Essilor's Proposed Combination with an Optical Lens Maker in Korea is Blocked

In its press release on March 17, 2014, the Korea Fair Trade Commission (the "KFTC") blocked the proposed acquisition of 50% shares by Essilor Amera Investment Pte. Ltd. (a subsidiary of Essilor International S.A., the largest optical lens maker in the world) in Daemyung Optical Co., Ltd. (the second largest optical lens maker in Korea) citing inter alia the likely lessening effect on price competition and the probable future abuses of the enhanced market power. On top of the expressed competitive concerns, the KFTC observed that allowing foreign firms to acquire local firms and turn them into their local sub-contractors worsens the competitive market structure of the domestic optical lens industry.

This was the first case in which the KFTC blocked a proposed combination since 2007 (when the KFTC blocked the business transfer deal between Owens Corning and Saint-Gobain Vetrotex for the latter's business of the glass fibre reinforcements and composite fabrics) and also the very first case in which an acquisition of a Korean firm by a non-Korean firm was blocked in Korea.

Factual Backdrop of the Proposed Combination

The filing of the proposed combination was preceded by a share acquisition agreement dated January 4, 2013 by and between Essilor Amera Investment Pte. Ltd. (a subsidiary acting as the acquiring party on behalf of Essilor International S.A.) and Daemyung Optical Co., Ltd. In 2002, Essilor International S.A. entered Korea by acquiring Chemiglas Corp., the largest optical lens maker in Korea at the time. As the largest maker of optical lens in Korea and the world, this proposed combination was Essilor's second attempt at acquiring a major local firm in the Korean optical lens industry.

The KFTC Blocks the Proposed Combination

After taking more than one year in its review, the KFTC announced its decision to block the proposed combination. The proposed combination itself seemed to gravely worsen the concentration ratio in the optical lens industry, on top of probable anti-competitive consequences the KFTC perceived as not only likely but irreversible once they occur. The relevant product markets were two: the one for short-focus lens and the other for multi-focal lens. Both product markets were then confined to the geographic perimeter of Korea.

In Korea, a proposed combination between the firms whose collective market share will surpass the statutory threshold will trigger a rebuttable presumption of likely competitive harm. More specifically, the requirements triggering such a presumption are: (i) the combining firms collectively claim a market share of 50% or higher (or the top three firms, including the combining firms, claim a market share of 75% or higher); (ii) the collective market share of the combining firms is the largest in the relevant market; and (iii) when the difference in market shares between the combining firms (collectively) and the second highest firm comprises 25% or more of the collective market share of the combining firms.

The KFTC concluded that the post-combination concentration ratio justified the presumption of competitive harm. More specifically, the proposed combination would have given the combining firms a collective market share of 66.3% in the market for short-focus lens and 46.2% in the market for multi-focal lens. In both of these markets, the collective market share of the combining firms would have far surpassed those of other competitors, most notably surpassing (by over 50%) the market share of 11.1% held by Hanmi Swiss Optical Co., Ltd. as the second largest firm in the short-focus lens market in Korea. The triggering of the statutory presumption of competitive harm seemed well justified.

On top of the statutory presumption, the KFTC also found the likelihood of competitive harms in the markets for short-focus lens and for multi-focal lens in Korea. More specifically, the KFTC concluded that: (i) Daemyung Optical has been acting as the price leader for the last ten years, and the proposed combination will wipe out price competition between Daemyung Optical and Essilor; (ii) the combined firm will be the only firm offering the full-line of optical lens and may leverage the enhanced market power to coerce tie-in sales or to impose other unreasonable terms of trade; and (iii) the disappearance of a maverick firm like Daemyung Optical will likely create oligopoly effects by making easier a market-wide practice of information sharing and consciously parallel behaviors. Furthermore, the in-flow of foreign competition from China seemed unlikely, given the quality difference etc.

The foregoing consideration seemed to show that the proposed combination will likely worsen the competitive structure in the optical lens industry for which an imposition of behavioral remedies (e.g., no price increase for a stipulated time period) will be inadequate. Therefore, the KFTC decided to block the proposed combination.

Remarks on the KFTC Decision

This decision made it clear once again that a combination posing probable competitive harms that are difficult to cure will be blocked by the agency. Under the Standards for Imposing Remedial Orders on Business Combinations issued in 2011 (the "Guidelines"), structural remedies are to be given consideration in priority over behavioral remedies. More specifically, the Guidelines authorize the KFTC to block or unwind any proposed combination if it poses probable competitive harms for which there is no other remedy. This was the first case of a blocked combination since the issuance of the Guidelines.

This decision also shows the KFTC's stern inclination to confine the geographical scope of relevant markets to the national boundary of Korea unless such a finding of geographic market is clearly refuted by facts. A broader definition of the geographic market may have helped Essilor on the effects of the probable competitive harms. However, citing the perceptions shared among the buyers and the sellers, the improbability of Chinese firms penetrating the Korean market, along with economic analyses, the KFTC defined the geographic scope of the markets as Korea.

The decision also appeared to have been motivated by the desire to protect the domestic market structure, specifically domestic lens makers that are small-to-medium-sized. The press release stated the KFTC's perceived need to "keep solid domestic firms from being acquired by foreign firms only to be relegated to the position of being their sub-contractors" and thereby "maintain the existing competitive structure". This may suggest the possibility that future attempts by foreign firms to acquire local small-to-medium-sized firms in Korea (if the culmination of which gives them much more enhanced market share and power) likely will face difficulties in obtaining clearance from the KFTC.

Since the adoption of "commitment decision" system in 2011, firms whose cases are under review or investigation by the KFTC may propose their own solutions to settle their cases with the KFTC without a finding of wrongdoing. Although there has not been any precedent to this date where a commitment decision was used on a business combination, this system may be used for business combination cases, especially if obtaining clearance is expected to be difficult.

In the case of Essilor, it may have helped Essilor to propose a combination of post-combination remedies (both behavioral and structural) to avail itself of the commitment decision system. As for the behavioral remedies, it may have helped Essilor to propose to commit for a certain post-combination period to not raise its prices and to also apply fair terms of trade to its dealers, as these are some of the typical concerns expressed by the KFTC in reviewing a prospect of enhanced market power. While these remedies alone would not have sufficed, they certainly could have been buttressed by proposing some structural remedies – i.e., implementing a separation of the management between Daemyung and Chemiglas to enable price competition between the two or, if necessary, proposing a partial sell-off of the short-focus lens business of Daemyung. On top of proposing these remedies, it may also have been a worthwhile idea to consider highlighting competitive pressure from adjacent markets, specifically due to the substitutability between the lens for eyeglasses and a variety of other "vision-correcting" solutions ranging from contact lens to surgical methods. Highlighting such competitive pressure may have helped Essilor to suggest the propriety of a commitment decision for its proposed combination.

Should you have any questions regarding any of the foregoing, please contact us at any time.

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