

## Statement of Preliminary Issues

### Elanco / Bayer Animal Health

20 February 2020

#### Introduction

1. On 14 February 2020, the Commerce Commission registered an application from Elanco Animal Health Inc. (Elanco or the Applicant) seeking clearance to acquire Bayer AG's animal health business (Bayer Animal Health)<sup>1</sup> (the Proposed Acquisition).<sup>2</sup>
2. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.<sup>3</sup>
4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that submissions are received by close of business on **5 March 2020**.

#### The parties

5. Elanco is a US-based global animal healthcare company 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, cattle and other ruminants).
6. Bayer Animal Health also develops, manufactures and distributes healthcare treatments for a range of different companion and production animals on a global basis.

#### Our framework

7. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.<sup>4</sup> As

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<sup>1</sup> Specifically, Elanco is seeking to acquire up to 100% of the shares of four entities that comprise Bayer Animal Health (namely: 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 Bayer Animal Health.

<sup>2</sup> A public version of the Applicant's clearance application is available on our website at: <https://comcom.govt.nz/case-register/case-register-entries/elanco-animal-health-inc-bayer-ags-animal-health-business>

<sup>3</sup> The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

required by the Commerce Act 1986 (the Act), we assess mergers and acquisitions using the substantial lessening of competition test.

8. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).<sup>5</sup> This allows us to assess the degree by which the Proposed Acquisition might lessen competition.
9. If the lessening of competition as a result of the Proposed Acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:
  - 9.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if the merged firm’s prices increased;
  - 9.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
  - 9.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.

## Preliminary issues

### Market definition

10. Market definition is a tool that provides a framework to help identify and assess the close competitive constraints the merged firm would likely face. We define markets in the way that we consider best isolates the key competition issues that arise from the proposed acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.<sup>6</sup>
11. In New Zealand, Elanco and Bayer Animal Health overlap in the supply of different products for the treatment of companion and production animals. Elanco has identified a number of treatment areas where there would be either existing or potential overlap between Elanco and Bayer Animal Health in New Zealand. These areas are treatments for:
  - 11.1 internal and external parasites in companion animals;
  - 11.2 otitis in dogs;

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<sup>4</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. Available on our website at [www.comcom.govt.nz](http://www.comcom.govt.nz)

<sup>5</sup> *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

<sup>6</sup> Section 3(1A) of the Act. See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

- 11.3 internal and external parasites in sheep;
  - 11.4 liver fluke in cattle;
  - 11.5 coccidial conditions in poultry; and
  - 11.6 microbial conditions in ruminant animals (such as sheep, cattle, deer and goats).
12. While we will test whether there are any other relevant products, our initial investigation will focus on the relevant product markets of the treatment areas identified by the Applicant.<sup>7</sup> This will involve testing:
- 12.1 the extent to which treatments with different active ingredients (or combination of active ingredients) are substitutes for each other (ie, do the products have the same therapeutic use?); and
  - 12.2 whether there are separate markets for treatments with the same therapeutic use but that can only be administered to particular animals (ie, some products may only be indicated to treat dogs).

#### **Without the acquisition**

13. We will consider what the merging parties would do if the Proposed Acquisition does not proceed. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo or whether there are other likely counterfactual scenarios.
14. We will consider whether absent the Proposed Acquisition either of the merging parties would have been likely to launch any new products that would have competed with the other merging party. This could be the case if one merging party is developing a treatment in its pipeline that would be a substitute for a product offered by the other merging party.

#### **Competition analysis**

15. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant markets by assessing whether unilateral effects might result from the Proposed Acquisition. The question that we will focus on is would the loss of competition between Elanco and Bayer Animal Health enable the merged firm to profitably raise prices or reduce quality or innovation.
16. In differentiated markets, some products will be closer substitutes and compete more vigorously with each other than other overlapping products. Unilateral effects are therefore more likely to arise when the products produced by Elanco and Bayer Animal Health are relatively close substitutes.

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<sup>7</sup> While Elanco develops and manufactures its products overseas and then imports them into New Zealand for supply, Bayer (as well as some other suppliers) manufactures certain products in New Zealand. At this stage, it appears likely that the geographic and functional dimensions are likely to be the national market for the manufacture/importation and wholesale supply for any relevant product.

17. The Applicant considers that the Proposed Acquisition would not be likely to substantially lessen competition in any New Zealand market because:
- 17.1 Elanco and Bayer Animal Health's product portfolios are largely complementary meaning that there is limited overlap between the two parties; and
  - 17.2 in the product and treatment areas where they do overlap, Elanco and Bayer Animal Health are not close competitors and the merged entity would be constrained by the presence of a number of well-established competitors in New Zealand.
18. To assess whether the merged firm will be able to profitably raise prices, or reduce quality or innovation we will consider:
- 18.1 the closeness of competition: the degree of existing and potential competitive constraint that Elanco and Bayer Animal Health impose upon one another. To the extent that any constraint is material, we will assess whether the competition lost between the merging parties could be replaced by rival competitors;
  - 18.2 remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity; and
  - 18.3 entry and expansion: how easily rivals could enter and/or expand in response to an increase in price or reduction in quality or innovation by the merging parties.
19. We will also test whether the Proposed Acquisition would increase the potential for conglomerate effects. A conglomerate merger is a merger between firms that supply products that may relate to each other (for example, complementary products). A conglomerate merger may increase a merged firms' ability and/or incentive to foreclose competitors, particularly if the merged entity would have any must have products and whether the Proposed Acquisition would enable the merged entity to bundle or tie its products.

### **Next steps in our investigation**

20. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **14 April 2020**. However, this date may change as our investigation progresses.<sup>8</sup> In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
21. As part of our investigation, we will identify and contact parties that we consider will be able to help us assess the preliminary issues identified above.

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<sup>8</sup> The Commission maintains a clearance register on our website at <https://comcom.govt.nz/case-register> where we update any changes to our deadlines and provide relevant documents.

## Making a submission

22. If you wish to make a submission, please send it to us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference 'Elanco/Bayer Animal Health' in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **5 March 2020**.
23. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
24. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.