, although tending not to supply the same volumes as Elanco, Bayer or Boehringer Ingelheim, in aggregate would account for a significant share of sales and, combined, would have a significant impact on the merged entity. This is because they have the ability to produce low cost, own label generic cyromazine products relatively easily.

Competition assessment – the external parasite prevention market

105. Outlined below is our assessment of the unilateral and coordinated effects of the Proposed Acquisition in the external parasite prevention market. As outlined above, prevention products are those used by farmers to protect sheep from lice and flystrike before they develop.

The extent of constraint on the merged entity from existing competition

106. In this section, we consider the state of existing competition and the existing alternative suppliers to the merged entity in the external parasite prevention market.

107. Table 3 lists the existing suppliers and brands in the external parasite prevention market. With the exception of Boehringer Ingelheim, these existing suppliers have a small market share compared to the merged entity. In this respect, all industry participants noted that the Proposed Acquisition would combine two of the largest suppliers of prevention products for external parasites on sheep.⁵⁵

Table 3: Suppliers and brands in the external parasite prevention market in 2019

Supplier	Brand	Sales in 2019 (\$)	Market share (%)
Elanco	Clik, Vetrazin [^] , Cyrex*, Extinosad, Expo	[
Bayer	Seraphos, Zapp Encore, Zapp [^]	[
<i>Merged entity</i>		[
Boehringer Ingelheim	Cypercare, Cyrazin*, Exit Extreme Fleece-master	[
MSD	Magnum, Vanquish, Wipe Out, Zenith	[
Ravensdown	Fleeceguard / Comboguard, Saturate, Cyromazine liquid/spray on	[
Alleva	Cyroshield	[
AHD	Cyguard, Unlock	[
Nexan #	Cyromax	[
Donaghys	Strike Out	[
Jurox	StrikeForce-S	[
Norbrook	Banish, Lucifly	[
Totals		[]	100

Source: Baron data, Applicant, Industry participants. *Includes sales when product used for treatment. #Nexan Corporation Limited also contract manufacturers certain products for Ravensdown (Cyromazine liquid/spray on). [^] Product discontinued.

⁵⁵ Commerce Commission interview with [] (20 February 2020); Commerce Commission interview with [] (21 February 2020); and Commerce Commission interview with [] (17 March 2020).

108. In considering the impact of the Proposed Acquisition on existing competition in the external parasite prevention market, we assessed the:

108.1 closeness of existing competition between Elanco and Bayer; and

108.2 level of constraint on the merged entity from branded suppliers, such as Boehringer Ingelheim and MSD, and generic suppliers of generic products such as Ravensdown, Alleva, AHD and Donaghys.⁵⁶

Closeness of competition between Elanco and Bayer

109. We consider that Elanco and Bayer compete closely with one another in the external parasite prevention market. While their portfolios of products are slightly different, they each have a number of prominent and effective products in the market and the competition between the two suppliers would be lost as a result of the Proposed Acquisition.

110. While price is an important aspect of competition between the different suppliers, many industry participants emphasised that efficacy is a more important consideration and it is the key determinant behind a farmer's choice of brand.⁵⁷ When considering efficacy, industry participants considered that Elanco and Bayer have many of the most effective products and, as a result, they have the most prominent and respected brands such as Clik, Cyrex, Extinosad and Zapp Encore.⁵⁸

111. Industry participants also emphasised that farmers are brand loyal, which can make many farmers reluctant to switch away from their preferred product, given the potential implications for animal welfare of making the wrong choice of product. In this respect, many farmers stay with the brands they know and trust. Industry participants identified this as one of the reasons why both Elanco and Bayer have a significant market presence.⁵⁹

112. Regardless of any brand loyalty, the Applicant emphasised that all products are susceptible to resistance and so farmers are advised to rotate the products they use between the different APIs contained in the different products.⁶⁰ The Applicant

⁵⁶ Boehringer Ingelheim and MSD (as well as Elanco and Bayer) are commonly referred to brand suppliers as they tended to be the 'originators' of the particular products they supply.

⁵⁷ Commerce Commission interview with [] (28 February 2020); Commerce Commission interview with [] (2 March 2020; and Commerce Commission interview with [] (27 February 2020).

⁵⁸ Commerce Commission interview with [] (20 February 2020); Commerce Commission interview with [] (17 March 2020); Commerce Commission interview with [] (28 February 2020); and Commerce Commission interview with [] (2 March 2020).

⁵⁹ Commerce Commission interview with [] (20 February 2020); Commerce Commission interview with [] (21 February 2020); Commerce Commission interview with [] (17 March 2020).

⁶⁰ "Ectoparasiticides in NZ and their control" (Section 5.5) provided in Attachment 4, Clearance application from Elanco (14 February 2020).

considers that rotation encourages regular switching between different suppliers because suppliers tend to supply products containing different APIs.⁶¹

113. All industry participants we interviewed emphasised that resistance is a major issue for the industry with both fly and lice having developed some degree of resistance to most of the older active ingredients used in prevention products. As a result, the most prominent products tend to be either combination products or products based on the newer active ingredients as these products have the least issues with resistance.
114. In this respect, because both Elanco and Bayer are supplying products with the newer APIs such as spinosad, dicyclanil and imidacloprid, they compete more closely with one another than with suppliers who have products containing older active ingredients such as cyromazine or diflubenzuron. As such, if a farmer was to switch products for rotation purposes, they are more likely to switch to the brands that would be supplied by the merged entity (such as to Clik, Cyrex and Zapp Encore) than switch away from the merged entity's products.⁶²
115. We note that Elanco's Clik product is one of the most popular products in the market. This is because it provides the longest prevention period against flystrike. Elanco's Clik contains the active ingredient dicyclanil. Bayer does not have an equivalent dicyclanil product. In this respect, the closest alternative to Elanco's Clik is Jurox's StrikeForce-S, which does contain dicyclanil.
116. Nevertheless, while Bayer may not have a product that competes closely with Elanco's Clik, Bayer's prevention products, namely Zapp Encore and Seraphos do compete closely with Elanco's other prevention products, namely Cyrex, Expo and Extinosad.⁶³ Further, industry participants emphasise that Bayer is particularly strong in products used to prevent lice.⁶⁴

Level of constraint from Boehringer Ingelheim

117. Boehringer Ingelheim would likely continue to provide a constraint on the merged entity as it has a number of established brands of prevention products including Cypercure, Cyrazin, Exit Extreme and Fleecemaster.
118. However, Boehringer Ingelheim would not be an option for all potential customers as it has a long-term policy of only distributing its products through veterinarians. To

⁶¹ Clearance application from Elanco (14 February 2020).

⁶² Commerce Commission interview with [](17 March 2020); Commerce Commission interview with [](20 February 2020); Commerce Commission interview with [](9 March 2020).

⁶³ Commerce Commission interview with [](20 February 2020); Commerce Commission interview with [](9 March 2020); "Managing flystrike and lice- a practical guide" Sheep and Beef Cattle Veterinarians Branch of the New Zealand Veterinary Association and Beef + Lamb New Zealand (August 2019).

⁶⁴ Commerce Commission interview with [](20 February 2020); Commerce Commission interview with [](2 March 2020).

this extent, Boehringer Ingelheim would likely need to expand its existing sales of its prevention products considerably to replace the lost competition between Elanco and Bayer.

Level of constraint from MSD

119. The Applicant advised that MSD is an aggressive competitor particularly in relation to the pricing of its Magnum product (containing diflubenzuron), which currently competes closely with Elanco's Cyrex and Bayer's Zapp Encore.⁶⁵

120. Like Boehringer Ingelheim, MSD is an established supplier in the prevention market and it supplies its products to both veterinarians and rural supply merchant stores.

[

66]

121. [

67]

122. [] we can only place limited weight on the constraint that MSD would impose on the merged entity.

Level of existing constraint from suppliers of generic products

123. The Applicant submitted that there are a number of local suppliers that compete aggressively in the external parasite prevention market and they either supply, or are well placed to begin supplying, products substitutable for those supplied by Elanco or Bayer. These local suppliers include Ravensdown, Alleva, AHD and Donaghys as well as Jurox (which is based in Australia).⁶⁸

124. Further, the Applicant stated that, although these local suppliers tend not to have revenue market shares as high as the major international players, they account for a significant share of the market and have a significant impact on branded products such as those supplied by Elanco, Bayer and Boehringer Ingelheim. The Applicant submitted that branded products must compete with generic products on price or customers will switch, and the fact particular suppliers may not have achieved substantial market share does not necessarily mean they face entry or expansion

⁶⁵ Submission from Elanco to the Commerce Commission (31 March 2020).

⁶⁶ []

⁶⁷ []

⁶⁸ Submission from Elanco to the Commerce Commission (31 March 2020).

barriers – it could equally mean the market is being well served by incumbents supplying competitively priced products.⁶⁹

125. There are a number of generic and/or locally based suppliers supplying products in the external parasite prevention market. However, as indicated by Table 3 above, their respective sales are relatively small in comparison to the branded suppliers. These suppliers include:

125.1 Alleva and Jurox, which only supply their products to veterinarians; and

125.2 AHD, Donaghys and Nexan, which only supply their products to the rural supply merchant stores⁷⁰ while Ravensdown distributes its products through its own network of retail stores.

126. While Jurox currently only supplies one product in the market, Jurox is likely to provide some constraint on the merged entity.

126.1 As noted above, Jurox and Elanco are the only two existing suppliers with dicyclanil-based prevention products. Dicyclanil-based products offer the longest protection against flystrike. Jurox advised
[
71]

126.2 Jurox introduced its only product (StrikeForce-S) into this market in late 2017 after a lengthy development and registration process. Jurox advised
[
72]

127. We consider that Alleva provides limited existing constraint on the merged entity. Alleva supplies a cyromazine-based product to vet clinics.

127.1 [
73]

127.2 [
74]

⁶⁹ Submission from Elanco to the Commerce Commission (31 March 2020).

⁷⁰ Nexan toll manufactures for PPG Wrightson and we understand that Norbrook’s products are no longer distributed in New Zealand.

⁷¹ []

⁷² []

⁷³ []

⁷⁴ []

128. Ravensdown, AHD and Donaghys each supply a number of cyromazine-based products and compete closely with one another in the prevention market, given their similar portfolios and distribution strategies. However, these products are not the closest substitutes for the merged entity's products. This implies that switching by customers in the event of a price increase and/or decrease in quality after the Proposed Acquisition is likely to be limited. Therefore, each individual alternative is unlikely to expand sufficiently to constrain the merged firm, nor is the combined expansion of these alternatives likely to be sufficient to provide an effective constraint on the merged entity with their existing product portfolios.
129. We consider that one of the main reasons for the limited constraint from Ravensdown, AHD, Donaghys and Alleva is the actual (as well as perceived) efficacy of the products they supply. Cyromazine-based products are indicated for the prevention of flystrike and so are not an alternative for lice prevention. In this respect, industry participants advised that cyromazine-based products, while widely available and significantly cheaper than products from the branded suppliers, tend to be less effective and this accounts for their relatively low market share overall.⁷⁵
130. Each supplier would have to expand significantly to provide an effective constraint on the merged entity. Accordingly, we have assessed the ability and incentive of any existing (or potential) supplier to develop new and/or improved generic products to compete more aggressively with the merged entity in the potential entry section below.

The extent of constraint on the merged entity from potential competition

131. In assessing the impact of the Proposed Acquisition, we assess whether entry by new competitors or expansion by existing competitors is likely to be sufficient in extent, and occur in a timely fashion to constrain the merged firm and prevent a substantial lessening of competition. This is referred to as the 'LET test'. The LET test is satisfied when entry or expansion in response to a price increase or other exercise of market power is Likely, and sufficient in Extent and Timely enough to constrain the merged firm.⁷⁶
132. The Applicant considers that there is nothing preventing existing or potential suppliers from developing, in a timely manner, new products for the prevention (or treatment) of external parasites on sheep.⁷⁷ In its view, the threat of expansion by existing suppliers would be a significant constraint on the merged entity's ability to materially increase prices to its customers.
133. The Applicant submitted that the ease of registration under the ACVM for new products in New Zealand means that barriers to entry and expansion in these

⁷⁵ For example, see Commerce Commission interview with [](17 March 2020); Commerce Commission interview with [](9 March 2020); Commerce Commission interview with [](17 March 2020); and Commerce Commission interview with [](16 April 2020).

⁷⁶ *Mergers and Acquisitions Guidelines* above n1.

⁷⁷ Clearance application from Elanco (14 February 2020).

markets are relatively low. In particular, the Applicant noted that many of the APIs used in the prevention market are currently off-patent and there are limited restrictions on existing industry participants, many of whom are large multinational animal healthcare companies with established research programmes, from developing new products using the readily available active ingredients and/or technology

134. In our view, the degree of constraint that potential competition would have on the merged entity is likely to be limited and would likely not be sufficient to constrain the merged entity.
135. New or novel products are mostly likely to come from an existing market or industry participant, due to the significant costs and time required to develop new products. However, given the time it takes to develop and register new products, existing industry participants are unlikely to introduce new or improved products to extend their existing range of products in a timely manner that constrain the merged entity and prevent any substantial lessening of competition.
136. The three main methods of entry into the external parasite prevention market are:
- 136.1 the development of a new pharmaceutical molecule or API;
 - 136.2 species extension, such as using an existing product or active ingredient/s formulated for one animal species and developing it for use on another animal species; or
 - 136.3 the introduction of a generic equivalent product using an existing API and/or formulation that is no longer patent protected.

Product development – new pharmaceutical molecule or active ingredient

137. We have no evidence to suggest it is likely that the merged entity would be constrained by new entry of a product containing a new or novel pharmaceutical molecule or API. Industry participants that we spoke with considered that the costs involved in developing new molecules are high and there are unlikely to be any new novel molecules developed specifically for the prevention of external parasites on sheep, or any other animal, for the foreseeable future.⁷⁸

Product development – extension across animal species

138. We have no evidence to suggest it is likely that the merged entity would be constrained in the prevention market by new entry from a product containing a pharmaceutical molecule or an API that is currently used to prevent external parasites on another animal species.
139. Certain animal healthcare products are indicated and can be used on more than one species of animal. While this is not currently the case for any products used in the

⁷⁸ Commerce Commission interview with [] (20 February 2020); Commerce Commission interview with [] (21 February 2020).

prevention of external parasites on sheep, several parties noted that they could not dismiss the potential that an API developed for use on other production animals like cattle or dairy cows (or even a companion animal) could then also be developed further for use on sheep.⁷⁹ However, even if this was the case, undertaking the necessary trial work on sheep to complete the formal registration process would still make such entry unlikely to occur within the foreseeable future.

140. MSD recently introduced a product called Bravecto Plus Spot On, containing the active ingredient fluralaner, for the prevention of external parasites on companion animals. In the Applicant's view, fluralaner has shown potency against flies that afflict sheep and so MSD is "well-placed" to introduce a brand new fluralaner-based product(s) to either the treatment or prevention markets.⁸⁰
141. As noted above,
[

⁸¹]

Product developments – introduction of generic equivalent products

142. We have insufficient evidence to be satisfied that the merged entity would be constrained in the external parasite prevention market by entry of a new generic equivalent product from either existing or potential suppliers. If incentivised by the actions of the merged entity, we cannot be satisfied that existing or potential suppliers would have the ability to introduce new or improved products, given the time it takes to develop and register any new products, even when using existing off-patent technology.
143. The Applicant considered that a number of the smaller existing locally based suppliers, such as Alleva, AHD and Donaghys, could easily expand by developing and registering new generic products. Even if they do not have the production facilities themselves, the Applicant considered that they all have the ability to either import the finished product into New Zealand or enter into toll manufacturing/distribution arrangements with local toll manufacturers, much like Bayer currently does for certain products.⁸²

⁷⁹ Clearance application from Elanco (14 February 2020), Commerce Commission interview with [] (21 February 2020).

⁸⁰ Submission from Elanco to the Commerce Commission (31 March 2020).

⁸¹ []

⁸² Submission from Elanco to the Commerce Commission (31 March 2020).

144. All industry participants advised that, if a supplier wanted to develop and register a new product under the ACVM, there are no significant issues in sourcing the relevant raw materials and there are a number of toll manufacturers based in New Zealand with the experience and capability to toll manufacture an external parasite prevention product for sheep. Such contract manufacturing is a relatively common industry practice for all suppliers.⁸³
145. Further, if an existing supplier was able to introduce a new product that would compete closely with the most prominent brands, containing the more effective APIs in the prevention market, such as Klik (Elanco), Cyrex (Elanco), Zapp Encore (Bayer) or Cyrazin (Boehringer Ingelheim), then such entry would likely allow the supplier to compete more aggressively with the merged entity. Such entry would, therefore, likely be of sufficient extent to impose a constraint on the merged entity.
146. Given this, we have focused our assessment on the likelihood and timeliness of any potential entry or expansion. This is because entry or expansion must be likely before it could constrain the merged firm and prevent a substantial lessening of competition. The mere possibility of entry or expansion is insufficient.⁸⁴
147. Industry participants noted that the physical manufacture of a prevention product for external parasites is relatively straightforward⁸⁵ and that several existing suppliers such as Alleva, AHD and Donaghys, have New Zealand-based research programs that could be used to expand their current range of products for use on external parasites on sheep.
148. We sought feedback from a number of suppliers on their ability to develop and register a new prevention product but we were not able to obtain any evidence that a potential supplier is in the advanced stages of developing a product.⁸⁶
149. To constrain the merged entity, entry or expansion with a new or novel product by existing suppliers must be likely to occur within a reasonably short time period. No existing supplier could provide us with any evidence that it could shorten the time required to develop a new product, even if incentivised by the actions of the merged entity. Accordingly, we are of the view that we cannot rely on potential entry or

⁸³ We understand that there are a number of toll manufacturers in New Zealand who do not compete downstream with any existing supplier of products for the treatment and/or prevention of the external parasites for sheep such as Jaychem Industries Limited and Argenta Manufacturing Limited. See Application and Commerce Commission interview with [] (10 March 2020); Commerce Commission interview with [] (13 March 2020); Commerce Commission interview with [] (12 March 2020).

⁸⁴ *Mergers and Acquisitions Guidelines* above n1.

⁸⁵ For example, [] noted that the easiest way to introduce a new product is to manufacture one using an existing registration. Commerce Commission interview with [] (14 May 2020).

⁸⁶ Commerce Commission interview with [] (12 March 2020); Commerce Commission interview with [] (10 March 2020); Commerce Commission interview with [] (13 March 2020).

expansion from existing suppliers in the foreseeable future to provide a constraint on the merged entity.

Conclusion on the constraint from potential competition in the external parasite prevention market

150. There are a number of existing suppliers with research and development programs that are focused on developing animal healthcare products for New Zealand-based customers. In the recent past, these programmes have resulted in some suppliers introducing new products in the external parasite prevention market, although we note that many of these new products have been less successful and have been based on older APIs.⁸⁷
151. Developing and registering new, or improved, prevention products can take a long time. Without evidence that a potential supplier is in the advanced stages of developing a product, we consider that the degree of constraint that potential competition would have on the merged entity in the external parasite prevention market is likely to be limited.
152. Accordingly, we do not consider that the threat of potential competition would be sufficient to constrain the merged entity in the external parasite prevention market.

The extent of constraint on the merged entity from countervailing power

153. We consider that customers are unlikely to have sufficient, if any, countervailing power to constrain the merged entity.
154. A merged firm's ability to exercise unilateral market power may be constrained by the ability of certain customers to exercise countervailing power. Countervailing power is more than a customer's ability to switch from buying products from the merged firm to buying products from a competitor. Similarly, a customer's size and commercial importance is not sufficient in itself to amount to countervailing power. Instead, countervailing power exists when a customer possesses special characteristics that give that customer the ability to substantially influence the price the merged firm charges (eg, an ability to switch to self-supply or sponsor entry).⁸⁸
155. The Applicant submitted that key customers such as veterinarian practices and rural supply stores all make high volume purchases, and all have the ability to switch between suppliers if they are unhappy with the price or service offering made available to them. In particular, the Applicant stated that rural supply stores, such as PGG Wrightson and Farmlands, are large, sophisticated distributors with significant countervailing power.⁸⁹

⁸⁷ Commerce Commission interview with [] (10 March 2020); Commerce Commission interview with [] (12 March 2020); and Commerce Commission interview with [] (13 March 2020).

⁸⁸ *Mergers and Acquisitions Guidelines* above n1.

⁸⁹ Clearance application from Elanco (14 February 2020).

156. However, even if a large customer such as PGG Wrightson, Farmlands or a chain of veterinarian clinics (or a vet buying group)⁹⁰ did have a degree of buyer power in its dealings with the merged entity compared with other smaller suppliers, this alone would be insufficient to constrain the merged entity's market power. In particular, small vet clinics which, individually, are unlikely to have any buyer power, would likely, in the face of a price increase from the merged entity, simply pass on any price increases to farmers.⁹¹
157. It would be necessary for a larger customer to be able to credibly threaten to self-supply or sponsor new entry in order to exercise countervailing power to constrain the merged firm's market power. We consider that it is unlikely that a retail customer would be able to self-supply by vertically integrating or importing alternative products in a timely or cost-effective manner, due to the high barriers to entry in the prevention market as discussed above.
158. In addition, given the time and cost it takes to register new products, we also do not consider that any customer would have an ability (or willingness) to sponsor entry. Given the uncertainties in being able to obtain the registration of a new product in a timely and cost effective manner, we are of the view that, even if incentivised by a large customer, new entry is unlikely to occur within the foreseeable future and any customers' countervailing power is therefore likely to remain limited in the foreseeable future.

Coordinated effects in the external parasite prevention market

159. We are satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition through coordinated effects in the external parasite prevention market.
160. There are some factors that could make the market vulnerable to coordination. Further, the Proposed Acquisition will increase concentration in a market that is already highly concentrated. This may increase the likelihood of coordination post-acquisition.
161. The Proposed Acquisition would not change conditions in the market so that coordination is more likely, more complete or sustainable. In particular, the Proposed Acquisition would be unlikely to increase market transparency. The lack of market transparency means that it would be hard for the remaining firms to reach a focal point for coordination. There is also no evidence to suggest that the Proposed Acquisition would result in greater symmetries in firm size or cost structures of the remaining suppliers in the external parasite prevention market.

⁹⁰ We understand that some vet clinics have been forming buying groups with other vet clinics in order to try to increase their purchasing power.

⁹¹ Commerce Commission interview with [] (28 February 2020); Commerce Commission interview with [] (2 March 2020).

Conclusion on the external parasite prevention market

162. The Proposed Acquisition would combine two of the largest suppliers of products in the external parasite prevention market. While we are satisfied that the market is not at increased risk of coordination post acquisition, we cannot be satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the external parasite prevention market due to unilateral effects.
- 162.1 Elanco and Bayer are currently close competitors in the supply of external parasite prevention products and this competition would be lost as a result of the Proposed Acquisition. The constraint from remaining suppliers is insufficient to constrain the merged entity.
- 162.2 Post-acquisition, entry and expansion is unlikely to be sufficient in extent and/or timely enough to constrain the merged entity.
- 162.3 Customers are unlikely to have countervailing power to constrain the merged entity.

Competition assessment – the external parasite treatment market

163. Outlined below is our assessment of the unilateral and coordinated effects of the Proposed Acquisition in the external parasite treatment market.
164. Given the similarities between prevention and treatment products, many of the issues we have identified in the external parasite prevention market are also relevant to the external parasite treatment market.
165. The Commission's view is that the Proposed Acquisition would remove the existing competition between Elanco and Bayer and this competition is unlikely to be replaced by existing competition, new entry or expansion, or customers' countervailing power. In our view, the removal of the existing rivalry between Elanco and Bayer is likely to give the merged entity the ability to profitably raise the price and/or reduce the quality of its treatment products.
166. Accordingly, we are not satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the external parasite treatment market through unilateral effects.
167. We are satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition through coordinated effects in the external parasite treatment market. There is a lack of transparency in the market that will not be affected by the Proposed Acquisition. Further, the Proposed Acquisition would increase asymmetry in market share in the external parasite treatment market. This means that the merged entity would have a greater incentive to exercise unilateral market power, rather than joint market power with its smaller rival.

The extent of constraint on the merged entity from existing competition

168. In this section, we consider the state of existing competition and the existing alternative suppliers to the merged entity in the external parasite treatment market.
169. At present, there are only three products that are indicated and used for the treatment or immediate knockdown of external parasites on sheep. These three products are listed in Table 4 below along with their indications, sales and estimated market shares in the external parasite treatment market in 2019.
170. We note that there are some limitations with the data used to calculate the market shares in Table 4. In particular, while Elanco’s Cyrex and Boehringer Ingelheim’s Cyrazin KO are used for treatment, they also have dual treatment and prevention indications which means they can be (and are) used for prevention.⁹² To this extent, sales reflected in Table 4 tend to overstate the presence of Cyrex and Cyrazin KO in the treatment market.

Table 4: Suppliers and brands in the external parasite treatment market in 2019

Supplier	Brand	Label indications	Total sales (\$)	Market share (%)
Elanco	Cyrex*	Prevention and treatment of flystrike; prevention of lice; treatment of lice. Sold in multiple container sizes (250 mL, 5 L, 10L)	[
Bayer	Maggo	Treatment of flystrike in sheep and protection against re-strike, and as a docking medication. Sold in 1L containers.	[
<i>Merged entity</i>			[
Boehringer Ingelheim	Cyrazin KO*	Prevention of flystrike; control of existing body lice infections; control of maggots in existing strike areas. Sold in 1L and 5L containers.	[
Total			[]	100

Source: Baron data, Applicant. *Includes sales when the product is used for prevention.

171. Industry participants advised that Bayer’s Maggo is the most widely used product for the treatment of external parasites on sheep and it is the only product that is used exclusively for treatment. Maggo was described as the “go to” product when a farmer comes across an obvious health issue requiring immediate treatment.⁹³

⁹² We do not have information on the split between usage for treatment and prevention for these products. To this extent, sales in Table 4 tend to overstate the presence of Cyrex and Cyrazin KO in the treatment market. For example, when Cyrex is used for treatment, it may only be used to treat one particular sheep, whereas when it is used as a prevention product, it would likely be administered to an entire flock.

⁹³ Commerce Commission interview with [](28 February 2020); Commerce Commission interview with [](9 March 2020).

172. Other than the products listed in Table 4, we are not aware of any other products with a prevention indication that are currently used in the treatment of external parasite on sheep. For example, [] advised that Maggo, Cyrex and Cyrazin KO are the only three products that are currently available for famers to use as a knockdown product to kill maggots on sheep.⁹⁴
173. Industry participants advised that the demand for treatment products is relatively low because farmers are focused primarily on prevention.⁹⁵ However, the use of treatment products is still an important part of any farmer’s pest management plan. This is because a treatment product will be required when a farmer needs to urgently treat sheep that already have external parasites.
174. While the demand for treatment products is significantly lower than for prevention products, we have no evidence to suggest that demand for such products will stop or decline within the foreseeable future.
175. APIs tend to target particular stages in the life cycle of external parasites. The most common APIs used on sheep for external parasites is cyromazine. Cyromazine is designed to regulate the growth of external parasites over time. However, this means that products with cyromazine are not effective for treating existing infestations of flies or lice. To this extent, when an infestation occurs, farmers are encouraged to treat it quickly using a treatment product with a “knockdown active ingredient”. These APIs are spinosad (contained in Cyrex), ivermectin (contained in Cyrazin KO) and propetamphos (contained in Maggo).⁹⁶
176. While both Cyrex and Cyrazin are also prevention products, their particular formulations mean that they are also used for treatment and compete directly with Maggo (unlike other prevention products). Many industry participants advised that most sheep farmers would always have a can of Maggo in the shed and, if they did not, then they would have a can of either Cyrazin KO or Cyrex, given the importance of treating infestations immediately.⁹⁷
177. While Boehringer Ingelheim’s Cyrazin KO product is a well-known product, there are some instances where it will not provide a strong constraint on the merged entity.
- 177.1 Maggo and Cyrex are available to be purchased from both veterinarians and rural supply merchant stores. However, Boehringer Ingelheim only supplies to

⁹⁴ Commerce Commission interview with [](13 May 2020).

⁹⁵ Commerce Commission interview with [](9 March 2020); Commerce Commission interview with [](13 May 2020); “Managing flystrike and lice- a practical guide” Sheep and Beef Cattle Veterinarians Branch of the New Zealand Veterinary Association and Beef + Lamb New Zealand (August 2019).

⁹⁶ “Managing flystrike and lice- a practical guide” Sheep and Beef Cattle Veterinarians Branch of the New Zealand Veterinary Association and Beef + Lamb New Zealand (August 2019).

⁹⁷ Commerce Commission interview with [](28 February 2020); Commerce Commission interview with [](9 March 2020); Commerce Commission interview with [](13 May 2020); Commerce Commission interview with [](14 May 2020).

veterinarians and so Maggo and Cyrex are the only two treatment products currently available in the rural supply merchant stores.⁹⁸

- 177.2 Cyrazin KO is only indicated for use on sheep with coarse wool whereas Cyrex and Maggo are indicated for use on both coarse and long/merino wool. In this respect, Cyrazin KO is not an option for merino farmers.⁹⁹

Conclusions on existing competition in the external parasite treatment market

178. Without the Proposed Acquisition, it is likely that Elanco and Bayer would continue to compete with one another as well as with Boehringer Ingelheim in the external parasite treatment market.
179. We consider that the Proposed Acquisition would remove the existing competition between Elanco and Bayer and reduce the number of existing suppliers from three to two. With Boehringer Ingelheim the only other supplier with a treatment product, we cannot be satisfied that existing competition would be sufficient to constrain the merged entity in the external parasite treatment market.

The extent of constraint on the merged entity from potential competition

180. For the same reasons identified in the external parasite prevention market, we do not consider that the threat of potential entry would be sufficient to constrain the merged entity in the external parasite treatment market.
181. Developing and registering new, or improved, treatment products can take a long time.¹⁰⁰ Further, the demand for treatment products is significantly lower than for prevention products, which is likely to further reduce the incentive for new entry.
182. Accordingly, while we have some evidence that a new treatment product might enter the market within the foreseeable future, we consider that the degree of constraint that potential entry would have on the merged entity in the external parasite treatment market is likely to be limited.

The extent of constraint on the merged entity from countervailing power

183. For similar reasons as in the external parasite prevention market, we consider that customers are unlikely to have sufficient, if any, countervailing power to constrain the merged entity in the external parasite treatment market. In particular:

- 183.1 there are only a limited number of treatment products and even if a customer wanted to switch between the existing suppliers this, by itself, is unlikely to

⁹⁸ Commerce Commission interview with [](3 March 2020); Commerce Commission interview with [](13 May 2020).

⁹⁹ Commerce Commission interview with [](28 February 2020).

¹⁰⁰ We understand that []

give any customer the ability to substantially influence the price the merged entity might charge for its treatment products;

- 183.2 even if a large customer such as PGG Wrightson, Farmlands or a chain of vet clinics (or a vet buying group) did have a degree of buyer power in its dealings with the merged entity, this would be insufficient to constrain the merged entity's market power;
- 183.3 while there are some large customers, there are currently a large number of small vet clinics who are unlikely to have buyer power and would not benefit from any buyer power of large suppliers;
- 183.4 due to high barriers to entry in the external parasite treatment market we consider that it is unlikely that customers would be able to self-supply through vertical integration or importation of alternative products in a timely or cost-effective manner; and
- 183.5 given the time and cost it takes to register new treatment products, and the low level of demand for treatment products, customers are unlikely to have an ability (or willingness) to sponsor entry.

Coordinated effects in the external parasite treatment market

184. We are satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition through coordinated effects in the external parasite treatment market.
185. There are some factors that could make the market vulnerable to coordination. Further, the Proposed Acquisition will increase concentration in a market that is already highly concentrated. This may increase the likelihood of coordination post-acquisition.
186. However, the Proposed Acquisition would not change conditions in the market so that coordination is more likely, more complete or sustainable. There is a lack of price transparency in the market and this would not be affected by the Proposed Acquisition. The lack of market transparency means that it would be hard for the remaining firms to reach a focal point for coordination.
187. Further, the Proposed Acquisition would increase asymmetry in market share in the external parasite treatment market. This means that the merged entity would have a greater incentive to exercise unilateral market power, rather than coordinated market power with its smaller remaining rival. There is also no evidence to suggest that the Proposed Acquisition would result in greater symmetries of the cost structures of the remaining suppliers in the external parasite treatment market.

Conclusion on the external parasite treatment market

188. The Proposed Acquisition would combine two of three existing suppliers in the external parasite treatment market. While we are satisfied that the market is not at increased risk of coordination post acquisition, we cannot be satisfied that the

Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the external parasite treatment market due to unilateral effects.

188.1 Elanco and Bayer are currently close competitors in the supply of external parasite treatment products and this competition would be lost as a result of the Proposed Acquisition.

188.2 The remaining constraint from Boehringer Ingelheim is insufficient to constrain the merged entity.

188.3 Post-acquisition, entry and expansion is unlikely to be sufficient in extent and/or timely enough to constrain the merged entity.

188.4 Customers are unlikely to have sufficient countervailing power to constrain the merged entity.

Conclusion on the competition assessment – all relevant markets

189. In the otitis treatment market, Bayer is in the process of introducing a new product and this product would compete closely with one of Elanco's products. We consider that the Proposed Acquisition is likely to have the effect of substantially lessening competition as it would remove the significant competitive constraint that Bayer would exert on Elanco.

190. In the external parasite prevention market, we cannot be satisfied that the Proposed Acquisition would not result in a substantial lessening of competition. This is primarily because Elanco and Bayer are currently significant competitors to each other, the merged entity would have a high market share, entry and expansion is unlikely to provide sufficient constraint on the merged entity and customers are unlikely to have any countervailing power.

191. In the external parasite treatment market, we consider the Proposed Acquisition is likely to have the effect of substantially lessening competition as it would reduce the number of existing suppliers from three to two, and existing and potential competition would not be likely to constrain the merged entity.

192. Accordingly, we are not satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any relevant market.

The proposed divestment

193. In order to allay the Commission's competition concerns with the Proposed Acquisition, Elanco provided the Commission with a divestment undertaking under section 69A of the Act (the Divestment Undertaking).¹⁰¹

¹⁰¹ See Attachment: Elanco's Divestment Undertaking.

194. In the Divestment Undertaking, Elanco would divest the assets, and rights, associated with three products to a buyer (or buyers) approved by the Commission. These assets are:

194.1 the Parasiticide Divestment Assets,¹⁰² which includes the brands Maggo and Zapp Encore; and

194.2 the Otitis Divestment Assets,¹⁰³ which includes the brand Osumnia.

195. Elanco proposed that the Parasiticide Divestment Assets and the Otitis Divestment Assets (together, the Divestment Assets) include all intellectual property rights, product technology information, customer records, relevant contractual rights and ACVM product registrations to enable a purchaser to effectively compete in the relevant markets.¹⁰⁴

Our approach to considering the Divestment Undertaking

196. In considering whether the Divestment Undertaking will be sufficient to restore competition to the relevant market post acquisition, we have had regard to our guidelines¹⁰⁵ as well as international best practice as set out in the International Competition Network Merger Remedies Guide 2016.¹⁰⁶

197. In making this assessment, we consider the relevant risks associated with divestment proposals. These risks arise because a divestment will occur in the future. Therefore, there will always be some uncertainty about a divestment's likely impact on competition in the relevant market. It follows that there will also be some uncertainty whether a divestment will actually remedy the competition concerns raised by the merger.

198. In order to assess these divestment risks, we compare the competitive situations with and without the divestment undertaking. We assess whether the divestment would, of itself, or in combination with other market conditions, likely remedy the competition concerns that have been identified.

199. In this case, the substantial lessening of competition that the Divestment Undertaking is intended to remedy is the loss of the constraint between Elanco and Bayer in:

199.1 the otitis treatment market (via the divestment of the Otitis Divestment Assets); and

199.2 both the external parasite treatment market and the external parasite prevention market (via the divestment of the Parasiticide Divestment Assets).

¹⁰² The Divestment Undertaking at [2.1].

¹⁰³ The Divestment Undertaking at [2.1].

¹⁰⁴ Letter from Elanco to the Commerce Commission about remedies (24 April 2020).

¹⁰⁵ *Mergers and Acquisitions Guidelines* above n1 at Attachment F.

¹⁰⁶ <http://www.internationalcompetitionnetwork.org/uploads/library/doc1082.pdf>.

200. The Divestment Undertaking seeks to restore competition by Elanco selling the Maggo (treatment) and Zapp Encore (prevention) products currently owned by Bayer, and the Osumnia (Otitis) product currently owned by Elanco, to an independent third party (or parties) to enable the new owner/s to effectively compete against the merged entity in each relevant market.
201. For the reasons set out below, we consider that the Divestment Undertaking would result in sufficient additional competitive constraint on the merged firm so as to remedy the substantial lessening of competition in any relevant market. In coming to this view, we consider that the risks associated with the divestment proposal are low.
202. To consider whether the Divestment Undertaking restores competition sufficiently, we assessed the proposed divestment in relation to three types of risks.
- 202.1 **Composition risk** – the risk that the scope of a divestment undertaking may be too constrained, or not appropriately configured, to attract a suitable purchaser, or that the contents of a divestment would not sufficiently restore competition.
- 202.2 **Asset risk** – the risk that the competitive effectiveness of a divestment package will deteriorate prior to completion of the divestment.
- 202.3 **Purchaser risk** – the risk that there may not be a purchaser acceptable to the Commission available and/or the risk that the applicant has an incentive to sell to a weak competitor.

Composition risk

203. We consider there are low composition risks with the Divestment Undertaking as the divestment is appropriately configured to allow a potential purchaser to operate as an effective competitor in the relevant markets.
204. In our assessment of the composition risks we considered:
- 204.1 the adequacy of the divestment package, taking into account the competition concerns identified in our competition analysis, and whether the proposed divestment is sufficient to remedy those concerns;
- 204.2 the structure of the proposed divestment, including whether intellectual property rights can be transferred outright or licensed to an approved purchaser;
- 204.3 the ability of the approved purchaser to obtain adequate supply of the APIs necessary to manufacture the products; and
- 204.4 the ability of the approved purchaser to access adequate manufacturing capability.

The adequacy of the divestment package

205. As a starting point, the divestment package offered by Elanco does not comprise the entirety of the overlap between Elanco and Bayer in the relevant markets. For example, while the divestment of Maggo would mean there would be no overlap in the external parasite treatment market, the Parasiticide Divestment Assets do not include all of Bayer's existing products in the external parasite prevention market.¹⁰⁷
206. In relation to the Parasiticide Divestment Assets, Elanco submitted that the divestment would remove the majority of the overlap between Elanco and Bayer in any relevant market for the supply of products for the treatment and/or prevention of external parasites on sheep. In its view, the Parasiticide Divestment Assets would allow a potential new entrant to provide an effective constraint on the merged entity or strengthen the existing constraint imposed by an existing smaller competitor.¹⁰⁸
207. In relation to the otitis treatment market, Elanco submitted that the divestment of the Otitis Divestment Assets would remove a close competitor to Bayer's pipeline product (Neptra) by divesting Osurmia to an approved purchaser. Elanco submitted that the remaining product sold by Elanco in this market (Surolan) is not a close competitor to Neptra (and by extension Osurmia) and therefore would provide limited competitive constraint.¹⁰⁹
208. We consider that the divestment package would be likely to effectively restore competition to the likely without-the-acquisition level of competition in relation to the otitis treatment and the external parasite treatment markets, as both Osurmia and Maggo would continue to be owned by a party independent of the merged entity.
209. In relation to the external parasite prevention market, the proposed divestment package would result in Zapp Encore being owned by a party independent of the merged entity.¹¹⁰ Zapp Encore is a branded prevention product with an established reputation. We consider that the divestment of Zapp Encore would result in Bayer and Elanco's branded ectoparasite prevention products being owned by independent parties and continuing to provide material competitive constraint on each other, so as to remedy the likely substantial lessening of competition in the external parasite prevention market.

Structure of the divestment package

210. We consider that the obligations set out in the Divestment Undertaking provide sufficient safeguards to ensure that the successful purchaser would have access to the key inputs, and the required intellectual property such that the successful

¹⁰⁷ Elanco would be acquiring Bayer's Seraphos product.

¹⁰⁸ Submission from Elanco to the Commerce Commission (21 May 2020) at 3.1 (b)-(e).

¹⁰⁹ Submission from Elanco to the Commerce Commission (21 May 2020) at 3.1(g)-(h).

¹¹⁰ As noted above, the divestment would not restore competition to the counterfactual level as Elanco will acquire Seraphos from Bayer, which has an existing market share of []

purchaser would be able to supply the divested products in competition with the merged entity.

211. Elanco submitted that the Divestment Undertaking includes:

211.1 all of the key assets required to supply Osurnia, Zapp Encore and Maggo;

211.2 all of the relevant supply contracts, intellectual property and other information necessary to enable a purchaser to operate a successful and highly competitive supply operation for the products in New Zealand.¹¹¹

212. The main composition risks that we identified were whether the divestment package gives the proposed purchaser the intellectual property rights needed to market and supply the products, and whether the proposed purchaser would be able to access the APIs needed to manufacture the products.

Transfer of intellectual property rights

213. The Divestment Undertaking requires Elanco to divest all the intellectual property rights relating to Maggo, Zapp Encore and Osurnia.

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¹¹¹ Submission from Elanco to the Commerce Commission (21 May 2020) at 4.

¹¹² [

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Access to APIs

217. The manufacture of the Osurnia, Maggo and Zapp Encore products requires access to the relevant APIs, which are the key raw ingredients that form the basis of each product. However, there appears to be limited risk to the ability of a potential purchaser to source the necessary APIs.
218. For Osurina, the relevant APIs are florfenicol and terbinafine. For Zapp Encore, the relevant APIs are imidacloprid and triflumuron. Elanco submitted that all these APIs are off-patent and can be widely sourced from numerous manufacturers. For example, the APIs required to manufacture Zapp Encore are readily available and are both currently used as APIs in several other products sold in New Zealand.
219. For Maggo, the relevant API is propetamphos.
[
¹¹³]As such, a purchaser of the Maggo Assets would need to secure access to this API in order to continue to supply the product.
220. Under the Divestment Undertaking, Elanco is required to use all reasonable endeavours
[
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221. [
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Maggo and Zapp Encore – access to contract manufacturers

222. Once a supplier has the necessary APIs, they still need to be able to manufacture and package each product to the required specifications and formulations. However, there appear to be limited risks in a potential purchaser finding a suitable manufacturer, if the purchaser did not already have the necessary facilities.
223. For Osurnia, the necessary manufacturing facilities are included in the Otitis Divestment Assets.
224. For both Zapp Encore and Maggo,
[
] In this respect, any potential purchaser would also need to be able to manufacture each product or find a contract manufacturer.

¹¹³ []

¹¹⁴ For example, Elanco would continue to supply Bayer's Seraphos post acquisition, which requires a supply of propetamphos.

225. If a potential purchaser did not have the necessary skills or expertise to manufacture either Maggo and/or Zapp Encore themselves, there are a number of independent contract manufacturers in New Zealand which hold the required manufacturing approvals under the ACVM, that would be able to undertake the manufacture each product on behalf of a potential purchaser.

[]¹¹⁵

Conclusion on composition risk

226. Overall, we consider that the proposed divestment presents an acceptable level of composition risk. The divestment package contains (or provides for the transfer of) all of the intellectual property, contracts and consents necessary for a purchaser to compete strongly in the relevant markets, and as such are likely to be attractive to a potential purchaser (as evidenced by the interest shown to date).¹¹⁶

Asset risk

227. We consider there is a low asset risk with the Divestment Undertaking as the undertaking contains sufficient arrangements to ensure the relevant assets would not deteriorate during the divestment periods.
228. Asset risks are risks that the competitive capability of a divestment package will deteriorate prior to the completion of the divestment. In assessing whether there is an acceptable level of asset risk with the Divestment Undertaking, we have considered:
- 228.1 how confidential information will be protected during the divestment process; and
- 228.2 the measures in place to ensure the ongoing competitiveness of the divestment assets during the divestment process.
229. Under the Divestment Undertaking:
- 229.1 Elanco undertakes to preserve the economic viability, marketability and competitiveness of the Divestment Business, including preserving its reputation and goodwill;
- 229.2 until closing, a Divestment Manager will manage the Divestment Assets independently to ensure their continued marketability and competitiveness and report on this to the Commission on a monthly basis;

¹¹⁵ Commerce Commission interview with [] (10 June 2020).

¹¹⁶ A number of potential purchasers of the divestment assets have been identified and have expressed interest in some or all of the divestment assets. This is discussed further in the purchaser risk section below.

229.3 Elanco will divest the Divestment Assets within [] months of acquiring the Bayer business;¹¹⁷ and

229.4 if the Divestment Assets are not sold at the end of the [] period, the Divestment Manager will be obligated to effect the sale of the Divestment Assets [].

230. The Divestment Undertaking provides that the Divestment Assets be held-separate from the merged entity and that they are appropriately ring-fenced so that neither Elanco nor its personnel have access to any information of a proprietary or confidential nature relating to the Divestment Assets. Specifically:

230.1 any information relating to the performance of the Divestment Assets will be reviewed by the Divestment Manager to ensure any confidential information is removed; and

230.2 those Elanco employees who require access to sensitive information for the purposes prescribed in the Undertaking (progressing the divestment, reporting to the Commission, and complying with legal or regulatory obligations) will be required to sign non-disclosure agreements.

231. In addition, Elanco’s and Bayer’s existing distribution arrangements are likely to reduce the risk that the Divestment Assets would deteriorate during the divestment periods.

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231.2 [

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¹¹⁷ []

¹¹⁸ []

¹¹⁹ Submission from Elanco to the Commerce Commission (19 June 2020) at [2.3].

Conduct of the sales process

232. We consider that there is limited and acceptable risk of asset deterioration during the divestment periods as there are a number of safeguards in place to ensure that any confidential information is protected during the sale process.

233. Elanco submitted that:¹²⁰

233.1 [

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234. We consider the Divestment Manager and the hold separate arrangements in the Divestment Undertaking would likely mitigate the risk that the competitiveness of the divested business would deteriorate during the divestment process.

[

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235. We consider that the obligations in the Divestment Undertaking provide acceptable protection of confidential information

[

] We also note that the reporting requirements give the Commission full visibility over the progress of the divestment and the ongoing performance of the Divestment Assets.

Purchaser risk

236. While there is no upfront buyer for the Parasiticide Divestment Assets, we have identified a number of potential purchasers and we consider that the Divestment Undertaking presents a low level of purchaser risk. We note that a potential purchaser for the Otitis Divestment Assets has been identified.¹²¹

237. Typically, we consider the main purchaser risks to be that:

237.1 a purchaser acceptable to us may not be available; and/or

¹²⁰ Submission from Elanco to the Commerce Commission (19 June 2020) at [3.1].

¹²¹ Commerce Commission Media release Dechra granted clearance to acquire Osurnia from Elanco (27 May 2020).

- 237.2 the Applicant has an incentive to sell to a weak competitor for a low price rather than to a strong competitor.
238. In some cases, there may be little or no interest from potential purchasers. This might indicate that the assets are unattractive to potential purchasers which may cast doubt on the effectiveness of the undertaking.
239. An acceptable purchaser needs to have certain attributes that enable it to be an effective competitor in the relevant market. Examples of attributes that may make a purchaser acceptable are set out below.
- 239.1 It is independent of the merged entity.
- 239.2 It possesses or has access to the necessary expertise, experience and resources to be an effective long-term competitor in the market.
- 239.3 The acquisition of the divested shares or assets by the proposed buyer does not raise competition concerns.
- 239.4 The purchase of the assets by the proposed purchaser will not lead to undue delay in the implementation of the proposed divestment.
240. Under the Divestment Undertaking, we would be required to approve the purchaser and any transitional arrangements or other contracts entered into between the approved purchaser and Elanco. This would allow us to ensure that the purchaser meets the requirements set out above.
241. We have assessed whether a suitable purchaser for the Divestment Assets is likely to exist, and whether a purchaser is likely to be sufficiently independent of Elanco.
242. In relation to the Otitis Divestment Assets, we granted clearance on 26 May 2020 for Dechra to acquire the assets, rights and liabilities relating to Osumnia. Should the Dechra matter not be completed prior to completion of the Proposed Acquisition, the same obligations apply to the Otitis Divestment Assets in terms of the Commission approving of any purchaser.

Likelihood of a suitable purchaser for the Parasiticide Divestment Assets

243. We consider that the Divestment Undertaking presents a low level of purchaser risk in relation to the Parasiticide Divestment Assets. While there is no upfront buyer for the Parasiticide Divestment Assets, we have identified a number of potential purchasers of Maggo and/or Zapp Encore that are likely to be suitably experienced and therefore have the ability to restore competition in the external parasite treatment market and the external parasite prevention market.

243.1 []¹²²

243.2 []¹²³

243.3 []¹²⁴

243.4 []¹²⁵

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Independence of the purchaser

244. An approved purchaser is likely to be partly reliant on Elanco for the supply of the APIs for both Zapp Encore and Maggo, and for the manufacture of the Zapp Encore product. We have therefore considered whether the lack of independence for the approved purchaser creates a purchaser risk such that the Divestment Undertaking is unlikely to remedy our competition concerns.

Zapp Encore – manufacturing

245. Elanco submits that there are multiple third party manufacturers in New Zealand who would be able to manufacture the Zapp Encore product and that if needed, Elanco is prepared to enter into a transitional services agreement with the Approved Purchaser while the purchaser makes alternative arrangements for the manufacture

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¹²⁴ []

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¹²⁶ []

[]

¹²⁷ []

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of the product. The transitional services agreements (if required) would be subject to approval by the Commission.

246. We consider that the potential links between Elanco and the approved purchaser are unlikely to undermine the effectiveness of the Divestment Undertaking, as:

246.1 the supply and manufacturing agreements (if necessary) would prevent Elanco from undermining the independence of the approved purchaser by ensuring it gets a supply of the relevant products on competitive terms; and

246.2 the potential purchaser(s) of the divestment assets are likely to be able to access both alternative manufacturing arrangements, and the relevant APIs from independent parties.

247. As such, we do not consider that there are significant purchaser risks arising from the potential link to Elanco caused by the supply agreement.

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Conclusion on Purchaser Risk

250. We consider that a purchaser acceptable to the Commission is likely to be available.
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251. While there is a proposed buyer for the Otitis Divestment Assets, we do not have an up-front purchaser for the Parasiticide Divestment Assets. This does add some measure of purchaser risk as a suitable purchaser of the Parasiticide Divestment Assets may not be available.

252. However, we consider that this purchaser risk would be mitigated through the purchaser approval process outlined in the Divestment Undertaking which places the onus on Elanco to demonstrate to the Commission that the proposed purchaser has

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the financial resources, proven expertise and incentive to operate and develop the Divestment Assets as a viable and active competitor.

Conclusion on the Divestment Undertaking

253. We consider that the Divestment Undertaking offered by Elanco would result in sufficient additional competitive constraint on the merged firm so that the likely substantial lessening of competition in the relevant markets would be remedied.
254. We also consider that the Divestment Undertaking does not present a significant level of asset or composition risk. In our view there are sufficient safeguards in place to ensure that the assets will not deteriorate prior to divestment and that the makeup of the divestiture assets, including the relevant intellectual property rights, and access to the APIs, is such that the purchaser is likely to be able to offer meaningful competition to the merged entity.
255. Further, we consider that the Divestment Undertaking presents a low level of purchaser risk. While there is an upfront buyer for the Otitis Divestment Assets, there is no upfront buyer for the Parasiticide Divestment Assets. However, we have identified a number of potential purchasers for the Parasiticide Assets that are likely to be suitably experienced and be in a position to remedy the competitive harm from the Proposed Acquisition in the relevant markets.

Overall conclusion

256. For the purposes of assessing the Proposed Acquisition, we consider the relevant markets to be the national market for the manufacture/importation and wholesale supply of products for:
- 256.1 the treatment for otitis in dogs;
- 256.2 the prevention of external parasites on sheep; and
- 256.3 the treatment of external parasites on sheep.
257. In the otitis treatment market, Bayer is in the process of introducing a new product and this product would compete closely with one of Elanco's products. We consider that the Proposed Acquisition is likely to have the effect of substantially lessening competition as it would remove the significant competitive constraint that Bayer would exert on Elanco.
258. In the external parasite prevention market, we cannot be satisfied that the Proposed Acquisition would not result in a substantial lessening of competition. This is primarily because Elanco and Bayer are currently significant competitors to each other, the merged entity would have a high market share, entry and expansion is unlikely to provide sufficient constraint on the merged entity and customers are unlikely to have any countervailing power.
259. In the external parasite treatment market, we consider that the Proposed Acquisition is likely to have the effect of substantially lessening competition as it

would reduce the number of existing suppliers from three to two, and existing and potential competition would not be likely to constrain the merged entity.

260. Accordingly, in the three relevant markets we identified, we are not satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition.
261. To address the Commission's concerns in the three relevant markets, Elanco offered to divest the necessary assets and licenses for one product brand in each market (Osurnia, Zapp Encore and Maggo). The Divestment Undertaking offered by Elanco would result in sufficient additional competitive constraint on the merged firm so that the likely substantial lessening of competition in the relevant markets would be remedied.
262. Accordingly, while we cannot be satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any relevant market, we consider that the divestments offered in the Divestment Undertaking are likely to be sufficient to remedy any competitive harm in the relevant markets. Accordingly, the Commission determines to give clearance to Elanco to acquire Bayer, subject to the Divestment Undertaking.

Determination on notice of clearance

263. Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to Elanco Animal Health Inc. to acquire up to 100% of the shares of four entities that currently comprise Bayer AG's animal health business namely: Bayer Animal Health GmbH, KVP Pharma+Veterinär Produkte GmbH, Bayer (Sichuan) Animal Health Co., Limited, and Bayer HealthCare Animal Health Inc. and the business assets that form Bayer AG's animal health business, subject to the Divestment Undertaking dated 8 July 2020 provided by Elanco Animal Health Inc. under section 69A of the Commerce Act 1986.

Dated this 9th day of July 2020

Sue Begg
Division Chair

Attachment: Elanco's divestment undertaking

Deed

relating to

the divestment of

the following products in New Zealand:

“Maggo”, ACVM registration number A005679

“Zapp Encore”, ACVM registration number A010400

“Osumnia”, ACVM registration number A011416

(the **Products**)

Given by Elanco Animal Health Inc.

in favour of the Commerce Commission

Date

8 July 2020

This **Deed** is made on 8 July 2020

and is given by **Elanco Animal Health Inc. (Elanco)**

in favour of **the Commerce Commission (the Commission)**

If accepted, this Deed forms part of the Commission's clearance to the Proposed Transaction under section 66(3)(a) of the Commerce Act 1986.

Introduction

- A. Elanco has applied to the Commission for clearance of the Proposed Transaction pursuant to section 66 of the Commerce Act 1986.
- B. As at the date of this Deed, the Commission is not satisfied that the Proposed Transaction will not be likely to substantially lessen competition in a New Zealand market and has not given clearance to the Proposed Transaction.
- C. In order to obtain clearance from the Commission Elanco undertakes to carry out Divestments of the Zapp Encore Divestment Assets, Maggo Divestment Assets and Otitis Divestment Assets.
- D. Elanco has entered into the Dechra Agreement, pursuant to which the Otitis Divestment Assets will be divested to Dechra. If the Dechra Agreement completes before completion of the Proposed Transaction, the obligations under this Deed will not apply to the Otitis Divestment Assets. If the Dechra Agreement completes after completion of the Proposed Transaction, Dechra is deemed to be an Approved Purchaser.

It is agreed

1. DEFINITIONS AND RELATED MATTERS

1.1 In this Deed:

- (a) **Approved Purchaser** means a purchaser of Divestment Assets approved by the Commission pursuant to clause 8.
- (b) **BAH** means all of the shares in the four relevant BAH entities (Bayer Animal Health GmbH, KVP Pharma+Veterinär Produkte GmbH, Bayer (Sichuan) Animal Health Co., Ltd. and Bayer HealthCare Animal Health Inc.) and the business assets that form the Animal Health business of Bayer.
- (c) **Bayer** means Bayer AG.
- (d) **Business Day** means a day when most businesses are open for business in New Zealand. It excludes Saturday, Sunday, and public holidays. A Business Day starts at 8:30am and ends at 5pm.
- (e) **Dechra Agreement** means the asset purchase agreement entered into between Elanco and Dechra on 3 January 2020 whereby Elanco has agreed to divest certain assets, including the Otitis Divestment Assets, to Dechra (via its wholly owned subsidiaries Dechra Limited and Dechra Veterinary Products LLC).
- (f) **Dechra** means Dechra Pharmaceuticals PLC.

- (g) **Divestment** means the divestment of the Zapp Encore Divestment Assets, Maggo Divestment Assets and the Otitis Divestment Assets during the Divestment Period or Second Divestment Period, in accordance with this Deed.
- (h) **Divestment Assets** means the Zapp Encore Divestment Assets, Maggo Divestment Assets and the Otitis Divestment Assets.
- (i) **Divestment Manager** means a person approved by the Commission and appointed pursuant to clause 6.1.
- (j) **Divestment Period** starts on completion of the Proposed Transaction and ends at [] on the date which is [] after the date on which completion of the Proposed Transaction occurs and **Second Divestment Period** means the period commencing at the end of the Divestment Period and ending at [] on the date which is [] from the end of the Divestment Period.
- (k) **Divestment Undertakings** means clause 2.1.
- (l) **Maggo Divestment Assets** means the assets described in Schedule 2 to this Deed which relate to Maggo;
- (m) **Material Issue** means an issue which a Divestment Manager, acting reasonably, believes may impact the profitability of a Divestment Asset by more than [] from forecast, or where a Divestment Manager concludes, acting reasonably, that Elanco is failing to materially comply with this Deed.
- (n) **Otitis Divestment Assets** means the assets described in Schedule 1 to this Deed.
- (o) **Proposed Transaction** means the proposed acquisition by Elanco Animal Health Inc. of BAH.
- (p) **Ring-fenced Information** means confidential documents and information relating to the Divestment Assets, including on:
 - (i) product strategy and development;
 - (ii) pricing data, including current, historic and future pricing, pricing changes, and margin;
 - (iii) customer contracts and data;
 - (iv) supply agreements; and
 - (v) all commercially sensitive information relating to the Divestment Assets.
- (q) **Zapp Encore Divestment Assets** means the assets described in Schedule 2 to this Deed which relate to Zapp Encore.

1.2 References to dates and time in this Deed are references to New Zealand Standard Time or Daylight Savings Time as applicable.

1.3 This Deed will be governed by, and construed in accordance with, the laws of New Zealand.

1.4 Any notice or communication that is given or served under or in connection with this Deed must be given in writing in the following manner:

- (a) if **addressed** to the Commission, by hand delivery or email to the following address:

- (c) maintain the provision of goods and services in a manner consistent with the provision of goods and services as at the date of this Deed.

5.2 During the Divestment Period and, if applicable, the Second Divestment Period, neither Elanco nor its affiliates will:

- (a) carry out any act upon its own authority that might have a significant adverse impact on the value or competitiveness of the Zapp Encore Divestment Assets, Maggo Divestment Assets or the Otitis Divestment Assets or that might alter the nature and scope of activity, or the industrial or commercial strategy in relation to the Zapp Encore Divestment Assets, Maggo Divestment Assets or the Otitis Divestment Assets; or
- (b) sell or transfer any of the Divestment Assets to any person other than an Approved Purchaser in accordance with this Deed.

6. HOLD SEPARATE OBLIGATIONS

6.1 Elanco will appoint one or more Divestment Managers who will during the Divestment Period and, if applicable, the Second Divestment Period, manage the Divestment Assets in such a way that preserves the economic viability, marketability, competitiveness and goodwill of the Divestment Assets for which it is responsible separately from the business operated by Elanco as at the date this Deed comes into effect.

6.2 The day-to-day management of the Divestment Assets is the responsibility of the relevant Divestment Manager during the Divestment Period (and, if applicable, the Second Divestment Period). To the extent required to discharge any legal reporting obligations, the Divestment Manager will report to [] In the event of a Material Issue arising each Divestment Manager reports directly to [](if strictly necessary) and to the Commerce Commission. Should Elanco receive any information through the reporting process, the information will be subject to clause 7 (Ring-fencing obligations) below.

6.3 Each Divestment Manager's terms of engagement will provide that it is required to use all reasonable endeavours to maximise the value and viability of the Divestment Assets on a standalone basis.

7. RING-FENCING

7.1 Elanco shall implement all necessary measures to ensure that, to the extent possible during the Divestment Period (and, if applicable, the Second Divestment Period) neither it nor its officers, employees, contractors, agents or advisers obtain any Ring-fenced Information relating to the Divestment Assets otherwise than as provided for by clause 6 or 7.2 or where such disclosure is strictly necessary for one or more of the purposes of:

- (a) progressing the Divestment (including relating to maintaining the viability of the Divestment Assets and the provision of any services in relation to the Divestment Assets on a transitional basis);
- (b) reporting to the Commission pursuant to clause 6.2; and

- (c) complying with legal, reporting and regulatory obligations (including obligations relating to taxation, accounting, financial reporting or stock exchange disclosure requirements) or to progress any legal dispute,

and provided such information is disclosed only to those officers, employees, contractors, agents or advisers who have signed a confidentiality undertaking and need to know the information in order to carry out the purposes listed at clause 7.1(a)-(c), above.

- 7.2 Elanco shall ensure that any employees with access to systems containing Ring-fenced Information have signed a confidentiality undertaking prohibiting the use of Ring-fenced Information, except for the purposes set out in clauses 7.1(a)-(c) above.
- 7.3 The Parties acknowledge that, on the date the Divestment Undertakings come into effect, Elanco may provide services to an Approved Purchaser in relation to the Divestment Assets, on a transitional basis.
- 7.4 If, after the date the Divestment Undertakings come into effect any employee of Elanco (or, for the avoidance of doubt, any of its affiliates) receives Ring-fenced Information in relation to the Divestment Assets and such employee is not already subject to a confidentiality undertaking, Elanco will ensure that such employees enter into a confidentiality undertaking, prohibiting the access or use of such information except for the purposes set out in clauses 7.1(a)-(c) above.
- 7.5 For the purposes of this clause 7, references to Elanco officers, employees, contractors, agents or advisers excludes those employed or engaged by Bayer immediately prior to the Divestment Period.

8. PURCHASER APPROVAL

- 8.1 As soon as practicable and no later than []before the anticipated completion of the Divestment, Elanco will notify the Commission in writing of the identity of the proposed purchaser (or where negotiations are ongoing with more than one potential purchaser, the potential purchasers) of the Divestment Assets.
- 8.2 Elanco must satisfy the Commission that the Divestment will be carried out in a manner consistent with the Deed and that any proposed purchaser of the Divestment Assets:
 - (a) is not associated with, or an interconnected body corporate of, Elanco or any of its affiliates (including, for the avoidance of doubt, any BAH entity which transfers to Elanco as part of the Proposed Transaction);
 - (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 relevant Divestment Assets.
- 8.3 The Commission shall have the discretion to approve or reject in writing any purchaser proposed by Elanco or the Divestment Agent.

- 8.4 The Commission's approval of any purchaser proposed by Elanco or the Divestment Agent shall also be contingent on:
- (a) Elanco or the Divestment Agent, as appropriate, providing all transaction documentation (including any sales and purchase, transitional and other ancillary agreements) to the Commission at least 10 days before the Divestment is expected to complete); and
 - (b) the Commission's approval in writing of that transaction documentation.
- 8.5 With the exception of the Dechra Agreement, Elanco will ensure that final binding agreements in relation to the Zapp Encore Divestment Assets, Maggo Divestment Assets and the Otitis Divestment Assets provide that settlement of the Divestment is conditional on obtaining the Commission's approval of the proposed purchaser based on the criteria set out in clauses 8.2 and 8.4.

9. MONITORING COMPLIANCE WITH THIS DEED

- 9.1 During the Divestment Period (and, if applicable the Second Divestment Period) Elanco will provide:
- (a) monthly reports to the Commission detailing Elanco's progress towards carrying out the Divestment; and
 - (b) at the Commission's request, any other information and documents reasonably required, that demonstrate that Elanco's conduct complies with the Divestment Undertakings.
- 9.2 If requested, Elanco will attend a meeting with the Commission at a time and place appointed by the Commission to answer any questions the Commission may have (including by telephone or video conference if more convenient).
- 9.3 Without limiting clause 9.1, Elanco will provide to the Commission:
- (a) for approval by the Commission, the name of each Divestment Manager, and the terms of engagement between Elanco and each Divestment Manager at least 5 Business Days prior to the commencement of the Divestment Period;
 - (b) a copy of any information memorandum provided to potential purchasers relating to the Divestment Assets;
 - (c) notification of the completion of the Divestment, within 2 Business Days of its completion.
- 9.4 Nothing in this Deed requires Elanco to provide legally privileged information or documents to the Commission or any other party.
- 9.5 During the Divestment Period (and, if applicable the Second Divestment Period) Elanco will procure that each Divestment Manager:
- (a) provides monthly reports to the Commission detailing the performance of the Divestment Assets, so the Commission can assess whether the Divestment Assets are being held in a manner consistent with this Deed; and
 - (b) at the Commission's request and within any time period specified by the Commission, give the Commission any further documents or information it requires:
 - (i) about the Divestment and Elanco's progress towards carrying out the Divestment; and
 - (ii) demonstrating Elanco's compliance with the Deed.

10. EXECUTION

Executed as a deed

Elanco Animal Health Inc.

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SCHEDULE 1 – Otitis Divestment Assets

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SCHEDULE 2 – Parasiticide Divestment Assets

- A. All of Elanco's intellectual property rights (registered and unregistered) owned or controlled by Elanco and exclusively related to the Maggo brand in New Zealand, and all of Elanco's associated intellectual property rights (to the extent exclusively related to the Maggo product).
- B. All of Elanco's intellectual property rights (registered and unregistered) owned or controlled by Elanco and exclusively related to Zapp Encore in New Zealand, including the Zapp registered trademark and the Encore registered trademark, and all of Elanco's associated intellectual property rights (to the extent exclusively related to the Zapp Encore product).
- C. Elanco will procure transfer of the ACVM registrations for Maggo (number A005679) and Zapp Encore (number A010400), along with any product license, permit, authorisation, certificate, or registration (except any manufacturing establishment registration) issued by or obtained from a governmental authority or entity that is necessary for the manufacturing, import, export, distribution, use, promotion or sale of the Maggo product or the Zapp Encore product (as applicable) in New Zealand and/or the active ingredients used in the manufacture of the Maggo product or the Zapp Encore product (as applicable), provided that Elanco will be entitled to retain any of the aforementioned for such time as is required for it to fulfil its obligations under any Transitional Services Agreement.
- D. For both Maggo and Zapp Encore products, Elanco will procure transfer of all finished goods, raw materials, intermediates, active ingredients, packaging materials, work-in-progress and other inventories that are exclusively related to the Maggo product or the Zapp Encore product in New Zealand, provided that Elanco will be entitled to retain any of the aforementioned for such time as is required for it to fulfil its obligations under any Transitional Services Agreement.
- E. For both Maggo and Zapp Encore products, Elanco will procure transfer of all rights in or to trade secrets, confidential information and know-how (including formulae, recipes and processes), and all data of any and all types and all databases, compilations and collections of data that are owned by Elanco and exclusively related to Maggo or Zapp Encore in New Zealand.
- F. For both Maggo and Zapp Encore products, if required by an Approved Purchaser, Elanco will procure transfer of any contract to which Elanco is a party (or to which Bayer was a party and that has been assigned to Elanco by Bayer) and which is exclusively related to Maggo or Zapp Encore (as applicable) in New Zealand, including contracts with customers, distributors and manufacturers.
- G. If required by an Approved Purchaser, Elanco will enter into a contract for the supply of propetamphos consistent with the terms set out in the Transitional API Supply Agreement Term Sheet.
- H. If required by an Approved Purchaser, Elanco will enter into a contract for the supply of Zapp Encore consistent with the terms set out in the Transitional Manufacturing and Supply Agreement Term Sheet.

SCHEDULE 3 – Transitional API Supply Agreement Term Sheet

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SCHEDULE 4 – Transitional Manufacturing and Supply Agreement Term Sheet

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