

Determination

Dechra Pharmaceuticals PLC and Elanco Tiergesundheit AG [2020] NZCC 12

The Commission:	Sue Begg Elisabeth Welson Dr Derek Johnston
Summary of application:	An application from Dechra Pharmaceuticals PLC, Dechra Limited and Dechra Veterinary Products LLC seeking clearance to acquire from Elanco Tiergesundheit AG its worldwide assets, rights and liabilities relating to the supply of Osurnia, a treatment for otitis in dogs.
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission gives clearance to the proposed acquisition.
Date of determination:	26 May 2020

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

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The proposed acquisition

1. On 26 March 2020, the Commerce Commission registered an application from Dechra Pharmaceuticals PLC, Dechra Limited and Dechra Veterinary Products LLC (together, Dechra or the Applicant) seeking clearance to acquire from Elanco Tiergesundheit AG (Elanco) its worldwide assets, rights and liabilities relating to the supply of Osurnia, a treatment for otitis in dogs (the Proposed Acquisition). The clearance application relates to the Proposed Acquisition to the extent that it relates to/affects a market in New Zealand.

Our decision

2. The Commission gives clearance to the Proposed Acquisition as it is satisfied that the merger will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. Both Dechra and Elanco supply products for the treatment of otitis and the Commission considered the potential impact of the Proposed Acquisition on competition in the market for the wholesale supply of products for the treatment of otitis in dogs. In this market, the Commission considers that:
 - 3.1 post-acquisition, there would be a number of suppliers, including Elanco, that would continue to supply otitis treatment products comparable to those offered by Dechra; and
 - 3.2 a new otitis treatment called Neptra is likely to be introduced into New Zealand shortly and this product would also compete closely with Dechra's otitis treatment products.
4. Accordingly, the Commission granted clearance to the Proposed Acquisition as it considered that the presence of competing suppliers, with the ability to expand, would likely constrain Dechra in its ability to raise prices or reduce the quality of its otitis treatment products.

Our framework

5. 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
 - 5.1 We assess mergers using the substantial lessening of competition test. 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

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

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

- 5.2 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.³ 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.⁴
- 5.3 We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.⁵ If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.

The key parties

Dechra

6. Dechra is a United Kingdom-based global animal healthcare company that develops, manufactures and distributes healthcare treatments for a range of companion animals (such as cats and dogs) and production animals (such as pigs, poultry and cattle). Dechra does not own or operate any manufacturing facilities in New Zealand and all its products registered for sale in New Zealand are manufactured in the United Kingdom.

Elanco

7. Elanco and its related entities also develop, manufacture, and distribute healthcare treatments for a range of companion and production animals on a global basis. Like Dechra, Elanco does not operate any manufacturing facilities in New Zealand and so all its products are imported into New Zealand.

Areas of overlap

8. In New Zealand, Dechra and Elanco only overlap in the supply of products used in the treatment of otitis externa (otitis) in dogs. Otitis is an inflammation of the external ear canal and it is a common condition in dogs. For the treatment of otitis in New Zealand:
- 8.1 Dechra supplies two daily dose otitis products under the brands PMP and Canaural; and
- 8.2 Elanco supplies one daily dose product under the brand Surolan and one long acting product under the brand Osurnia.

Rationale for the Proposed Acquisition

9. One of Elanco's related entities, Elanco Animal Health Inc., is seeking to acquire Bayer AG's (Bayer) global animal health business (the Proposed Elanco/Bayer Acquisition). Given the overlap that would occur between Elanco and Bayer in respect of treatments for otitis in dogs, Elanco is proposing to divest the worldwide

³ *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

⁴ *Mergers and Acquisitions Guidelines* above n1 at [2.23].

⁵ Section 66(3)(a) of the Commerce Act 1986.

assets, rights and liabilities relating to one of its products, Osumnia, as a fix-it-first remedy to address potential competition issues in a number of jurisdictions in which the transaction has been notified, including New Zealand.

10. Against this backdrop, Dechra, as an interested purchaser of the Osumnia assets, sought clearance from the Commission to acquire the assets insofar as they relate to New Zealand. The Commission considers that a decision on this application is not contingent on any decision the Commission makes on the Proposed Elanco/Bayer Acquisition.

Industry background

Background on otitis

11. Otitis is not a disease in itself but rather a symptom of other diseases, such as parasitic, bacterial or fungal infections. Most products to treat otitis require the administration of a daily dose product over a number of days. More recently, suppliers such as Elanco and Bayer have introduced (or are in the process of introducing) longer acting treatments that require only one or two applications over a period of days.
12. A supplier wishing to supply otitis treatment products (once developed) in New Zealand must obtain regulatory approval in accordance with the Agricultural Compounds and Veterinary Medicines Act 1997 (ACVM).⁶ Developing and then registering new animal healthcare products, such as those for otitis, 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.
13. Once a product is registered under the ACVM, it can be legally sold in New Zealand. Products to treat otitis in dogs can only be purchased with a prescription and so they are typically purchased from a veterinary clinic under the guidance of the prescribing veterinarian.

Other relevant parties

14. Other than Dechra and Elanco, there are several existing suppliers of otitis treatments for dogs in New Zealand:
 - 14.1 MSD Animal Health, which is a division of Merck Sharp & Dohme (New Zealand) Limited (MSD);
 - 14.2 Virbac New Zealand Limited (Virbac);
 - 14.3 Troy Laboratories Pty Limited (Troy); and

⁶ See <https://www.mpi.govt.nz/processing/agricultural-compounds-and-vet-medicines/acvm-overview/authorisation-of-acvm/>

14.4 Vetoquinol New Zealand Limited (Vetoquinol).

15. We note that either Bayer or Elanco would likely introduce a long acting treatment called Neptra that would closely compete with Osumnia.⁷

Market definition

16. Market definition is a tool that helps identify and assess the close competitive constraints the merged entity would face. Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market.
17. We define markets in the way that best isolates the key competition issues that arise from the 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 which fall outside the market, but which still impose some degree of competitive constraint on the merged entity.
18. In general, the more closely substitutable two products are, the closer the competition and the greater the competitive constraint between the products.

The Applicant's view of the relevant markets

19. Dechra submitted that there is a single product market for all the different types of products used to treat otitis in dogs. While there are daily dose and long acting products, Dechra (as well as Elanco) consider that all the different otitis products have similar characteristics.⁸ For example, Dechra advised that there are a number of existing products that contain either the same antibiotic or the same antifungal ingredient (or both) and each of the existing treatments have features that may make them more or less suitable for individual cases of otitis.⁹
20. To this extent, Dechra considers that the degree of closeness and desirability of the different products for treating otitis depends on the condition of the dog in question, the cause of the underlying infection and the veterinarian's view of the pet-owner's ability to administer the medication.
21. In addition, Dechra noted that a single market for otitis treatments is consistent with the approach taken by the European Commission, which considered it was appropriate to assess all otitis pharmaceuticals within the one product market.¹⁰

⁷ The party that would supply Neptra depends on the outcome of the Proposed Elanco/Bayer Acquisition.

⁸ Clearance application from Dechra (26 March 2020); Clearance application from Elanco (14 February 2020).

⁹ Clearance application from Dechra (26 March 2020).

¹⁰ Clearance application from Dechra (26 March 2020).

The Commission's view on the relevant markets

Product market

22. 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 as alternatives for the treatment of otitis in dogs.
23. Based on the feedback from industry participants, we consider that daily dose and long acting products for treating otitis in dogs are likely to be alternatives for one another because they have the same therapeutic indication, the treatment of otitis in dogs. We understand that:
 - 23.1 otitis treatments are broad spectrum products with the primary drivers of prescriptions falling along a spectrum of indications (bacterial, fungal, parasitic indications etc) as well as the length of action;¹¹ and
 - 23.2 the choice of application (or application rate) depends on the symptoms and circumstances of the afflicted dog.¹²
24. Evidence from our market 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.
 - 24.1 We understand that if an otitis product is not administered correctly it could lead to long-term problems.¹³ 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 pet owners who find it difficult to comply with the administration of daily dose treatments over a period of time.¹⁴
 - 24.2 A price premium is also typically attached to products that are more user friendly. For example, long acting products and pump products are more expensive than daily dose droplet products.¹⁵
25. As there are some differentiating factors between daily dose products and long acting products, we will consider the implications of any differences in the closeness

¹¹ Email from [] to the Commerce Commission (20 March 2020).

¹² Commerce Commission interview with [] (22 April 2020); Email from [] to the Commerce Commission (4 May 2020).

¹³ Clearance application from Elanco (14 February 2020); Clearance application from Dechra (26 March 2020).

¹⁴ Commerce Commission interview with [] (22 April 2020).

¹⁵ Commerce Commission interview with [] (22 April 2020); Commerce Commission interview with Dechra (20 May 2020).

of competition between daily dose and long acting products in the competitive effects section below.

Other market dimensions

26. Both Dechra and Elanco develop and manufacture their otitis treatments overseas and then import them into New Zealand for supply nationwide. 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, we consider the relevant geographic and functional dimensions are likely to be the national market for the manufacture/importation and wholesale supply to veterinarians of products for the treatment of otitis in dogs.

Conclusion on market definition

27. For the purposes of assessing the competitive effects of the Proposed Acquisition, we consider that the relevant market is the national market for the manufacture/importation and wholesale supply to veterinarians of products for the treatment of otitis in dogs (the otitis treatment market).

How the acquisition could substantially lessen competition

28. We have considered whether the acquisition would be likely to substantially lessen competition by assessing the unilateral and coordinated effects of the Proposed Acquisition.
29. Unilateral effects may occur when a firm acquires a current or potential competitor that would otherwise provide a competitive constraint. The Proposed Acquisition would likely have the effect of substantially lessening competition if the acquisition by Dechra of Elanco's long acting product, Osumnia, when combined with Dechra's existing portfolio of otitis products might result in it acquiring a substantial degree of market power and allow Dechra to be able to profitably raise prices to its customers.
30. 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. Our approach is to test whether the relevant market is vulnerable to coordination and then consider how the Proposed Acquisition might change the likelihood of coordination.

With and without scenarios

31. To assess whether competition is likely to be substantially lessened in any market, we compare the likely state of competition with the acquisition to the likely state of competition without the acquisition.¹⁶

¹⁶ *Mergers and Acquisitions Guidelines* above n1 at [2.29]; *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

32. With the acquisition, Dechra would acquire Elanco's long acting treatment, Osurnia, as well as continuing to supply its two existing daily dose treatments (PMP and Canaural). In addition:
- 32.1 Elanco would continue to supply a daily dose treatment (Surolan); and
 - 32.2 either Bayer or Elanco would likely introduce a long acting treatment called Neptra, which would closely compete with Osurnia.¹⁷
33. The Commission considers that absent the Proposed Acquisition of Osurnia by Dechra, it is likely that Elanco would seek to sell the Osurnia assets to a purchaser that does not give rise to competition concerns in any jurisdiction in order to complete the Proposed Elanco/Bayer Acquisition. Both the United States Federal Trade Commission and the European Commission have approved Dechra as a potential purchaser of Osurnia.

Competition analysis – the otitis treatment market

34. In this section, we assess the potential unilateral and coordinated effects of the Proposed Acquisition.
35. In relation to potential unilateral effects, the Commission considers that the Proposed Acquisition is unlikely to substantially lessen competition in the otitis treatment market because:
- 35.1 post-acquisition, Dechra would be constrained by a number of existing suppliers with daily dose products, notably Virbac (Easotic); and
 - 35.2 post-acquisition, Dechra would be constrained by new entry, as either Bayer or Elanco would likely introduce a long acting treatment (Neptra) that would compete closely with Osurnia.
36. In relation to potential coordinated effects, the Commission considers that the Proposed Acquisition is unlikely to substantially lessen competition in the otitis treatment market as the Proposed Acquisition is unlikely to make coordination materially more likely, sustainable or complete.

The extent of constraint on the merged entity from existing competition

37. Dechra considers that the Proposed Acquisition is unlikely to create any significant competition issues in the otitis treatment market, given the number of existing suppliers.¹⁸ 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 newly registered product (Neptra), it had no sales in 2019.

¹⁷ As above, the owner of Neptra would depend on the outcome of the Proposed Elanco/Bayer Acquisition.

¹⁸ Clearance application from Dechra (26 March 2020).

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

Suppliers	Brand	Application	Sales (\$)	Share (%)
Dechra	Canaural*	daily dose	[]	[]
	PMP	daily dose	[]	[]
Elanco (product to be divested)	Osurnia	long acting	[]	[]
<i>Dechra's market share post acquisition</i>			[]	[]
Elanco	Surolan*	daily dose	[]	[]
Bayer	Neptra	long acting	0	0
Virbac	Easotic	daily dose	[]	[]
MSD	Otomax	daily dose	[]	[]
Troy	Dermotic	daily dose	[]	[]
Vetoquinol	Aurizon	daily dose	[]	[]
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 encountered supply shocks in 2019.

38. Table 1 shows that Elanco, Dechra and Virbac are currently the largest suppliers in the market. Further, once Neptra is introduced, the owners of Osurnia and Neptra 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.

Existing competition in the otitis treatment market

39. As indicated by Table 1, Dechra has a substantial market presence with its two daily dose droplet products and it currently competes closely with daily dose droplet suppliers including Elanco (Surolan). For example, Dechra's PMP product (as well as Troy's Dermotic) is a generic equivalent to Elanco's Surolan.¹⁹
40. Elanco's launch of its long acting product (Osurnia) in 2019 has been relatively successful and it now accounts for [] Elanco's sales of its treatments for otitis in dogs. One of the main reasons for this success is that a long acting product helps avoid a "daily battle" between the owner and dog (especially if the dog is reluctant to receive a daily dose product).²⁰ In this respect, given the difference in application (as well as price), Dechra's daily dose droplet products do not appear to compete closely with Osurnia.

¹⁹ Commerce Commission interview with Dechra (20 May 2020).

²⁰ Email from [] to the Commerce Commission (4 May 2020).

41. Further, to the extent daily dose and long acting products compete to treat otitis in dogs, post-acquisition, Dechra would be constrained by a number of existing suppliers with daily dose products.
- 41.1 Daily dose droplet suppliers such as Vetoquinol (with Aurizon), Troy (with Dermotic) and MSD (with Otomax) as well as Elanco (Surolan) would continue to provide some degree of constraint on Dechra.
- 41.2 Virbac, with its daily dose pump product, Easotic, would also provide a degree of constraint on Dechra. Virbac advised that Easotic [] is easy to administer and the required daily dose is delivered via a pump, instead of droplets. []²¹

The constraint from new entry into the otitis treatment market

42. Post-acquisition, Dechra would be constrained by new entry, as either Bayer or Elanco would likely introduce a long acting treatment (Neptra) that would closely compete with Osumnia.
43. Neptra was registered for sale in New Zealand in March 2020.²² While Bayer does not currently have a presence in the otitis treatment market, Bayer's Neptra has a significant presence in overseas markets and Bayer anticipates [] following its expected launch later this year.²³
44. Osumnia and Bayer's Neptra are likely to be each other's closest alternatives, given they contain the same antibiotic and antifungal active ingredients and they would be the only long acting products available in New Zealand.²⁴
45. Bayer's Neptra competes closely with Elanco's Osumnia in the United States, where both products have been available for some time. Further, Dechra considers that Osumnia faces a strong constraint from Neptra.²⁵

Conclusion on unilateral effects in the otitis treatment market

46. In relation to unilateral effects, the Commission considers that the Proposed Acquisition is unlikely to substantially lessen competition in the otitis treatment market because:

²¹ []

²² 25 March 2020. See <https://eatsafe.nzfsa.govt.nz/web/public/acvm-register>

²³ [] attached to an email from Simpson Grierson (acting for Bayer Animal Health) to the Commerce Commission (9 March 2020).

²⁴ Clearance application from Dechra (26 March 2020).

²⁵ [], attached to an email from DLA Piper (acting for Dechra) to the Commerce Commission (24 March 2020).

- 46.1 post-acquisition, Dechra would be constrained by a number of existing suppliers with daily dose products, notably Virbac (Easotic); and
- 46.2 post-acquisition, Dechra would be constrained by new entry, as either Bayer or Elanco would likely introduce a long acting treatment called Neptra that would closely compete with Osurnia.

Coordinated effects in the otitis treatment market

- 47. 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.
- 48. 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.

Overall conclusion

- 49. In New Zealand, Dechra and Elanco overlap in the supply of products used in the treatment of otitis in dogs.
- 50. We consider the relevant market to be the national market for the manufacture/importation and wholesale supply to veterinarians of products for the treatment of otitis in dogs. In this market, we consider that:
 - 50.1 post-acquisition, Dechra would be constrained by a number of existing suppliers with daily dose products; and
 - 50.2 post-acquisition, Dechra would be constrained by potential entry, as either Elanco or Bayer would likely introduce a long acting treatment called Neptra that would closely compete with Osurnia.
- 51. In addition, in relation to coordinated effects, given the differentiated nature of otitis treatment products, the Proposed Acquisition is unlikely to make coordination materially more likely, complete or sustainable.
- 52. Accordingly, we are satisfied that the Proposed Acquisition is unlikely to substantially lessen competition in any relevant market.

Determination on notice of clearance

53. Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to Dechra Pharmaceuticals PLC, Dechra Limited and Dechra Veterinary Products LLC to acquire from Elanco Tiergesundheit AG its worldwide assets, rights and liabilities relating to the supply of Osrurnia, a treatment for otitis in dogs.

Dated this 26th day of May 2020

Sue Begg
Division Chair