



Chinese Ministry of Commerce imposes conditions on Novartis for its acquisition of Alcon

On 13 August 2010, the Chinese Ministry of Commerce (MOFCOM) conditionally cleared the acquisition by Novartis of Alcon. This marks the sixth occasion that MOFCOM has imposed conditions since China's Anti-monopoly Law came into effect in August 2008. This briefing explores the conditions in more detail.

Parties and the transaction

Novartis is a Swiss pharmaceutical company with global activities in developing, producing, distributing and marketing medical products (including eye care products), contact lenses and lens care products, human vaccines and animal health products. Alcon is a Swiss company that is active in developing, manufacturing and distributing eye care products and, to a lesser extent, products to treat ear and nose diseases.

The transaction was conditionally cleared by the antitrust regulators in the EU, Canada and Australia, who required divestment of a number of businesses in those jurisdictions. The Chinese Ministry of Commerce's (MOFCOM) conditional clearance decision followed, with the decision from the US Federal Trade Commission outstanding at the date this briefing was issued. It is unclear whether MOFCOM liaised with the other antitrust regulators in reviewing the transaction.

MOFCOM's concerns

MOFCOM identified two areas of competitive concern: ophthalmic anti-infective and anti-inflammatory compounds; and contact lens care products.

For the ophthalmic anti-infective and anti-inflammatory compounds that MOFCOM found to constitute a relevant product market, the parties overlapped in China with a combined market share of more than 60 per cent and more than 50 per cent globally. Novartis has less than a 1 per cent market share in China and although it stated

to MOFCOM that it would, following the transaction, strategically exit the relevant market both in China and globally, MOFCOM nevertheless took the view that Novartis could still be a market player and would still be able to re-enter the Chinese market, thereby potentially restricting or eliminating competition in the future. While not entirely clear in the decision, MOFCOM has either decided that a less than 1 per cent market share increment was enough to result in the elimination or restriction of competition (a highly unusual conclusion to have reached) or that the possibility of Novartis re-entering and increasing that share is such that it could eliminate or restrict competition (which would seem to be highly speculative given the low market share in the first place and the company's stated intention to exit the market globally).

In the market for contact lens care products, the parties' combined global market share was found to be far in excess of other competitors at nearly 60 per cent. In China, the parties' combined market share will be almost 20 per cent – second to Hydron Contact Lens Co, Ltd (Hydron), whose market share exceeds 30 per cent. While the 20 per cent combined market share was not found to be problematic in itself, it was revealed as part of the review that Novartis has had in place since 2008 a distribution arrangement with Hydron, where Hydron has acted as the exclusive supplier for Novartis' contact lens care products and a strategic partner to Novartis in China. MOFCOM came to the view that this arrangement between Novartis and Hydron may eliminate or restrict competition as it may lead to co-ordination between the

merged entity and Hydron over the price, volume and sales territories of contact lens care products.

Remedies

MOFCOM accepted a remedies package offered by the parties that would, in its view, reduce the anti-competitive effect that would be brought about by the transaction, and imposed the following conditions:

In the market for ophthalmic anti-infective and anti-inflammatory compounds, Novartis is required to:

- cease all sales of its product in China by the end of 2010;
- refrain from re-entering the Chinese market with products under the same or a different brand for five years from the date of the decision; and
- refrain from supplying to the Chinese market for five years its ophthalmic anti-infective and anti-inflammatory compounds currently sold outside China.

In the contact lens care products market, Novartis is required to terminate its supply arrangements with Hydron within 12 months, at which point it is required to notify MOFCOM of the termination.

This is also the first occasion that MOFCOM has invoked its powers under the newly issued divestment guidelines, by requiring Novartis to appoint a monitoring trustee to supervise the implementation of the remedies.

Analysis

In common with the previous six published merger decisions issued by MOFCOM, the decision is relatively light on its reasoning. However, there are a number of points of interest arising from the decision.

Procedurally, it is encouraging that MOFCOM was able to complete the review within the 90-day phase two review period without needing to extend it (which it can do by a further 60 days).

As a matter of substance, MOFCOM's requirement that Novartis terminate its distribution arrangement and strategic partnership with Hydron is significant, as it marks the first time that MOFCOM has invoked the theory of harm of co-ordinated effects in a published decision.

This demonstrates that MOFCOM takes into account existing relationships between the merging parties and competitors in assessing the competitive impact of a transaction, even where the combined market share of the parties resulting from the transaction is not unduly high.

MOFCOM's decision to impose a remedy for Novartis' activities in the market for ophthalmic anti-infective and anti-inflammatory compounds is interesting, perhaps concerning. It is difficult to see on the face of the decision how an incremental gain of less than a 1 per cent market share in China could give rise to concerns that the transaction could eliminate or restrict competition, particularly where Novartis has already informed MOFCOM that it would in any event be exiting the market. The decision also does not set out the theory or the relevant facts (such as the likelihood of re-entry) to substantiate how the merged entity might be motivated to re-introduce Novartis' product, or how the parties might be able to restrict or eliminate competition with that re-launch.

The nature of the remedy imposed on Novartis' product is also curious, as it effectively requires Novartis to remove from the market for five years its under-performing brand that occupies less than 1 per cent of the market share in China. If the incremental gain of less than 1 per cent market share is of real concern, the most clear-cut remedy in many jurisdictions would have been to require parties to divest the business to a competitor. Instead, MOFCOM has imposed a behavioural remedy that needs monitoring over five years. From the perspective of Chinese consumers, it is questionable whether removing a brand would be to their benefit, as it would reduce the number of choices available to consumers in treating eye infections.

Conclusion

MOFCOM is to be applauded for continuing its efforts to maintain transparency of the two-year-old regime by publishing, in a timely manner, its merger control decisions in cases where it has intervened. Further transparency would be welcome, however, particularly through a more detailed reasoning of the anti-competitive effects and theories of harm, to help businesses and their advisers in planning M&A

activities that affect China. Until that happens, a degree of nervousness is likely to remain in the business community about the predictability of the merger control review process in China.

For further information please contact	Nicholas French T +86 10 6535 4534 E nicholas.french@freshfields.com
	Michael Han T +86 10 6535 4525 E michael.han@freshfields.com
	Margaret Wang T +852 2913 2671 E margaret.wang@freshfields.com

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