ANTICIPATED ACQUISITION BY COCHLEAR LIMITED OF THE HEARING IMPLANTS BUSINESS OF DEMANT A/S, KNOWN AS OTICON MEDICAL

Summary of final report

Notified: 22 June 2023

Overview of our findings

1. The Competition and Markets Authority (**CMA**) has found that Cochlear Limited's (**Cochlear**'s) proposed purchase of the hearing implants division (**Oticon Medical**) of Demant A\S (**Demant**) (the **Merger**) may be expected to result in a substantial lessening of competition (**SLC**) in the supply of bone conduction solutions (**BCS**) in the UK.[1] This could lead to poorer patient outcomes, with patients potentially facing less choice, reduced quality or reduced product innovation, as well as the potential for higher prices for the NHS.

2. Having found that the Merger may be expected to result in an SLC in the supply of BCS, we have concluded that a partial prohibition of the Merger, that is prohibiting the sale of the BCS business of Oticon Medical to Cochlear, would be an effective and proportionate remedy to address our concerns.

Who are the businesses and what products do they provide?

3. Cochlear manufactures and supplies hearing devices used by healthcare professionals to treat a range of types of hearing loss, with a particular focus on cochlear implants (**CI**) and BCS (together, **hearing implants**).[2]

[1] We refer to Cochlear and Demant collectively as 'the **Parties**', and post-Merger to Cochlear and Oticon Medical collectively as 'the **Merged Entity**'.
[2] Final Merger Notice (FMN), paragraph 45.

4. Demant develops, manufactures and supplies hearing implants (both CI and BCS) through Oticon Medical.[3] Demant also supplies hearing aids, operates clinics providing hearing care solutions, and supplies hearing diagnostic products and audio solutions for enterprise, gaming and air traffic control.[4]

5. BCS are used in the treatment of conductive, mixed and single-sided hearing loss. They bypass damaged parts of the ear by using a sound processor that converts sounds into vibrations that are sent directly to the inner ear.[5] There are two types of BCS products: Passive and Active. They differ in the way they connect the transducer (that translates sounds into vibrations transmitted through the bone) to the sound processor.

Our assessment

Why did we review this merger?

6. The CMA's primary duty is to seek to promote competition for the benefit of consumers.[6] It has a duty to investigate mergers that could raise competition concerns in the UK, provided it has jurisdiction to do so.[7]

7. In this case, the CMA has jurisdiction over the Merger because the Parties' overlapping activities meet the 'share of supply' jurisdictional test: the Parties have a combined share of supply of BCS products in the UK of [90-100%].

What evidence have we looked at?

8. In assessing the competitive effects of the Merger, we looked at a wide range of evidence that we considered in the round to reach our findings.

9. We received submissions and responses to information requests from the Parties and held hearings with each of Cochlear and Demant. We also examined a significant volume of the Parties' own internal documents, which show how they run their businesses and how they view their rivals in the ordinary course of business. These internal documents were also helpful in understanding the Parties' thinking at the time of the proposals for the Merger and their plans for the future of their businesses.

[3] FMN, paragraph 49.
[4] FMN, paragraph 49.
[5] FMN, page 2.
[6] Section 25(3) Enterprise and Regulatory Reform Act 2013.
[7] In relation to anticipated mergers, sections 33 and 36 Enterprise Act 2002.

10. We spoke to and gathered information from NHS purchasing authorities, clinics that are responsible for selecting these products on behalf of patients, competitors and other interested parties to understand the competitive landscape and get their views on the impact of the Merger.

11. We also considered evidence from the Parties and third parties received during the CMA's phase 1 investigation into the Merger.

What did the evidence tell us …

… about what would likely have happened had the Merger not taken place?

12. In order to determine what (if any) impact the Merger may be expected to have on competition, we have considered what would likely have happened had the Merger not taken place. This is known as the counterfactual.

13. Demant told us that it had taken a decision to exit the business for the supply of hearing implants and that if it had been unable to sell the business, it would have closed it down, while maintaining some services to people who already had been fitted with its hearing implants, such as servicing and repairs of their implants. Demant said that the Oticon Medical business had been loss-making for some time; it was only a small proportion of Demant's overall business; and it was an unwelcome distraction from Demant's core business in hearing aids.

14. The Parties told us that Cochlear was the only potential purchaser who had the scale needed to cover fixed costs, would be able to invest in the required level of R&D, and would be able to provide an appropriate level of long-term support for Oticon Medical's existing patients.

15. We considered whether it was likely that Demant would have closed the implant business, if it was unable to sell the business to Cochlear.

16. Oticon Medical has been loss-making. This was exacerbated by a product recall for its CI product in 2021 and by the Coronavirus (COVID-19) pandemic, which effectively stopped most implant surgeries. There is no evidence from the time the Merger was agreed of a decision to close the Oticon Medical business. Demant provided evidence, which was prepared after the announcement of the Merger, describing discussions at Board level about a desire to exit the hearing implant business with a solution that would ensure the best lifelong support for its patients.

17. Internal Demant management accounts from the time show the BCS business to have been profitable and growing, a trend that has continued since the

announcement of the Merger. Internal Oticon Medical documents also show that the development of a new Active BCS product (Sentio) to rival Cochlear's Osia product was continuing, despite challenges along the way.

18. The Parties provided evidence which was produced after the announcement of the Merger to show that the BCS profitability may have been supported to some extent by services from the wider Demant group and may have benefitted from some costs shared with the CI side of the business. Our view is that this type of cross-business support is quite common for large, multi-product businesses and is not evidence that Demant would necessarily have had an incentive to close the business. In response to the Remedies Notice, Demant produced further analysis showing the BCS business (separate from the CI business, but retained within the Demant Group) to be profitable. Moreover, the growing revenues in Oticon Medical's existing Passive BCS implants and processors, along with a potentially valuable IP asset in Sentio, would have made Oticon Medical's BCS business potentially attractive to alternative purchasers, whether as a standalone business or as part of the wider Oticon Medical business.

19. Alternative purchasers expressed interest in Oticon Medical, particularly, but not solely, in the BCS business. These potential purchasers continue to express interest in the business.

20. We conclude that if the Merger did not go ahead, the most likely counterfactual is that Oticon Medical would have continued to operate in the BCS business, either as part of Demant or having been sold to an alternative purchaser.

… about the effects of the Merger?

21. We considered the degree of rivalry between the Parties in the supply of BCS products. The Parties are the two largest BCS suppliers in the UK with a combined market share of [90–100%] in 2022. MED-EL UK Limited (**MED-EL**) is the only other supplier in the UK.

22. The Parties told us that the sector is shifting from Passive BCS to Active BCS at a significant rate. Oticon Medical does not currently have an Active BCS product and the Parties told us that the future of Sentio is unclear.

23. The evidence from clinics and from the Parties' internal documents shows that Passive BCS products will continue to be prescribed to a significant percentage of patients over the next two to three years, despite the increasing use of Active BCS.

24. The evidence shows that the Parties are each other's closest competitor in relation to Passive BCS and competition from MED-EL's Active BCS product

is significantly weaker. Our view is that the Merger would likely lead to a reduction in competition in Passive BCS by bringing together the only two suppliers of Passive BCS products in the UK.

25. Our view is that the Merger would also likely lead to a reduction in competition for Active BCS products. Cochlear is by far the larger of the only two existing suppliers of Active BCS products in the UK: MED-EL being the other supplier. The evidence from Oticon Medical shows that the development of Sentio, Oticon Medical's new Active BCS product, is progressing. If launched, both Parties expect Sentio to compete with Cochlear's Osia product. In our view, internal documents show that Cochlear views Sentio as a competitive threat and is already responding to that threat. Our view is that the Merger would likely result in the loss of that competition from Sentio.

26. Contrary to the Parties' view that BCS suppliers compete with providers of other hearing solutions, our view is that the evidence from clinics and internal documents shows that competition from other hearing solutions is limited.

27. Our view is that the Parties currently impose an important competitive constraint on each other that would be lost as a result of the Merger. The market is already highly concentrated, and the Merged Entity would face limited competition from other suppliers post-Merger.

…. about the extent of buyer power against the Parties?

28. The Parties told us that the NHS is the main buyer of BCS products in the UK and has significant buyer power. With the exception of entry, which we cover below, a customer's buyer power depends on the availability of good alternative suppliers it can switch to which in our view would be likely substantially reduced as a result of the Merger.

…. about any countervailing factors?

29. We considered whether there are any actions which customers and/or potential entrants could take to prevent or mitigate any SLC arising from the Merger in the supply of BCS products in the UK.

30. We have not received any evidence on whether there are any Merger-specific, rivalry enhancing efficiencies which benefit UK customers that would be timely, likely and sufficient to prevent an SLC.

31. Nor have we received evidence from the Parties or third parties that entry or expansion, including that sponsored by the NHS, would be timely, likely and sufficient to prevent an SLC.

… about the overall impact of the Merger on consumers and the NHS?

32. Our statutory duty is to assess whether the Merger may be expected to result in an SLC within any market or markets in the UK for goods or services. Any such reduction in competition can have a potential impact on consumers.

33. In this case, we are concerned that the Merger could lead to poorer patient outcomes, with patients potentially facing less choice, reduced quality or reduced product innovation, as well as the potential for higher prices for the NHS.

Conclusion

34. Our view is that the Merger will eliminate a major BCS competitor from the market, that in addition to the Merged Entity only one BCS supplier would remain, and that the competition from that supplier and other hearing solutions would not be sufficient to offset the effects on competition of the Merger. The loss of this competitor would significantly reduce the alternatives available to the NHS and patients. We do not consider that entry or expansion would be likely, timely and sufficient to prevent an SLC from arising.

35. For the reasons above, we conclude that the Merger may be expected to result in an SLC in the supply of BCS products in the UK.

How will we address the competition concerns we have found?

36. Where we conclude that an anticipated merger may be expected to result in an SLC, we are required to decide what, if any, action should be taken to remedy, mitigate or prevent that SLC, or any adverse effect resulting from the SLC. In assessing possible remedies, we have sought to identify remedies that will be effective in addressing the SLC and resulting adverse effects we found and then selected the most proportionate remedy that we consider to be effective.

37. Following consultation with the Parties and third parties, we have decided that a partial prohibition of the Merger, that is prohibiting the sale of the BCS business to Cochlear, is the least costly or restrictive remedy out of the remedies that we consider to be effective in addressing the SLC and its adverse effects that we have found.

38. We acknowledge that there are possible risks associated with a partial prohibition, such as those arising from the need for an ongoing relationship

between the two key competitors in the market for BCS products, for a transitional period, while Demant supports the CI business's transfer to Cochlear. In order to ensure that the effectiveness of a partial prohibition remedy is not undermined, the terms of the separation process and sale of the CI business will require our approval before the transaction may complete.

What happens next?

39. The CMA will now take steps to implement the remedy described above. In line with statutory requirements, the CMA will implement its remedy decision within 12 weeks of publication of the final report, which may be extended once by up to six weeks if there are special reasons for doing so.[8]

40. If the CI business is sold to Cochlear, we will require that a monitoring trustee or equivalent independent expert is appointed to assist our assessment of the separation process and ensure that the effectiveness of the remedy is not undermined. The Parties will only be able to complete the transfer of the CI business to Cochlear subject to our approval of the terms of all agreements related to the separation. In the event that we do not approve the terms of the transaction, it will not be permitted to go ahead, and in that case the entire transaction would be prohibited.

[8] Section 41A of the Enterprise Act 2002; see also Merger remedies guidance (CMA87), December 2018, paragraph 4.68.