
Completed acquisition by Advanced Medical Optics Inc. of Pfizer Inc.'s Surgical Ophthalmic Business

The OFT's decision on reference under section 22 (1) given on 23 July 2004

Please note that square brackets indicate information excised, or exact figures replaced by a range, at the parties' or third parties' request

PARTIES

1. **Advanced Medical Optics Inc.** (AMO) is a global supplier of ophthalmic surgical products. Specifically it is active in the research & development (R&D), manufacture and supply of phaco-emulsification machines (phaco equipment), intraocular lenses (IOLs) and various disposables surgical products (disposables).
2. **Surgical Ophthalmic Business** (SB) is a global manufacturer of ophthalmic surgical products. SB supplies viscoelastic solutions for ocular surgery, IOLs and various disposables. SB is owned by **Pfizer Inc.** (Pfizer), a global pharmaceutical company active in health care, animal health and consumer health care.

TRANSACTION

3. AMO has acquired Pfizer's SB in a \$450 million all-cash transaction. The assets acquired include the Healon[®] line of viscoelastic products, the CeeOn[®] and the Tecnis[®] IOLs and the Baerveldt[®] glaucoma shunt. AMO has also acquired related R&D and manufacturing facilities in Groningen, Netherlands; Uppsala, Sweden; and Bangalore, India.
4. The transaction was announced on 21 April 2004 and completed on 28 June 2004. The 40-day administrative deadline expires on 13 September 2004. The 4-month statutory deadline expires on 28 October 2004.

JURISDICTION

5. AMO and SB have ceased to be distinct enterprises. They primarily overlap in IOLs, where their share of supply exceeds 25 per cent of the UK market ([20-30] per cent with an increment of [0-10]) per cent meeting the share of supply test in section 23 of the Enterprise Act 2002 (the Act). The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

RELEVANT MARKET

6. The parties are suppliers of ophthalmic surgical products, which are products used in eye surgery procedures. Here below is a description of the stages of a typical procedure – the microincision procedure - and of the various ophthalmic surgical products used:
 - a) Incision: the act of making a cut into the eye following the application of anaesthesia to the patient. A **viscoelastic solution** is then injected into the anterior chamber to protect the cornea and to create space for the surgeon to operate.
 - b) Capsulorhexus: the act of creating an opening in the anterior capsule, which is a thin membrane surrounding the cataract.
 - c) Phaco-emulsification: the aspect of the procedure in which ultrasonic vibrations are used to break the cataract into smaller fragments through the use of specialised medical **phaco equipment**. The fragments are then aspirated from the eye using the same instrumentation.
 - d) IOL Implantation: the act of inserting a synthetic lens, an **IOL**, to replace the cataractous natural lenses. The viscoelastic is suctioned out and an antibiotic is injected.

To perform the operation, the surgeon use various **disposables**, including sutures, knives/scalpels and other surgical instruments, like wipes, drapes, eye spears, shields and balanced salt solutions.

Parties' products

7. The parties overlap primarily in IOLs and to a lesser extent in viscoelastic solutions and disposables. AMO is also active in phaco equipment. Overlaps may be summarised as follows:

Table 1: Overlaps between the parties

Eye surgery procedure	AMO product	SB product
Viscoelastics	X ¹	X
Phaco-equipment	X	N/A
IOLs	X	X
Disposables	X	X

Product market

Viscoelastics solutions

8. Viscoelastic solutions are generally differentiated according to their degree of viscosity, which determines how readily they remain in the eye and how easily they are removed following the procedure. On the demand side, surgeons have generally varying preferences for particular brands based upon historical usage, which may generate resistance to substituting them for others. However, viscoelastics perform fundamentally the same function and as such there is no operational reason why substitution cannot take place. For the purposes of assessing this case the appropriate frame of reference would appear to be the R&D, manufacture and supply of viscoelastic solutions.

Phaco-equipment

9. AMO is active in R&D and supply of phaco-equipment manufactured by a third-party. SB is not present in this segment and therefore there is no direct overlap. Discussion is included here for completeness given concerns raised about the portfolio effects of the merger discussed below.

Disposables

10. The direct overlaps between the parties in this segment are restricted to the resale of balanced salt solutions purchased from independent third party manufactures. In the UK, the parties estimate that they supply less than 5 per cent in this narrowly identified segment for balanced salt solutions and no larger than 5 per cent in the wider supply segment. Given the minimal overlaps, it has not been necessary to reach a conclusion on whether disposables should be considered by specific product or as a whole.

IOLs

11. The parties state that IOLs are highly differentiated products, undergoing constant technological innovation. They can be foldable or non-foldable and mono-focal or multi-focal. Foldable IOLs can be made from different materials (silicone and acrylic) and can have different optical edge designs (rounded or square).
12. On the demand side, all types of IOLs are used to replace the natural lens in eyes that have developed cataracts and therefore they may all be considered possible substitutes. However, surgeons and patients generally have preferences for different lens attributes including flexibility, firmness, comfort, safety and overall visual quality. There may also be instances where a particular lens manufactured by a particular company is best suited for a particular procedure. Given their differentiated nature, at its narrowest each IOL may be considered as a separate frame of reference.
13. On the supply side, IOL suppliers offer a range of different lenses with varying characteristics. The NHS Purchasing and Supply Agency (PASA), which negotiates a national framework agreement for IOLs, has ten suppliers on the agreement all of which offer the key capabilities of IOLs. Furthermore all companies are actively seeking to innovate and develop next-generation lenses with a range of different characteristics. It would therefore appear that on supply side there exists substitution between the range of lenses.
14. Given supply side substitution between lens types, the appropriate frame of reference for analysing this case is considered to be the R&D, manufacture and supply of IOLs.

Geographic market

15. The parties submit that the relevant geographic market is worldwide. Both are global suppliers but have R&D facilities and manufacturing operations in a few countries. Products are therefore imported and transport costs represent a low percentage of the total delivered cost². The parties' main competitors are also global suppliers.

¹ AMO resells viscoelastics produced by Corneal and Allergan in certain European countries and also into the US. It is not active in the supply of viscoelastics in the UK.

² The parties estimate that transport costs represent around [less than 5] per cent of the total delivered cost.

16. One third party identified difficulties in exporting products outside Europe due to the existence of special regulatory controls in the US, Canadian and Japanese jurisdictions, possibly suggesting a narrower geographic market.
17. Furthermore, although companies active in these products are generally global suppliers it would appear beneficial for companies to have a presence at the national level particularly for understanding negotiating and pricing strategies vis-a-vis hospitals and the health service and for distribution purposes. On this basis, a cautious view is taken in this case and the merger will be assessed in the context of the UK.

HORIZONTAL ISSUES

18. In the UK the parties are active primarily in the supply of IOLs. Direct overlaps in disposables are minimal.

Viscoelastics and phaco equipment

19. There are no direct overlaps between the parties in these segments in the UK. In the supply of viscoelastics, core to SB's business, AMO is not active in the UK. Post merger the parties estimate that they will supply [30-40] per cent of viscoelastics (increment [0-10] per cent) in Europe. Only AMO is active in phaco equipment.

IOLs

20. The parties estimate that post-merger they will supply [20-30] per cent of IOLs in the UK, an increment of [0-10] per cent enhancing AMO's position as the second largest supplier of IOLs behind Alcon. There are also a number of smaller providers. The post merger Herfindahl Hirschman Index figure of 2449 (increment 176) suggests that on normal measures the supply of IOLs is highly concentrated. UK shares of supply are shown on table 2 below.
21. The parties claim that in competitive tenders AMO has competed infrequently against SB and instead faced competition mainly from Alcon and Bausch & Lomb. Evidence supplied by the parties suggests that SB has only negotiated contracts individually with hospitals and with the PASA.

Table 2: UK Share of supply of IOLs

	Share of supply of IOLS
AMO	[20-30]%
SB	[0-10]%
Combined	[20-30]%
Alcon	[30-40]%
Bausch&Lomb/Chauvin	[10-20]%
Rayner	[10-20]%
IOL Tech/Ciba	[0-10]%
Others	[0-10]%

Source: The parties

Based on value, Value of UK IOL supply £[] million

Disposables

22. As discussed above (§10), the parties have a minimal presence in this segment (no more than 5 per cent).

Barriers to Entry

23. The necessity for investment in R&D may act as a barrier to entry. However, the investments permit companies to expand and reposition themselves in the market once a foothold has been gained. Reputation is also considered to be a barrier. It is important for products to have a track record of successful performance for them to be credible amongst users. Surgeons therefore tend to be loyal to particular lenses and brands. This indicates that it may be difficult for new entrants to penetrate the market.

Buyer Power

24. Customers, competitors and the PASA agree that the NHS acts as a 'de-facto' price setter in the UK and exercises significant buyer power. It sets reimbursement rates for cataract procedures and conducts national tenders based upon which it issues pricing guidelines, which are used by individual hospitals as a benchmark to keenly negotiate lower prices. Evidence that such practices have resulted in lower prices being charged in the UK than in other industrialised countries suggests that customers exert at least some countervailing buyer power.

PORTFOLIO ISSUES

25. Third parties have alleged that the complementary nature of viscoelastics and IOLs leads to foreclosure concerns. The primary source of these alleged

concerns may be summarized as resting on the following propositions:

- The merger will provide the parties with a strong portfolio of ophthalmic surgical products. As illustrated by table 3 below, AMO is active in IOLs and phaco-equipment and SB is strong in viscoelastics.

Table 3: UK shares of supply across the products required to perform cataract surgery

	IOLS	Viscoelastics	Phacomachines
AMO	[20-30]%	0%	[10-20]%
SOB	[0-10]%	[50-60]%	0%
Combined	[20-30]%	[50-60]%	[10-20]%
Alcon	[30-40]%	[20-30]%	[40-50]%
Bausch&Lomb/Chauvin	[20-30]%	[0-10]%	[10-20]%
Rayner	[10-20]%		
IOL Tech/Ciba	[0-10]%	[0-10]%	
Others	5%	9%	27%

Source: IOLs and Viscoelastics based on the parties estimates, Phacomachines taken from 'Market Scope 2002' report

- Customers sometimes conduct tenders that include viscoelastics, IOLs and disposables. By acquiring SB's viscoelastics, AMO will use this strength in viscoelastics to grow its IOL business by linking purchases of IOLs to its viscoelastics products. The concern would appear to be substantiated to some degree by presentations made to AMO's [] pre-merger which state that the acquisition '*provides the ability to bundle IOL and viscoelastic products*'³.

26. The parties have denied such claims, maintaining that the term 'bundling' in the presentation does not refer to tying goods such that the sale of one product to a customer is conditional on the purchase of the second nor to other forms of exclusionary conduct based on leveraging market power from one product to another. The parties claim that the term refers to the enhanced ability of combined AMO/SB to respond to customers who request competitive bids covering multiple cataract surgical products.

27. In any event, a post merger strategy of tying would not be expected to be sustainable. First, customers face a number of alternative providers in each segment to whom they could switch which would destabilise any tie-in behaviour. Secondly, although benefits may be derived from sourcing from a

³ [].

single supplier (see below), some customers appear very willing to source from a range of different companies even where the same product is concerned.

28. It is plausible that post merger the parties could benefit from being able to offer customers a broader product range. Indeed, having a narrower product line compared to its main rivals appears to have disadvantaged SB at least in the past, resulting in the possible loss of customers⁴. As such, it may be the case that by providing AMO with a range of products, the merger will increase competitive pressure on the largest supplier in this sector, Alcon, thus generating rivalry enhancing efficiencies.
29. Third parties have commented that it is possible that the merger will bring them benefits of sourcing from a single supplier: prices are generally lower and it is also more practical when performing surgery and re-ordering products.

Conclusion

30. The weight of overall evidence suggest that the conglomerate concerns arising from this merger are not sufficiently well-founded as to justify the OFT's statutory belief for reference under section 22 of the Act. The OFT considers there to be no realistic prospect that AMO has both the ability and incentives to foreclose rivals in IOLs and thus ultimately harm consumers.

THIRD PARTY VIEWS

31. Two third parties expressed concerns regarding AMO's enhanced portfolio of cataract products post merger. These concerns are addressed above.

ASSESSMENT

32. The parties overlap primarily in the supply of IOLs. The merger will enhance AMO's position as the second largest supplier of IOLs in the UK. Direct overlaps in other segments are minimal.
33. As viscoelastics and IOLs are highly complementary, third parties have raised some foreclosure concerns. The evidence gathered does not support the proposition that AMO has either the ability or incentives to foreclose rivals, in particular, by linking in purchases of IOLs to viscoelastics.
34. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted, or may be expected to result, in a substantial lessening of

⁴ Market Scope report states that SB has lost share in its viscoelastic product to Alcon as it has not had the breadth of product line that Alcon has developed over recent years.

competition within a market or markets in the United Kingdom.

DECISION

35. This merger will therefore **not be referred** to the Competition Commission under section 22 (1) of the Enterprise Act.