

VETERINARY MEDICINES MONOPOLY INQUIRY

ISSUES STATEMENT

This statement sets out the issues which the Commission is currently considering in connection with its inquiry into the supply of prescription-only veterinary medicines in the United Kingdom.

The statement sets out one provisional conclusion and a number of other issues which it is still considering. The Commission has not yet reached any final conclusions on these or other questions arising from the terms of reference of this inquiry.

The Director General of Fair Trading referred this matter to the Commission on 9 October 2001. The Commission is due to submit its report by 8 January 2003.

A copy of this statement of issues can be found on the Commission's website: www.Competition-Commission.org.uk./inquiries/vetmed.htm

Background

1 Appendix A sets out the Commission's terms of reference. These require the Commission to investigate the possible existence of monopoly situations in relation to the supply within the United Kingdom of prescription-only veterinary medicines. Appendix A also contains the definitions of these and other terms.

Provisional findings so far

2 The Commission has provisionally concluded that, on the basis of information at present available to it, a scale monopoly situation (as defined in Appendix A) exists in relation to the supply within the United Kingdom of prescription-only veterinary medicines since it appears that National Veterinary Services Ltd (NVS), a wholly owned subsidiary of Dechra Pharmaceuticals plc, supplies at least one-quarter of prescription-only veterinary medicines to veterinary surgeons. The Commission has also provisionally concluded that this scale monopoly situation exists in favour of Dechra Pharmaceuticals PLC.

3 The evidence which has led the Commission to this provisional conclusion is set out in Appendix B. This finding does not imply the existence of any facts which operate (or may be expected to operate) against the public interest: this will be considered further in the next stage of the inquiry.

4 The Commission also has to consider whether any complex monopoly situations (as defined in Appendix A) exist. Although there are a number of practices that prevent, restrict or distort competition which may be currently carried out by more than one veterinary manufacturer, veterinary wholesaler or veterinary surgeon in total accounting for more than 25 per cent of the

supply of prescription-only veterinary medicines, the Commission is not in a position at this stage to conclude even provisionally whether or not any complex monopoly situations exist.

The public interest

5 When the Commission forms a view as to the possible existence of one or more scale monopolies or one or more complex monopoly situations in the supply of prescription-only veterinary medicines, the Commission considers whether any steps are being taken by any persons in whose favour such monopoly situations exist for the purpose of exploiting or maintaining the monopoly situations. Where this is found, the Commission will then consider whether this operates (or may be expected to operate) against the public interest. The Commission will also consider whether any other facts operate or may be expected to operate against the public interest.

The timetable

6 Over the next three months, the Commission will conduct hearings with interested parties and organisations representing interested parties to hear their views on the issues set out in this issues statement. The Commission will also be undertaking fact-finding visits and commissioning market research. The Commission will inform the parties of any further provisional conclusions.

7 In the event that the Commission provisionally concludes that one or more monopoly situations exist, it will consider the questions raised in paragraphs (c), (d) and (e) of the terms of reference. If facts found by the Commission operate or may be expected to operate against the public interest, it will consider what remedies may be appropriate. Any potential remedies will be the subject of further consultation with interested parties before the Commission draws up its report to the Government later in the year.

8 The full timetable is set out on the Commission's web-site.

The issues

9 The issues are divided into four groups:

- issues arising from the regulatory regime which governs the supply of prescription-only veterinary medicines in the United Kingdom,
- issues stemming from the practices of veterinary manufacturers,
- issues stemming from the practices of the veterinary wholesalers, and
- issues stemming from the practices of veterinary surgeons.

10 Although these issues are divided into four groups for convenience, the Commission recognises that many of the practices of those engaged in the supply of prescription-only veterinary medicines are closely inter-related. These issues are set out fully in Appendix C.

The economic definition of the market for prescription-only veterinary medicines.

11 As part of the inquiry, the Commission is considering the relevant markets in which those who supply veterinary medicines operate in order to establish an analytical framework for an assessment of competition. Market definition is also a necessary first step in measuring market shares. Appendix D sets out the Commission's current thinking.

Possible further issues

12 The issues set out in this statement are based on submissions made to the Commission. During the course of the Commission's investigations further issues may arise, which will be notified to the parties and considered insofar as they are relevant to the Commission's assessment of the effectiveness of competition in the supply of the prescription-only veterinary medicines in the UK.

Appendix A

Part I: Terms of Reference

"The Director General of Fair Trading in exercise of his powers under sections 10(3), 10(4), 47(1), 49(1) and 50(1) of the Fair Trading Act 1973 hereby refers to the Competition Commission the matter of the existence or possible existence of a monopoly situation in relation to the supply within the United Kingdom of prescription only veterinary medicines.

The Commission shall investigate and report on the questions whether a monopoly situation exists and, if so:

- a) By virtue of which of the provisions of sections 6 to 8 of the said Act that monopoly situation is to be taken to exist;
- b) In favour of what person or persons that monopoly situation exists;
- c) Whether any steps (by way of uncompetitive practices or otherwise) are being taken by that person or those persons for the purpose of exploiting or maintaining the monopoly situation and, if so, by what uncompetitive practices or in what other way;
- d) Whether any action or omission of the part of that person or those persons is attributable to the existence of the monopoly situation and, if so, what action or omission and in what way it is so attributable; and
- e) Whether any facts found by the Commission in pursuance of their investigations under the preceding provisions of this paragraph operate, or may be expected to operate, against the public interest.

For the purposes of this reference:

"prescription only veterinary medicines" means medicinal products that are subject to an order under section 58 of the Medicines Act 1968 and which may be sold only by veterinary surgeons or veterinary practitioners for administration to animals under their care or by pharmacists on a written prescription from a veterinary surgeon or veterinary practitioner.

"medicinal product" means a product falling within either section 130 of the Medicines Act 1968 or Article 1.2 of Council Directive 65/65/EEC.

"veterinary surgeon" and "veterinary practitioner" have the meanings given to these terms by section 132(1) of the Medicines Act 1968.

The Commission shall report upon this reference within a period of 15 months from the date hereof."

Dated: 9 October 2001

Part II: Definitions

For the purposes of this inquiry, the following definitions are used:

"**AMTRA**" means the Animal Medicines Training Regulatory Authority.

"**Animal owners**" means any person or organisation that owns an animal or cares for it (in the absence of its owner) and who may require medicines for such animal.

"**BVA**" means the British Veterinary Association.

"**Cascade**" refers to the procedure under the Medicines (Restrictions on the Administration of Veterinary Medicinal Products) Regulations 1994 as amended. This provides that no person may administer any veterinary medicinal product to an animal unless it has been granted a marketing authorisation for the treatment of the particular condition in the species being treated. Under these Regulations, where no authorised veterinary medicine exists for a condition in a particular species, a veterinary surgeon may administer to a particular animal:

- (a) a veterinary medicine authorised in the UK for use in another animal species or for another condition in the same species;
- (b) if there is no such veterinary medicine as described in (a) above, a product authorised for use in the UK in a human being;
or

(c) if there is no such human medicine as described in (b) above, a veterinary medicinal product prepared by an authorised person in accordance with a veterinary prescription.

"Centralised Marketing Authorisation" means a marketing authorisation which is valid in all EU member states.

A **"complex monopoly situation"** is defined in section 6 (1) (c) the Fair Trading Act 1973.

"Decentralised Marketing Authorisation" means a marketing authorisation which is valid in one or more Member States.

"EMA" means the European Agency for the Evaluation of Medicinal Products.

"GfK" means Martin Hamblin GfK Healthcare UK, a market research company.

"GSL" means veterinary medicines classified as General Sales List. A product is classified as GSL when it neither requires any specific advice concerning its method of use nor poses significant risk to the animal being treated, the person administering the product, or the environment. These products can therefore be sold at any retail outlet.

"Human medicine" means any medicine authorised for use by human beings.

"List price" means the veterinary manufactures recommended price for the sale of veterinary medicines to veterinary surgeons.

"MA" means a marketing authorisation granted by the VMD or the EMA.

"MFS" means the regulatory classification given to a medicinal product that is a pre-mix for incorporation into medicated feedingstuff that may only be supplied on presentation of a prescription written by a veterinary surgeon.

"MFSX" means the regulatory classification given to a medicinal product that is a pre-mix for incorporation into a medicated feedingstuff that may be sold without a prescription.

"MRLs" means maximum residue limits.

"Marketing authorisation" means the authorisation obtained by a veterinary manufacturer to enable it to market a veterinary medicine. A marketing authorisation can be obtained through the centralised procedure, the decentralised procedure or the national procedure.

"Marsh Report" means the report titled "Report of the Independent Review of Dispensing by Veterinary Surgeons of Prescription Only Medicines" published in May 2001.

"Medicinal product" shall have the same meaning as that given to it in the Terms of Reference set out in Part I of this Appendix.

"Medicine" includes veterinary medicine and any other medicine whether for animal use or otherwise.

"Monopoly situations" refers to both scale monopoly situations and complex monopoly situations.

"NOAH" means the National Office of Animal Health which is the veterinary manufacturers trade association.

"NVS" means the National Veterinary Service Limited.

"National Marketing Authorisation" means a marketing authorisation that is valid only in the Member State it was issued in. With effect from 1 January 1998 no national marketing authorisation can be granted if the product is already authorised in another Member State. In this event the decentralised procedure must be followed.

"P" means veterinary medicines classified as Pharmacy. These may be sold under the supervision of a pharmacist and by veterinary surgeons to animals under their care.

"PML" means veterinary medicines classified as Pharmacy and Merchants' List. These may be sold to animal owners by an agricultural merchant or saddlers who have been suitably trained and are registered with Royal Pharmaceutical Society of Great Britain. PML veterinary medicines may also be sold by a pharmacist and by veterinary surgeons to animals under their care.

"POM" means prescription-only veterinary medicines.

"Prescription-only veterinary medicine" shall have the same meaning as that given to it in the Terms of Reference set out in Part I of this Appendix.

"RCVS" means the Royal College of Veterinary Surgeons.

"SQP" means a suitably qualified person and is a person whose name is included on an annual list kept for businesses in England, Scotland or Wales by the Royal Pharmaceutical Society of Great Britain and for businesses in Northern Ireland by the Department of Health and Social Services of Northern Ireland. A person cannot be entered on this list unless he has successfully completed an approved course of training related to the composition, storage, use, purchase, and sale of veterinary medicines or is a qualified pharmacist or veterinary surgeon who has applied to join the register.

A "**scale monopoly situation**" is defined in section 6 (1) (a) of the Fair Trading Act 1973.

"**Trade wholesaler**" means any wholesaler who holds a licence granted by the Medicines Control Agency and who is not a member of AWVP.

"**VMD**" means the Veterinary Medicines Directorate, an Executive Agency of the Department for the Environment, Food and Rural Affairs.

"**Veterinary manufacturer**" means a UK company that manufactures, markets or sells veterinary medicines in the UK or any other company that markets or sells in the UK veterinary medicines manufactured by an affiliate of that company.

"**Veterinary medicine**" means any medicine for animal use which has a market authorisation granted by either the VMD or the EMEA.

"**Veterinary surgeon**" includes both "veterinary surgeon" and "veterinary practitioner" and these terms have the meanings given to them in the Terms of Reference set out in Part I of this Appendix.

"**Veterinary wholesaler**" means a member of the Association of Wholesalers to the Veterinary Profession (AWVP) who also holds a wholesale licence granted by the Medicines Control Agency.

"**Wholesalers**" means any person or entity whether or not incorporated that supplies human medicines to retail outlets.

Part III: Monopoly situations

A scale monopoly situation

A scale monopoly would exist in relation to the supply of prescription-only veterinary medicines in the United Kingdom if one supplier accounted for at least one-quarter of prescription-only veterinary medicines in the United Kingdom.

A complex monopoly situation

A complex monopoly would exist if at least one-quarter of prescription only medicines are supplied by members of a group of persons (not being a group of interconnected companies) who, whether voluntarily or not and whether by agreement or not, so conduct their respective affairs so as to prevent, restrict or distort competition in connection with the supply of prescription-only veterinary medicines.

A scale monopoly would exist in relation to the supply of prescription-only veterinary medicines in the United Kingdom if one supplier accounted for at least one-quarter of prescription-only veterinary medicines in the United Kingdom.

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Appendix B

The share of supply of prescription-only medicines in the UK attributable to National Veterinary Service Ltd.

NVS, a wholly owned subsidiary of Dechra Pharmaceuticals plc, has provided the Competition Commission with a table, setting out data that it had obtained from GfK showing the shares of the six veterinary wholesalers' sales of veterinary medicines for each of the six years 1996 to 2001. Over this period NVS's share increased from about 36 per cent to more than 40 per cent. The share of NVS's nearest competitor was around 25 per cent, and those of the other four veterinary wholesalers remained below 20 per cent throughout the six years. The GfK data covered the sales of all veterinary medicines by the six veterinary wholesalers, rather than their share of POMs. Because of differences in the range of veterinary medicines supplied by the six wholesalers, their respective shares of POM sales might differ slightly from their shares of sales of veterinary medicines

Some POMs are sold by the veterinary manufacturers to customers other than veterinary wholesalers. We separately asked the veterinary manufacturers to provide us with an analysis for 2001 of their sales for each of the classifications of veterinary medicines by customer type. We have had replies from most of them, including all the largest ones, and these indicate that on average around 90 per cent of these veterinary manufacturers' sales of POMs were made to the six veterinary wholesalers. Taken together with the GfK data, these suggest that NVS's share of the total UK supply of POMs is more than 35 per cent, while none of the other five wholesalers has a share of more than 25 per cent.

From this, the Commission has provisionally concluded that NVS supplies at least 25 per cent of prescription-only veterinary medicines in the UK.

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Appendix C

Issues identified in respect of the supply of prescription-only veterinary medicines

In this Appendix the Commission has elaborated on the issues set out in brief in its issues statement. The aim is to illustrate the thinking of the Commission at this stage of the inquiry. The issues are divided into four groups:

- issues arising from the regulatory regime which governs the supply of prescription-only veterinary medicines in the United Kingdom,

- issues stemming from the practices of veterinary manufacturers,
- issues stemming from the practices of the veterinary wholesalers, and
- issues stemming from the practices of veterinary surgeons.

Although these issues are divided into four groups for convenience, the Commission recognises that many of the practices of those engaged in the supply of prescription-only veterinary medicines are closely inter-related.

I. Regulation

1 The way in which veterinary medicines are regulated has a considerable impact on the supply of veterinary medicines. Regulatory requirements must be satisfied before a veterinary medicine can be introduced into the market. In addition, the classification given to each veterinary medicine by the regulatory process determines who may sell to the animal owner.

2 There are currently around 2,000 authorised veterinary medicines in the UK, of which more than 900 are POMs. The focus of the Commission's inquiry is the supply of POMs, but it is also considering the supply of the three other classifications of veterinary medicines (PML, P and GSL) which may be substitutable for POMs in some situations.

3 Veterinary medicines may only be supplied in the UK if they have an MA, usually held by the manufacturer of the veterinary medicine, though it sometimes may be held by an associate company of that manufacturer incorporated in another EU member state. Every MA is subject to 5-yearly renewal, is specific to its holder and lays down the animal species which may be treated with the veterinary medicine.

4 Veterinary medicines can be authorised for use in the UK by:

- a. a centralised marketing authorisation granted by the EMEA. This centralised procedure is mandatory for a small group of new-technology medicines, while a wider group has optional access to the procedure;
- b. a national marketing authorisation;
- c. a decentralised marketing authorisation.

5 The criteria to be met by every veterinary medicine are laid down in European directives and relate to its safety, quality and efficacy. They include, in the case of medicines for food animals, determination of the minimum allowable interval (the "withdrawal period") between the last treatment of an animal and its entry into the human food chain. Withdrawal periods depend on prior determination of species-specific MRLs for each active substance in the medicine. Within the European Union, all MRLs are determined centrally by the EMEA. However, some animals kept as pets (such as rabbits) are classified as "food producing animals" and medicines specified for these will be subject to MRLs.

6 Article 67 of European directive 2001/82/EC specifies certain classes of veterinary medicine that may only be supplied on prescription. UK law extends this because classification for distribution purposes is a matter for the national authority responsible for MA. The system of classification differs widely between the member states and the same medicine may be prescription-only in one country and over-the-counter in another.

7 The supply of a veterinary medicines in the UK begins with supply by the veterinary manufacturer. Distribution of veterinary medicines may then take place in several stages; the supply route by which these medicines reach their animal owners typically depends on each veterinary medicine's legal classification.

8 The regulatory system provides that POMs be supplied either direct from the veterinary manufacturer or through a wholesaler licensed under the Medicines Act 1968. In practice, most POMs are supplied to veterinary surgeries through veterinary wholesalers. Other POMs, such as poultry or fish medicines, are usually sold directly to large poultry producers or fish farms which employ veterinary surgeons.

9 At the retail level, the law requires that POMs may only be:

dispensed by a veterinary surgeon for an animal under his or her care; or

dispensed by a pharmacist from a prescription written by a veterinary surgeon having the animal under his or her care.

10 At present, very little veterinary medicine appears to be supplied to or through pharmacists.

11 Veterinary medicines classified as PML may only be dispensed by a veterinary surgeon, pharmacist or by a registered agricultural merchant or saddler. No veterinary surgeon's prescription is needed, but every sale must be authorised by an SQP listed by the AMTRA.

12 In strict regulatory terms, wholesale supply of PMLs is no different from that of POMs: a Medicines Act 1968 licence is required. In practice, PML wholesaling to veterinary surgeries is undertaken by the veterinary wholesalers, whilst wholesaling to agricultural merchants and saddlers is undertaken by trade wholesalers. Relatively few pharmacy businesses sell PML medicines.

13 Another group of veterinary medicines are those classified P. As with PML medicines, no veterinary surgeon's prescription is required, but only veterinary surgeons and pharmacists may supply veterinary medicines in this group. The small amount of wholesaling to pharmacists appears to be channelled through trade wholesalers.

14 The last group of veterinary medicines consists of those classified as GSL. These medicines may be supplied retail by anyone without prescription. They are usually distributed to retailers by trade wholesalers. Because they are available "over the counter" at pet shops, supermarkets and other stores, this group is of particular importance to pet owners.

15 A distinct group of veterinary medicines are medicated feeding stuffs and the concentrates ("pre-mixes") used in the making-up of such feeding stuffs. The pre-mixes are subject to MA like any other veterinary medicine and are supplied to feed manufacturers by the MA holder, an agricultural merchant registered before 6 May 1998 who has not been specifically been barred from doing so, or a manufacturer of medicated feedingstuffs. The medicated feeding stuffs themselves may only be supplied on a veterinary surgeon's prescription, by agricultural merchants registered before 6 May 1998 and not barred from supplying medicated feedingstuffs, and specifically approved distributors.

16 Non-prescription medicines may also be supplied through veterinary surgeries, but most are supplied through trade wholesalers and then agricultural merchants, as described above.

17 Consideration of the way in which the regulatory system affects the supply of POMs has led the Commission to identify the following regulatory issues.

I. Regulatory issues

I (i) Whether the current MRL requirements restrict competition in, and availability of, veterinary medicines, particularly for minor species.

Determination of MRLs increases test costs and may discourage veterinary manufacturers from widening the range of species for which individual products are authorised. This would tend to impair competition between rival products.

I (ii) Whether the inclusion of an efficacy test in the marketing authorisation procedure unnecessarily increases the barriers to introducing a veterinary medicine to the market.

The testing of medicines for efficacy may add little to overall testing costs as veterinary manufacturers will in any event wish to check efficacy as part of normal product development. However its inclusion in the scope of regulation slows down the giving of marketing authorisation, reducing the time available for marketing with patent protection. This will deter innovation and tend to reduce the range of competing products.

I (iii) Whether the absence of provision for a third party to request reclassification of a veterinary medicine, or for regular review of classification, leads to an over-classification of veterinary medicines.

Veterinary manufacturers accept very different classifications of the same product in different EU Member States. Where the UK classification is higher, and distribution channels consequently more restricted than would be the case if the UK classification were lower, competition is restricted without an evident regulatory justification. Competition could be improved if the regulatory authority were willing to consider re-classification on application from a person other than the marketing authorisation holder.

Medicines containing an active ingredient new to veterinary medicine are always classified POM when first authorised. This gives time for pharmacovigilance to spot most significant problems before the first 5-yearly review and appears consistent with an automatic review of classification at that point, based upon the marketing authorisation holder's original test data and practical experience through pharmacovigilance.

I (iv) Whether the lack of a prescription-only sub-classification for medicines that could be prescribed by a veterinary surgeon (for animals under his/her care) without prior clinical examination restricts competition.

Veterinary surgeons do not dispense or prescribe non-GSL medicines except after a clinical examination of the animal or having seen the animal or herd recently enough to be sure of its condition. It is possible that certain medicines, notably anti-parasitic treatments, though warranting POM or PML classification, could safely be prescribed without clinical examination. This principle is included in Recommendation 14 of the Marsh inquiry, where it is part of a 3-tier scheme (replacing the present PML) designed to fit better with European practice. If introduced, such a sub-classification would allow certain medicines to be obtained without the present need for the cost of an associated veterinary consultation. The effective price would thus be reduced.

I (v) Whether the length of time allowed to regulators to reach a decision on marketing authorisations is a barrier to introducing a new medicine.

Delay to the commercialisation of a new medicine can seriously affect its viability as a product and deter veterinary manufacturers from introducing new veterinary medicines. Minimisation of delay will therefore tend to increase the range of medicines available and widen competition. The UK and European regulators responsible for marketing authorisations and MRL determinations operate to strictly defined timetables expressed in "clock days" - ie excluding time spent waiting for responses from the applicant. There is no built-in incentive to complete assessments ahead of timetable.

I (vi) Whether the requirement that medicines on the Pharmacy and Merchants List (PMLs) may only be dispensed by veterinary surgeons, pharmacists, and Suitably Qualified Persons (SQPs) employed by agricultural merchants or saddlers restricts competition in the supply of PMLs (and hence of any POMs which may be reclassified as PMLs).

Pet shops, supermarkets and many other retail outlets cannot obtain supplies of PML veterinary medicines from wholesalers. The immediate cause is the

lack of any regulatory provision for these retailers to register in the way agricultural merchants and saddlers may do. An insurmountable entry barrier facing many retailers thus restricts competition in the supply of PML veterinary medicines.

The supply of PML veterinary medicines is outside the inquiry's terms of reference. However it would be a relevant consideration in assessing the impact on competition of any regulatory change designed to encourage re-classification of existing POMs to lower categories (including PML) or to discourage over-classification in the first place.

I (vii) Whether the current arrangements which preclude SQP's from breaking bulk in supplying veterinary medicines places them at a competitive disadvantage to veterinary surgeons.

Agricultural merchants and saddlers do not use their SQPs to divide up authorised packs of veterinary medicines. Because each marketing authorisation relates not just to a branded product, but to each of its presentations and pack sizes, acquisition costs are artificially raised in cases where the authorised pack is larger than the customer needs. The veterinary manufacturer's commercial choice of pack sizes therefore gains regulatory significance because only a veterinary surgeon or pharmacist may split packs of non-GSL medicines. Any changes designed to expand the range of PML retailers and guard against over-classification could be hampered if pack sizes were such as to favour veterinary surgeons (and pharmacists).

Pack-splitting can be dangerous (for example, through contamination, use of an unsuitable container or loss of labelling and instructions) so safeguards remain necessary.

I (viii) Whether the conditions under which the European centralised procedure is available could restrict competition, either:

by being too narrow, and therefore compelling companies to use the decentralised procedure even if this is a greater barrier to introducing the product to market, or

by being too narrow, and so allowing companies to gain a POM classification for their products which can not subsequently be revised to PML.

Only limited classes of veterinary medicines are eligible for marketing authorisation through the European centralised procedure. The regulatory costs and delays in using national/decentralised procedures to obtain marketing authorisation in more than a few of the larger Member States exceed those of the centralised procedure, whose limited scope may therefore have the effect of reducing the range of veterinary medicines able to compete in all, or most of European market.

There is no legal impediment to the downward re-classification of medicines authorised through the centralised procedure (except for the classes of medicines required by law to be prescription-only). In practice, though, this is unlikely to happen because of the multilateral decision-making process used.

I (ix) Whether the potential for competition from extra-EU markets is prevented by the lack of mutual arrangements between the EU and other regulatory regimes.

Markets outside Western Europe make up almost 70% of the world market for veterinary medicines. Despite regional differences in animal species and pathogens the market for many veterinary medicines spans not only the UK but many other parts of the world as well. There is therefore potential to reduce global regulatory costs through the mutual recognition both of test results and regulatory authorisation. This would build on the arrangements already in place within the EU (including the work in this direction being undertaken by the Committee on Veterinary Harmonisation) and encourage veterinary manufacturers to introduce a greater number of new medicines to the UK and European market, increasing choice and strengthening competition.

II. Issues relating to manufacturers of prescription-only veterinary medicines

The Commission has identified the following issues arising from the terms of reference relating to veterinary manufacturers.

II (i) Whether veterinary manufacturers tie in the sales of some or all products in their ranges with an anti-competitive effect.

If veterinary surgeons are obliged or influenced to buy a range of products from the same veterinary manufacturer, it may be difficult for other veterinary manufacturers to compete in the supply of individual products in that range. An effective tie-in may be the result of a pricing structure that makes the alternative (not buying all of the tied-in products) commercially unattractive. Tie-in sales of veterinary medicines may take the form of linked promotions or of cross-product rebates.

Subsidiary issues are as follows.

II (I) a Whether veterinary manufacturers, via linked price promotions, use the existing market power of some products as a lever to gain share of other markets.

Linked price promotions offer an overall discount on two or more products purchased together. In a two-product linked promotion, if demand is strong for product A, the veterinary surgeon may be encouraged to buy the linked package of A and B, and a substitute for product B, sold individually, may not be able to compete, leading to an overall reduction in competition.

II (i) b Whether veterinary manufacturers operate rebate schemes which are a barrier to successful market entry, in that they encourage veterinary surgeons to buy more from larger veterinary manufacturers.

Rebate schemes may give veterinary surgeons an incentive to purchase medicines from those suppliers from whom they already make substantial purchases (and hence a high marginal rate of rebate). This may give larger veterinary manufacturers an advantage over smaller veterinary manufacturers – both because they are more likely to provide a wide range of different medicines, and to have strong brands, or even ‘must have’ products in their portfolios. Rebates can potentially have the same effect as exclusive dealing – i.e. preventing the veterinary surgeon from buying competing products.

The magnitude of any effect of rebates on competition will depend on a range of factors such as whether:

- rebates are calculated over a short period (eg monthly) or a long one (e.g. annually),
- rebates are incremental – that is increasing levels of purchases attract higher rates of rebate,
- the highest increment applied by the customer applies to all purchases made under the scheme in that time period,
- rebates are retrospective – that is increasing levels of purchases lead to the application of a higher rate not only on additional purchases but on previous purchases,
- rebates, in particular target levels of purchases, are individually negotiated,
- sales representatives and veterinary surgeons discuss the extent to which higher discounts/rebates could be achieved through the purchase of additional products,
- veterinary surgeons’ purchasing decisions are strongly influenced by the terms of rebate schemes.

II (ii) Whether rebates have any other anti-competitive effect, apart from as a barrier to entry or expansion.

This leads to further issues.

II (ii) a Whether veterinary manufacturers design their rebate schemes in such a way as to reduce price transparency.

Veterinary surgeons’ rebates from veterinary manufacturers differ, and they depend on the volume of purchases from each within a certain time period. As a result, veterinary surgeons may have difficulty in comparing the prices of similar products from different suppliers. Individual negotiation of rebates may also reduce price transparency.

II (ii) b Whether veterinary manufacturers’ rebate schemes are structured in such a way as to cause veterinary surgeons to charge higher prices than they would otherwise do.

Some veterinary surgeons set selling prices by adding a standard mark-up to veterinary manufacturers' list prices, rather than to the much lower price that they actually pay after the distributor's discount and supplier's rebate are deducted. This may result in prices to animal owners being higher than they otherwise would be. This effect may be greater when the rate of rebate is not known because a sales target may or may not be reached.

II (ii) c Whether veterinary manufacturers who operate rebate schemes gain an informational advantage over those who do not, and whether this enables them to strengthen their position in the market in an anti-competitive way.

Veterinary manufacturers who operate a rebate scheme for veterinary surgeons gain access to information about purchases of particular products by individual veterinary practices, which can be used in marketing activities in order to gain market shares or to reinforce a dominant position. Veterinary surgeons allow wholesalers to give this information to veterinary manufacturers because they want to participate in the rebate schemes. Information on veterinary surgeons purchases from wholesalers can also be bought from GfK, a market research company, but this is at a more aggregated level, and may be less recent, than the information provided as part of rebate schemes.

II (ii) d Whether veterinary manufacturers with a large market share in particular veterinary medicine sub-markets carry out anti-competitive practices to maintain their position, and in particular: whether veterinary manufacturers engage in predatory pricing.

Predatory pricing is the setting of prices by an incumbent firm at levels which will deter or remove actual or potential competition. A veterinary manufacturer with a dominant share of a particular market may react to the threat of a competing product by aggressively lowering its prices in the short term, until the threat has been removed.

II (ii) e Whether veterinary manufacturers promote brand loyalty to such an extent as to limit price competition and restrict market entry.

While it is normal commercial practice to use marketing techniques to increase brand awareness, in some circumstances competitive marketing can replace price competition, its costs may be passed on to the consumer in increased prices, and a barrier to market entry may be created. There appears to be a considerable emphasis on non-price competition in the supply of veterinary medicines, with veterinary manufacturers advertising to veterinary surgeons and animal owners, organising events for the benefit of the veterinary profession, and helping to fund veterinary surgeons continuing professional development (CPD). Other inducements, such as free gifts, may also be offered. Most large veterinary manufacturers employ a team of professionally qualified sales representatives who regularly visit veterinary practices, in order to promote both the veterinary manufacturer's offering as a whole, and individual products. Veterinary manufacturers may use the period

for which a medicine is patent-protected to develop the medicine as a brand, and so maintain a high market share after the patent has expired.

II (ii) f Whether veterinary manufacturers engage in anti-competitive market sharing, by jointly choosing not to launch or promote products that directly compete with those of other suppliers.

High market shares in individual product markets may be indicative of market sharing. Alternatively, large market shares may be due to a number of other reasons, including patents, markets being too small to sustain several players, or high entry barriers relative to market size.

II (iii) Whether the manufacturers of veterinary medicines are protected by the provisions of the cascade from competition from substitutable human medicines, and whether they exploit this protection by charging higher prices than would otherwise be the case.

Under the cascade, a veterinary surgeon may only prescribe a human medicine for an animal if no suitable veterinary medicine is available. As a result, veterinary medicines do not generally face competition from human medicines even when equally appropriate human medicines may be available. This may enable veterinary manufacturers of veterinary medicines to charge higher prices than would otherwise be the case. It may also have an effect on competition at the retail level as the dispensing of prescription veterinary medicines is largely limited to veterinary surgeons, whereas human prescription medicines are available from high street chemists and increasingly qualified persons other than doctors are being permitted to write prescriptions for human medicines..

II (iv) Whether veterinary manufacturers set the price or influence the retail mark-up on veterinary medicines, and in particular whether veterinary manufacturers, through published list prices, effectively set minimum resale prices.

If a large proportion of veterinary surgeons apply standard margins to veterinary manufacturers list prices, the result may be a standard resale price (equal to the list price plus the veterinary surgeon's margin). Veterinary manufacturers' published list prices are above the prices for which medicines are sold to wholesalers (the difference being the 15 per cent wholesaler margin), and this may lead to retail prices which are higher than would otherwise be the case.

II (v) Whether veterinary manufacturers otherwise set, or influence, the price at which their products are resold.

While veterinary manufacturers may not directly determine veterinary surgeons retail prices for veterinary medicines, they may have an influence on the price charged by veterinary surgeons:

Most larger veterinary manufacturers employ teams of sales representatives to visit veterinary practices, and some of these discuss the veterinary surgeons' resale prices in their visits.

If veterinary manufacturers expect veterinary surgeons to price at a mark-up on the list price, they may structure their offer to veterinary surgeons (e.g. have a higher list price with a higher discount, or a lower list price with a lower discount) in order to influence the resale price.

Veterinary manufacturers may also, in some cases, attempt to influence or set retail prices by advertising prices to animal owners.

II (vi) Whether veterinary manufacturers request, or fail to initiate review of, classification of a medicine as prescription-only in cases where this is not necessary on grounds of safety.

An applicant for a marketing authorisation (MA) can request that the product be classified as prescription-only or for one of the non-prescription categories. Veterinary manufacturers may prefer to sell medicines as prescription-only for a number of reasons. For example, because veterinary surgeons are a smaller and more easily identifiable group than animal owners, intensive advertising, PR and personal contact can be directed to this group at lower cost than to the wider end-user market. Over-classification may lead to higher prices at the retail level, due to veterinary surgeons charging higher mark-ups than pharmacists or agricultural merchants (who can supply non-prescription medicines if they employ a suitably-qualified person).

II (vii) Whether veterinary manufacturers encourage veterinary surgeons to buy certain prescription-only veterinary medicines by asserting that they will not be subject to reclassification.

Prescription-only medicines authorised via the centralised procedure are rarely if ever reclassified. By advertising to veterinary surgeons that certain medicines will never be given a lower classification, veterinary manufacturers may encourage them to favour these products, which they can dispense without the prospect of competition from non-vet retailers, at the expense of potentially more widely-available products which are open to such competition.

II (viii) Whether veterinary manufacturers charge differential prices to veterinary surgeons in such a way as to restrict competition.

Pricing is discriminatory if it is designed to confront localised competition without conceding price reductions more widely. Differential pricing can, in some markets, be seen as a legitimate response to competition, or the result of negotiations between buyer and seller, with bargaining power on both sides. However it may act as a deterrent to actual or potential competitors – the most extreme version being predatory pricing. Rebates may be viewed as a means of price differentiation, in the sense that after adjusting for rebates veterinary surgeons may pay widely differing prices for the same product. In

addition, some veterinary manufacturers allow their sales representatives to negotiate prices individually with veterinary surgeons.

II (ix) Whether veterinary manufacturers refuse to supply to certain intermediaries (wholesalers or retailers) or classes of intermediaries; supply certain intermediaries on less favourable terms than others; or fail to respond to requests for supply by certain intermediaries.

Refusal to supply, or supply on less favourable terms, may have an anti-competitive effect if it forecloses the market to wholesalers other than veterinary wholesalers, or to retailers other than veterinary surgeons. Foreclosure to retailers other than veterinary surgeons will only occur if the veterinary wholesalers engage in similar conduct.

III. Issues relating to veterinary wholesalers

1 In supplying medicines to veterinary wholesalers, most veterinary manufacturers appear to sell at 'list' prices and give the wholesalers a standard 15% discount off their list price. Veterinary wholesalers generally sell to veterinary surgeries at a discount on the veterinary manufacturer's list prices, usually with a standard percentage discount which applies across all medicines sold, although different veterinary surgeries might not get the same discount from the same wholesaler. (The discount given by wholesalers to veterinary surgeons is less than that given by veterinary manufacturers to wholesalers: the difference between the two is the wholesaler's margin.) Most veterinary manufacturers receive information from the wholesalers on the value of purchases of their medicines in respect of each veterinary surgery supplied by the wholesaler. The veterinary manufacturers use this information to give different veterinary surgeries a further discount or rebate.

2 Veterinary surgeries usually charge a mark-up based on the veterinary manufacturers' list price of the medicine. This mark-up is usually based on the veterinary manufacturers' list price of the medicine. Alternatively, discounts and/or rebates may be deducted from the list price before the mark-up is added: this will depend on the individual veterinary practice.

3 Veterinary surgeons usually charge for medicines at the same time as they charge for consultation fees and other costs. Some, though not all, provide itemised bills. The Report of the Independent Review of Dispensing by Veterinary Surgeons of Prescription-Only Medicines chaired by Professor Marsh (the Marsh report) noted that veterinary surgeons tend to under-charge for their consultation time, and subsidise this with their charges for veterinary medicines

4 The Commission has identified the following issues relating to the veterinary wholesalers.

III (i) Whether veterinary wholesalers refuse to supply customers other than veterinary practices, universities and research establishments, and in particular refuse to supply pharmacies.

Prescription-only veterinary medicines may only be sold to businesses employing a veterinary surgeon or a pharmacist. Some pharmacists complained to us that although they wanted to purchase POMs, the veterinary manufacturers refused to supply them and they were also unable to obtain supplies from the veterinary wholesalers.

III (ii) Whether discounts granted by veterinary wholesalers are cost-related.

It seems veterinary wholesalers pass to veterinary surgeries much of discounts they receive from veterinary manufacturers: the level of these discounts would appear to be one of the main areas of competition between veterinary wholesalers. Where these discounts take the form of a flat-rate prompt payment discount, large orders may cross-subsidise small orders and may in total exceed the veterinary wholesalers' financing and administrative costs.

III (iii) Whether the provision of detailed sales information by veterinary wholesalers to veterinary manufacturers is detrimental to veterinary surgeries or consumers.

Veterinary manufacturers who gain access to detailed sales information from the veterinary wholesalers may have an informational advantage in negotiations with veterinary practices. This information would not be available without the involvement of the veterinary wholesalers.

IV. Issues Relating to Veterinary Surgeons

Only veterinary surgeons can prescribe POMs; in practice, they also dispense most of the veterinary medicines they prescribe. Pharmacists can dispense POMs on a written prescription from a veterinary surgeon. In this situation, there are a number of ways veterinary surgeons could be frustrating the development of competition in dispensing, leading to animal owners having less choice and paying higher prices for veterinary medicines requiring a prescription than would occur in a fully competitive market. The Commission has therefore identified the following issues relating to veterinary surgeons.

IV (i) Whether veterinary surgeons fail to inform animal owners of the option to have written prescriptions for veterinary medicines dispensed by a pharmacist.

The Marsh Report commented that many animal owners are unaware that they may request a written prescription from a veterinary surgeon which can then be dispensed by a pharmacist. The Royal College of Veterinary Surgeons has revised its Guide to Professional Conduct to emphasise animal owners' right to choose - "Veterinary surgeons are encouraged to make their clients aware that veterinary medicines may be obtained on prescription from other suppliers, for example pharmacies....." Given that veterinary surgeons usually dispense the medicines they have prescribed, many animal owners may have gained the impression that they do not have a choice.

IV (ii) Whether veterinary surgeons fail to provide itemised invoices showing a breakdown between the cost of professional fees and the cost of medicines dispensed.

Transparent pricing of professional services and medicine charges would facilitate consumer choice and the efficient working of the market. If animal owners are unaware of the charges they are paying for veterinary medicines, they are less likely to explore alternative dispensing options. While most veterinary practices can now readily offer itemised invoices to their clients, there remains an issue of whether a substantial number of pet-owners do not automatically receive detailed invoices.

IV (iii) Whether veterinary surgeons charge unreasonable sums for writing a prescription to be dispensed by a pharmacist.

By charging a fee which exceeds the marginal administrative cost of writing a prescription, a veterinary surgeon could recoup some of the profit lost on dispensing medicines. This practice would seem to discourage animal owners from seeking written prescriptions if the fee was similar in value to the potential price saving by having the medicine dispensed by a pharmacist.

IV (iv) Whether veterinary surgeons refuse to write prescriptions, or by some action or omission, discourage requests from animal owners for prescriptions.

Competition would be greatly restricted if veterinary surgeons refused or discouraged requests for prescriptions. The Royal College of Veterinary Surgeons Guide to Professional Conduct makes clear that veterinary surgeons should not unreasonably refuse to write prescriptions. However, the low level of prescriptions being written requires us to investigate whether animal owners are discouraged from demanding prescriptions. An example of a method of discouraging requests would be if a veterinary surgeon required an additional consultation (with fee) before writing a prescription for a repeat course of medicine, when he/she would not have required the additional consultation if their surgery were dispensing the repeat course.

IV (v) Whether veterinary surgeons by some action or omission may have indicated to veterinary manufacturers and/or veterinary wholesalers that they should refuse to supply pharmacists, or supply them on less-favourable terms.

Pharmacists have experienced difficulties in obtaining supplies of prescription-only veterinary medicines and in obtaining these supplies on non-discriminatory terms. One possible interpretation of these difficulties is that veterinary manufacturers and veterinary wholesalers have been influenced by veterinary surgeons in an attempt to maintain their control of dispensing, and prevent potential competitors getting access to supplies of veterinary medicines on non-discriminatory terms.

IV (vi) Whether veterinary surgeons influence veterinary manufacturers not to reclassify prescription-only medicines to a lower classification.

Some medicines which are prescription-only in the UK appear to be available more cheaply without a prescription from a pharmacist or other retailer in other countries. The issue here is whether some veterinary surgeons attempt to influence veterinary manufacturers' decisions about the classification of their products, in order to limit opportunities for pharmacists and other retailers to compete on price with veterinary surgeons.

IV (vii) Whether the regulatory regime causes veterinary surgeons not to dispense prescriptions written in other veterinary practices, thereby restricting competition between veterinary surgeons.

Veterinary surgeons can only dispense medicines in respect of animals under their care. Consequently, veterinary surgeons may not dispense medicines on another veterinary surgeons' prescription. The issue is whether this is an unnecessary restriction on competition between veterinary surgeons and leads to animal owners paying higher prices for medicines.

IV (viii) Whether, due to the regulatory regime, veterinary surgeons choose treatments for companion animals in an unnecessarily restricted way, leading to higher costs for pet owners or a reduction in animal welfare.

The prescribing cascade severely limits the circumstances in which a veterinary surgeon can consider the use of a human medicine. This part of the regulatory regime ensures a high standard of safety, particularly in regard to food producing animals. Relaxing the prescribing cascade may result in a reduction in the cost of medicines dispensed by veterinary surgeons particularly for pet owners.

IV (ix) Whether veterinary surgeons take steps that make it difficult for animal owners to switch from one veterinary surgery to another.

Competition in the marketplace would be limited if animal owners found it difficult to switch their veterinary surgery, for example if a veterinary surgeon asks the previous practice if they object to the animal owners changing veterinary surgeon.

IV (x) Whether veterinary surgeons set their charges for dispensing medicines in such a way that they subsidise their consultation fees.

The Commission has been informed that it is not uncommon for veterinary surgeons to allocate a disproportionate amount of the veterinary surgery's overheads to their medicine charges. In practice, this results in veterinary surgeons compensating with their mark-up on medicines for relatively low charges for their professional services. One explanation offered is that, historically, animal owners have been reluctant to pay for the veterinary surgeons time. This practice also hinders transparency of pricing. Clients whose animals require a medicine but only a brief or occasional consultation,

are in effect subsidising animal owners who require more extensive professional service. Animal owners requiring repeat prescriptions for chronically ill pets may be penalised particularly by this practice.

IV (xi) Whether veterinary surgeons charge higher than necessary prices on prescription-only medicines.

This practice could arise for a number of reasons. First, if veterinary surgeons derive the charge for a medicine by applying a standard mark-up to the veterinary manufacturers' or wholesalers' list price rather than to the actual cost after discounts and rebates, this will result in the highest mark-ups being charged on the medicines which attract the largest discounts and/or rebates. This would mean that animal owners whose animals require medicines on which the veterinary surgeon obtains high discounts or rebates are effectively subsidising other clients whose animals require medicines on which the veterinary surgeon obtains little or no discount and/or rebate. Second, by applying higher mark-ups to prescription-only medicines, veterinary surgeons could charge lower mark ups on non-prescription medicines thereby subsidising prices on all other medicines excluding POMs which may also be available in other competing retail outlets. Third, if a veterinary surgery were not run efficiently, high mark-ups on medicine charges could compensate financially for inefficiencies in the management of that veterinary surgery. Fourth, the owners of the practice could be seeking a higher return than would be expected of a similarly sized business in a fully competitive market..

IV (xii) Whether veterinary surgeons allow their purchasing and dispensing decisions to be influenced by rebates or discounts from veterinary manufacturers, in such a way as to restrict consumer choice or to increase prices to animal owners.

Veterinary manufacturers would not offer rebates and discounts unless they considered that they considered these rebates and discounts influenced the purchasing decisions of veterinary surgeons. A number of veterinary surgeons have indicted their dislike of this practice by veterinary manufacturers, but the issue remains whether it has an impact on the choice of veterinary medicines prescribed and value for money obtained by animal owners. The impact of this practice will be greater where veterinary surgeons apply a mark-up to the list price.

IV (xiii) Whether veterinary surgeons discriminate on prices charged to different animal owners (for example, depending on whether the client has a pet insurance policy).

Charging different mark-ups on veterinary medicines, depending on an assessment of the price responsiveness of the customer (e.g. whether the customer is a farmer or a pet-owner, or whether the customer is insured or not) would constitute a form of price discrimination by veterinary surgeons.

IV (xiv) Whether veterinary surgeons charge relatively higher prices in areas where there is less competition from other similar practices.

Farmers have commented that increasingly in many areas of the UK there may only be a single practice specialising in large animals. The advent of corporate practices, and possible economic advantages in adjacent veterinary surgery-owned practices merging (e.g. increased buyer power, lower cost of providing out-of-hours service, more efficient use of specialised diagnostic or operating equipment) could both lead to a reduction in choice for animal owners in future. The issue is whether a lack of local competition leads to higher prices for medicines.

Appendix D

Market Definition

1 The Competition Commission defines the relevant markets in which a firm operates in order to establish an analytical framework for an assessment of competition. Market definition is also a necessary first step in measuring market shares. It should be noted that a high market share is not, in itself, sufficient evidence that a firm has market power: the Commission also considers other market features such as buyer power and barriers to entry.

2 Customers of veterinary practices are generally divided into two groups – farmers and pet-owners. Most veterinary practices are either pet-only (usually called small animal veterinary practices), or mixed practices (which means that they treat pets and farm animals). Few, if any, are large animal practices i.e. farm-only. There are also a number of equine veterinary practices, and some which specialise in exotic birds and fish. Pet owners are the final customers for over half (by value) of all veterinary medicines. Their price sensitivity may be low, but this will vary depending on their personal circumstances – including their access to help from the pet charities. Farmers are the final customers for veterinary medicines used as an input in the supply of meat and dairy products: it is estimated that veterinary bills account for around 5 per cent of farmer turnover, of which around 3 per cent is medicines. (Previous figure amended 04 July 2002) As such, a farmer's willingness to buy a veterinary medicine will usually depend on the total cost of treatment (which may include a veterinary surgeons consultation fee as well as the price of the medicine) relative to the value of the animal. A small proportion of veterinary medicines are used by those looking after zoo animals and other exotic species.

3 For the purposes of our inquiry, we distinguish three levels for the supply of most POMs:

- Veterinary manufacturer supply (through veterinary surgeries) of veterinary medicines to final customers;
- Veterinary wholesaler supply of delivery services to veterinary practices;
- Veterinary surgery supply of medicines and professional services to farmers and pet-owners.

4 In order to define the relevant markets, the Commission will consider both the specific products and the geographic area in which they are sold. We assess customers' ability and willingness to switch to different products (demand-side substitution), and suppliers' willingness and ability to substitute production (supply-side substitution).

Veterinary manufacturer supply (through veterinary surgeries) of veterinary medicines to final customers

(i) Demand-side issues

5 On the demand side, substitutability of medicines will usually depend on the scope for different medicines being capable of being used to treat a condition diagnosed by the veterinary surgeon (i.e. having the same "therapeutic indication"). The marketing authorisation for each medicine will specify the species for which approval has been granted. Some medicines (notably vaccines) may be effective against more than one disease. Thus where two vaccines are each used against a different disease they are not direct substitutes. But a third vaccine could be effective against both of these diseases, and therefore in competition with both of the other two vaccines. According to this 'chain of substitution' analysis, all three vaccines may therefore be in the same market. Similarly if one medicine can be used to treat a particular illness in dogs, another in cats, and a third in both dogs and cats, all three could be in the same market. Furthermore, farmers may seek to optimise their purchases across all veterinary medicines, or all preventative veterinary medicines – e.g. a farmer having regard to the relative risk of the herd being infected with a variety of diseases, and the price of different vaccines.

6 This suggests that two medicines with different therapeutic indications may be in the same market. Conversely, two medicines with the same indication may be in different markets. Pet owners and farmers may have a very strong preference for a particular route of administration (e.g. tablets or spray-on), and animal owners may be unwilling to substitute between two medicines with different administration routes (e.g. injection versus food additive).

7 In assessing demand-side substitutability, we have considered categorising medicines sold by veterinary surgeons (mainly POMs but also some non-POMs) as follows: (a) medicines for acute conditions in pets e.g. emergency/one-off treatment (b) medicines for chronic conditions in pets e.g. for repeat treatment (c) medicines for curative treatment (d) medicines for preventative treatment of farm animals. We shall consider each in turn.

8 When a veterinary surgeon diagnoses the most appropriate treatment of acute conditions in pets, the pet-owner will usually not know which medicine is appropriate, whether suitable alternatives exist, or the prices of these alternatives. Although the veterinary surgeon is likely to discuss the recommended treatment with the pet owner, the charge for the medicine being dispensed may only become clear if an itemised bill is issued for

payment. Decisions about inter-product substitution are therefore likely to be made by the veterinary surgeon, under the ultimate constraint that, if the total treatment cost is too high, the pet-owner may be deterred from coming back. For pet owners the choice will be to stay with the veterinary surgeon, to seek a transfer to another veterinary surgery or to allow the pet to suffer the consequences. If there is sufficient competition between veterinary surgeries, pet owners would be able to make choices based on price as well as quality and price discrepancies will tend to diminish for the same medicine dispensed by different surgeries. If veterinary surgeons always choose the most effective product, regardless of its cost, this would suggest that veterinary manufacturers face a 'winner takes all' situation where the price of the most effective product is not constrained by the price of alternatives.

9 The price of medicines for the treatment of chronic conditions of pets and preventative medicines, have been the subject of most of the complaints we have received. The fact that most animal owners will have paid for the same medicine before will mean that they have an expectation of what the price will be. As it is non-emergency, there is time for animal owners to inform themselves about alternatives. The customer faces a stream of payments in the future, rather than a one-off payment, and so usually has an incentive to minimise costs. Finally, any consultation fee charged by the veterinary surgeon is likely to be smaller for repeat treatments than for emergencies, making the cost of the medicine relatively more important. All of these factors would suggest that pet-owners should be more price-sensitive as regards repeat treatments.

10 Farmers seem to be more price-sensitive than pet-owners. We have been told on several occasions that a farmer would not treat an animal if the cost of treatment was greater than the expected value of the animal.

11 The Commission has also been told that farmers are likely to scrutinise carefully the relative cost of medicines designed to prevent diseases. It is not yet clear how common this is, or how many medicines are substitutable in this way.

12 A 'prescribing cascade' is allowed under EU legislation. A veterinary surgeon can use the prescribing cascade to prescribe a medicine authorised for a different species or for a different illness than the one he/she is treating. The veterinary surgeon may only use the cascade if the appropriate medicine for the particular species and illness is not available. The cascade therefore affects the market definition because, even if a medicine that is licensed for treatment of cats is also effective in treating dogs, the veterinary surgeon may not use it to treat dogs if another product exists which is licensed for the treatment for dogs. So even though the two are technical substitutes, there is a regulatory barrier to substitution. In other cases the cascade will be the rule (e.g., for minor species such as rabbits).

(ii) Supply-side issues

13 Supply-side substitution is likely to be difficult at the product level given the time and cost of getting a marketing authorisation from the VMD. Patents and R&D costs will raise these barriers even higher. Even if a veterinary manufacturer already sells a given medicine in another country, the time necessary in order to get mutual recognition of an authorisation in the UK makes supply-side substitution unlikely to be an effective constraint on competition. Launching a product that competes with an existing product is more straightforward for those which have become commodities, in which case the veterinary manufacturer can apply for an accelerated "generic" marketing authorisation.

(iii) Geographic Market

14 A medicine may only be sold in the UK if it has a UK marketing authorisation. There is provision for specific authority to be granted to certain parallel imports but we understand this extends to a tiny fraction of the market. There is some evidence of substantial illegal imports. These would be relevant if suppliers are constrained from increasing prices by the fear of prompting an increase in illegal imports. On the whole, however, it appears at this stage that the relevant geographical market for the supply of veterinary medicines at the veterinary manufacturer level is the UK.

Veterinary wholesaler supply of delivery services to veterinary practices

(i) Demand-side issues

15 Veterinary wholesalers appear to stock the complete range of POMs (and other veterinary medicines) of all veterinary manufacturers. They do not appear to set the price of individual medicines, preferring instead to follow the recommended price lists provided by suppliers for resale of medicines to veterinary practices. The wholesalers compete with each other on the discount that the veterinary surgeon obtains over total purchases, and on services (e.g., speed of delivery and provision of a computerised order system). On the other hand, there appears to be no competition on prices of individual POMs.

(ii) Supply-side issues

16 Some short-line or trade wholesalers exist, largely to supply non-POMs to agricultural merchants. As such, they do not appear to compete with veterinary wholesalers.

iii. Geographic market

17 None of the six main veterinary wholesalers operates outside the UK. One wholesaler operates entirely in Northern Ireland and another in northern Scotland. Each of the other four wholesalers operates in most regions of Great Britain.

Veterinary surgery supply of medicines and professional services to farmers and pet-owners.

(i) Demand-side substitution

18 Veterinary practices supply a wide range of POMs and other veterinary medicines. However, a veterinary surgeon can only dispense medicines to an animal under his or her care. The species of animals under a veterinary surgeon's care will depend on the nature of the practice to which the veterinary surgeon belongs – i.e. whether it is a pet-only practice, a mixed practice, or an equine or other specialist practice.

19 Animal owners choose which veterinary surgery to use, out of those in their local area that treat the type of animal concerned. A pet owner will be able to choose between all pet-only and mixed practices in the area, a farmer between all mixed practices in the area, and a horse owner between all mixed and equine practices in the area. Veterinary surgeons face competition from agricultural merchants and other outlets in the supply of non-POM veterinary medicines. However, they face little or no competition from pharmacies in the supply of POMs.

ii. Supply-side substitution

20 Inter-product substitution is of less importance in defining the market at the retail (veterinary surgery) level, than at the veterinary manufacturer level, because a veterinary practice will be able to dispense any veterinary medicines for the treatment of animals under the care of one of its veterinary surgeons.

(iii) Geographic market

21 On the geographic side, competition between veterinary practices is local, because the veterinary surgery must be close enough to treat the animal when required. In urban areas chains of substitution may lead to relatively large geographic markets. For instance, if Veterinary surgeon A competes with Veterinary surgeon B who is 5 miles away, and B competes with Veterinary surgeon C who is a further 5 miles away in the same direction, in competition terms Veterinary surgeon A and Veterinary surgeon C are in the same geographical market: they are linked by a chain of substitution even though they do not compete directly.