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## MOFCOM's Stance On Novartis/Alcon

--By Adrian Emch, Andrew McGinty, and Jun Wei, Hogan Lovells LLP.

Law360, New York (September 09, 2010) -- On Aug. 1, 2010, China's Anti-Monopoly Law (AML) turned two. The Ministry of Commerce (MOFCOM) — the agency in charge of merger control in China — celebrated the anniversary with a bang: on Aug. 13, it cleared the acquisition by life sciences company Novartis of a majority stake in rival Alcon, but only subject to conditions.

Almost 10 months have passed since the last time MOFCOM imposed conditions on a merger clearance decision. The Novartis/Alcon case is only the sixth MOFCOM decision involving remedies, but already the second in the life sciences field (after Pfizer/Wyeth).

### Introduction

Like the Hart-Scott-Rodino Act and similar provisions throughout the world, the AML merger control regime requires pre-closing filing to MOFCOM for certain types of business transactions if specified thresholds are exceeded. In China, the filing thresholds only focus on sales revenues. Pending examination by MOFCOM, the transaction cannot be closed.

In the first phase of the procedure, MOFCOM has 30 days after receipt of the complete set of notification documents to carry out an initial review. If it finds that an in-depth investigation is necessary, MOFCOM will open the second phase investigation for up to 90

days. Under certain circumstances, the deadline can be extended for a maximum of 60 additional days (which is sometimes referred to as "phase 3").

## **The Novartis/Alcon Transaction**

The transaction concerned the acquisition by Novartis, one of the world's leading life sciences companies, of shares in Alcon, giving it a majority stake of 77 percent in the target. Alcon is a Texas-based life sciences company with a certain degree of specialization in eye care products.

The transaction was subject to merger control in a variety of jurisdictions, including the United States and the European Union. The EU and the U.S. cleared the acquisition, also subject to conditions. Their clearance decisions were issued a few days before and after MOFCOM's decision, on Aug. 9 and 16, respectively.

## **MOFCOM's decision**

Novartis notified MOFCOM about the proposed transaction on April 20, 2010. After identifying competition concerns in the first phase of the procedure, MOFCOM decided to open an in-depth investigation. MOFCOM found competition issues to exist in two relevant product markets: the markets for ophthalmological anti-inflammatory/anti-infective products and for contact-lens care products, respectively.

In the ophthalmological anti-inflammatory/anti-infective product market, Novartis and Alcon have an aggregate market share of 55 percent worldwide and over 60 percent in China. Yet, Novartis' share alone is less than 1 percent in China. With respect to contact lens care products, the merged entity holds a global market share of nearly 60 percent and a share of around 20 percent in China.

With a share of more than 30 percent, the market leader in China is the Taiwanese company Ginko International, through its Hydron business. Novartis had entered into an agreement to appoint Hydron as exclusive distributor of its contact lens care products in China. As a result, in order to address MOFCOM's concerns, the parties had to offer certain undertakings which were accepted by the regulator after two rounds of negotiations.

While MOFCOM noted that Novartis had already taken the strategic decision to withdraw from the ophthalmological anti-inflammatory/anti-infective product market, it imposed an additional condition: During the next five years, Novartis will be barred from selling Infectoflam or similar ophthalmological anti-infective products in China.

To overcome MOFCOM's concerns with respect to the contact lens care product market, Novartis had to commit to terminate the distribution agreement with Hydron within the next 12 months.

### **Streamlined Timing?**

In this case, MOFCOM closely followed the timeline set out in the AML. After the first phase investigation, MOFCOM went into the second phase for its in-depth review of the transaction. According to an interview, which the head of MOFCOM's merger control unit gave just one day prior to the Novartis/Alcon decision, up to one third of the transactions filed with MOFCOM enter "phase 2."

It is notable that MOFCOM issued the conditional clearance right at the end of phase 2, thereby averting the need to go into "phase 3." This may be pure coincidence or an attempt by MOFCOM to keep at bay those voices within the international investment community who have criticized the length of time needed for MOFCOM to complete its internal and external processes and reach a decision.

Perhaps the most striking aspect regarding timing in the Novartis/Alcon decision was the fact that MOFCOM accepted the submissions and opened the case file on the same day as it received the notification. The seemingly instantaneous acceptance and case opening is in stark contrast with earlier cases filed in 2008 and 2009, where MOFCOM only opened the case file after several weeks or months, during which time the parties were required to provide further data, clarifications or even to make on-site presentations to the MOFCOM case team members.

Nonetheless, that filing and case registration should occur on the very same day was too much of a coincidence for many observers. While no information is available in the public domain on this point, it may well be the parties filed draft versions of the filing during the pre-notification phase.

### **MOFCOM's Continuing Evolution Regarding Substantive Analysis**

The Novartis/Alcon decision is the first in which MOFCOM has imposed conditions to address "coordinated effects" arising from a merger transaction. "Coordinated effects" refer to the reduction of competition between the newly merged entity and another rival in the market — in this case, Hydron.

Although the very short text of the published decision does not provide a full analysis of MOFCOM's reasoning, it seems that the regulator may have been concerned that the link between the new Novartis/Alcon entity and Hydron (through the distribution agreement) would align their behavior in the marketplace.

More generally, coordinated effects appear to be a topic to which MOFCOM has given considerable thought lately. Indeed, guidance on how MOFCOM will analyze coordinated effects was already contained in the draft guidelines on horizontal mergers prepared by MOFCOM for internal discussion towards the end 2009. In the summer months of 2010,

MOFCOM held internal seminars with a few selected academics on topics including coordinated effects.

The coordinated effects theory complements the broad spectrum of theories of harm which MOFCOM has used so far. In most of the cases that ended with a published MOFCOM decision, the sole or main issue was "unilateral effects" (ie, reduction of competition between the merging parties) — or sometimes MOFCOM simply did not explain its legal and economic thinking in detail at all.

When examining unilateral effects, MOFCOM has taken into consideration a variety of factors, the most important of which is market share. Judging from past cases (such as the Panasonic/Sanyo transaction) it appears that combined market shares of 45 percent and above are potentially problematic.

In addition, in Coca-Cola/Huiyuan, MOFCOM blocked the transaction due to concerns that the parties' product portfolios would give rise to "conglomerate effects." But, of course, some observers have voiced the view that the real issue in that case was industrial rather than antitrust policy.

Finally, in the Mitsubishi Rayon/Lucite International and General Motors/Delphi transactions, MOFCOM examined the vertical effects of mergers. In General Motors/ Delphi, MOFCOM's concern was that the vertical integration between General Motors as a carmaker and Delphi as a car parts supplier would have negative impacts on their competitors at both levels in the production chain.

In Mitsubishi Rayon/Lucite International, the acquiror already operated at both levels within the supply chain. MOFCOM essentially found that the addition of the target's business on the upstream market would increase the merged entity's ability to foreclose downstream competitors.

## **Focus Remains on Remedies**

While the Novartis/Alcon decision illustrates the gradual expansion of MOFCOM's "toolbox" for substantive assessment — to some extent in alignment with international practice — other aspects of the decision depart from the approach of antitrust agencies in other jurisdictions: With less than a 1 percent market share, Novartis' addition to the 60 percent share of Alcon in the Chinese ophthalmological anti-inflammatory/anti-infective product market seems negligible and would hardly justify the imposition of remedies, no matter what their nature or extent.

A few weeks before the Novartis/Alcon decision, on July 8, MOFCOM had issued a regulation on the implementation of divestiture remedies. Although the regulation came into force with immediate effect, MOFCOM did not rely on it in the Novartis/Alcon case. Instead, MOFCOM decided to impose behavioral remedies, also to address the miniscule overlap in the ophthalmological anti-inflammatory/anti-infective product market.

While it is difficult to interpret the link between the adoption of the new regulation on divestiture remedies and the Novartis/Alcon decision, the combination of these two developments may at least convey one message: MOFCOM continues to focus on remedies of all sorts, including the increasingly detailed practical issues of implementing them.

Indeed, over the past few months, MOFCOM has held workshops on remedies and focused a good part of its legislative efforts on this issue. Some observers on the ground believe that, especially in cases where the U.S. and EU antitrust agencies have imposed (or, in MOFCOM's view, are likely to impose) remedies, MOFCOM is keen to also subject the transactions to remedies in China — whether structural or behavioral — even though the remedies often display characteristics seemingly tailored for the Chinese market.

## Conclusions

The Novartis/Alcon decision is only the sixth decision in which MOFCOM has imposed conditions, out of a total of around 140 notified transactions. While the high number of relatively routine transactions currently going into the phase 2 procedure is clearly unsatisfactory, the fact that the vast majority of cases are being cleared unconditionally shows a certain degree of restraint on the part of MOFCOM.

MOFCOM has recently been going on a charm offensive in the Chinese media, claiming that the AML is applied equally to foreign and domestic applicants alike and there is no "discrimination:" MOFCOM asserts it is simply because foreign companies have relatively high market shares that all the conditional clearance and prohibition decisions have impacted on multinationals (as opposed to home-grown companies).

However, the Novartis/Alcon case will continue to provide fuel for the fire of those observers who complain about discrimination. To date, there has not been any published decision in which a local Chinese company has been subject to an adverse ruling under the AML merger control regime.

The Novartis/Alcon decision evidences MOFCOM's continued willingness to intervene in foreign-to-foreign transactions which it believes raise competition issues in China. Hence, even foreign companies with small market shares are not immune from MOFCOM intervention when submitting for clearance, and all foreign investors should take note of the increasing sophistication of MOFCOM's scrutiny of business transactions caught by the AML.

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