

Anticipated acquisition by Phonak AG of Comfort Audio i Halmstad AB

ME/6451-14

Summary

1. **Phonak AG (Phonak)**, a provider of hearing aid products and a range of wireless communication systems, has entered into an agreement with Holistic Hearing AB, **Comfort Audio i Halmstad AB (Comfort Audio)** (the **Merger**), which develops and supplies digital wireless high-end assistive listening devices (together the **Parties**).
2. The Competition and Markets Authority (**CMA**) considers that the Parties will cease to be distinct and that the share of supply is met. Therefore, it considers that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation pursuant to section 23(2) of the Enterprise Act (the **Act**).
3. On the narrowest basis, in the UK the Parties overlap in the supply of FM systems, a type of assistive listening devices for hearing-impaired people. The Parties sell these systems to local authorities (for use in schools) and to retailers (including private audiologists and high-street stores), either directly or via distributors. The CMA distinguished in its analysis between the supply of FM systems to local authorities and to retailers. The CMA assessed the Merger on a UK-wide frame of reference.
4. In the local authority segment, where sales are made to local authorities, based on the estimates from the Parties and information from third parties, the Parties will have a combined market share of around [70–90]%, with an increment of [5–15]%. Comfort Audio is currently [X], with two other suppliers, Oticon and Connevans, also present. The CMA has found limited evidence of switching providers by local authorities and considers that after the Merger other companies in the segment are likely to provide only a limited constraint on the Parties. Third parties commented that there were limited suppliers in the industry.
5. In the retail segment, the CMA has found a significant difference in share of supply estimates derived from information provided by the Parties and estimates based on information from third parties. The Parties' estimated

combined share in this segment ranges from around [20–45]%, with an increment of around [5–20]%. The CMA’s market investigation indicates that the range of products and suppliers in the retail segment is wider than in the local authorities segment, which forms the main focus of the FM systems segment in the UK. However, the CMA cannot rule out potential concerns because the merged entity will be the largest supplier in the retail segment.

6. For the reasons set out above, the CMA considers that the Merger gives rise to some competition concerns in the UK and cannot rule out that the test for reference may be met in this case. However, having taken account of all relevant factors, the CMA considers that the public cost of a reference would be greater than the impact of the Merger on consumers. The CMA therefore considers that, to the extent that its duty to refer may be met, it is appropriate to exercise its discretion to apply the ‘de minimis exception’ in this case.
7. The Merger will therefore **not be referred** under section 33(1) of the Act.

Assessment

Parties

8. **Phonak**, a private Swiss company, is a provider of hearing aid products and wireless communication systems. Phonak is part of the Sonova Group, also headquartered in Switzerland, a manufacturer of hearing care solutions, which operates through its core business brands of Phonak, Unitron, Advanced Bionics and Connect Hearing. Within the UK, Sonova’s turnover was £[⌘] million for the financial year ended 31 March 2014. On a retail level, Sonova is a 51% shareholder in a joint venture (**JV**) with Alliance Boots, the ‘David Ormerod/Boots’ JV, which was renamed in February 2014 as ‘Boots Hearingcare Limited’.
9. **Comfort Audio** is based in Sweden and had a total turnover in 2013 of SEK143.4 million (around £12.7 million), which develops and supplies digital assistive listening devices, the production of which is [⌘]. Comfort Audio started selling its products on the UK market through a distributor during 2004/05. While Comfort Audio formed a UK subsidiary, Comfort Audio Ltd, in May 2006, this entity has always been a dormant company. Comfort Audio’s UK turnover for the year ended 31 December 2013 was SEK[⌘] million (around £[⌘]).

Transaction

10. Pursuant to a share purchase agreement, signed on 13 June 2014 and announced on 16 June 2014, Phonak will acquire Comfort Audio for a

purchase price of SEK[~~xxx~~] million (approximately £[~~xxx~~] million). The Parties notified the Merger in Norway and the UK, and it is conditional upon regulatory approval in both jurisdictions. The Norwegian Competition Authority has since cleared the Merger.

Jurisdiction

11. As a result of the Merger, the enterprises of Phonak and Comfort Audio will cease to be distinct. The Parties are both active in the supply of FM systems (a type of assistive listening device) to local authorities and retailers and their combined share of supply to these customer groups exceeds 25% in the UK (see Tables 1 and 2 below). The CMA therefore considers that the share of supply test in section 23 of the Act is met in this case.
12. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation. The initial period for consideration of the Merger started on 22 July 2014, and the statutory deadline for a decision is 17 September 2014.

Background

13. The Parties overlap in supply of FM systems. The Parties submitted that these are assistive listening devices (**ALDs**) for hearing-impaired people and consist of wireless communication systems, generally consisting of a radio transmitter/microphone and a radio receiver, where the transmitter is placed close to the sound source (eg a teacher in a classroom) and the receiver is on the user. The microphone in the FM system captures sounds (speech and background noise), and then processes it so that the speech is enhanced and the background noise filtered out. The sound is then transmitted through the transmitter wirelessly to a receiver, without the background noises or echoes, allowing a purer sound to be received. FM systems are normally used in combination with hearing aid devices, although some can be used with headphones without the need for a hearing aid.
14. The Parties submitted that Phonak develops, manufactures and sells hearing aids as well as a range of wireless FM systems and assistive listening devices. Phonak's range of products comprises a variety of wireless accessories and FM systems.¹ Comfort Audio, on the other hand, is not active in the supply of hearing aids but develops and supplies other digital hearing products, in particular digital wireless high-end assistive listening devices.

¹ Phonak's brands include SmartLink+, ZoomLink+, EasyLink+, MLxi, ComPilot, MicroLink and Roger.

Comfort Audio supplies two types of wireless equipment: a personal hearing amplifier (Comfort Audio Duett) and FM systems (Comfort Audio Contego and Digisystems).

15. The Parties submitted that hearing aid devices may be dispensed through the NHS, although patients may alternatively choose to buy hearing aids from retailers, where they can choose among more options and avoid waiting periods.² FM systems, on the other hand, are not provided by the NHS and are sold to local authorities, distributors and retailers. Direct sales from manufacturers to end-users are rare.

Product frame of reference

16. The CMA considers that market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.³
17. The Parties overlap in the supply of FM systems to the local authority and retail segments. The overlap between the Parties in other types of ALDs in the UK is minimal, given that, according to the Parties, Comfort Audio's only ALD that is not an FM system (its 'Duett' product) [X].
18. Phonak sells its FM systems directly to local authorities, private audiologists, retailers and high-street stores (eg Boots Hearingcare), as well as selling through Connevans, its authorised distributor in the UK. Comfort Audio does not have offices in the UK, and sells its products through distributors. Distributors of Phonak and Comfort Audio also sell to retailers and local authorities.

Distinction between types of hearing solutions

19. The Parties submitted that FM systems formed part of the wider market for hearing solutions, including hearing aids. The Parties submitted that, in some cases, hearing-impaired individuals fitted with a hearing aid might require further improvement of the hearing aid solution, in particular where the

² Over 80% of hearing aids in the UK were sold to the NHS in 2012 (iData (2013) – European Market for Hearing Devices).

³ *Merger Assessment Guidelines* (OFT1254/CC2, September 2010), paragraph 5.2.2. The *Merger Assessment Guidelines* have been adopted by the CMA (see Annex D to *Mergers: Guidance on the CMA's Jurisdiction and Procedure*, CMA2, January 2014).

distance to the sound source is significant or the environment is very noisy, has a high degree of reverberation, and/or when their hearing impairment is severe. According to the Parties, these situations can be addressed by a number of different solutions, such as through the use of the 'T-loop' function in the hearing aid, an advanced hearing aid device or by using FM systems/ALDs.

20. The Parties submitted that therefore the majority of hearing aid devices were capable, at least to some degree, of addressing many of the issues that FM systems/ALDs seek to address, and these solutions were to some extent interchangeable from a demand-side perspective in that they all seek to address the issue of impaired hearing and thus target the same customer base.
21. Responses from third parties, however, indicated that there is limited, if any, substitutability on the demand side between hearing aids and FM systems/ALDs, as the technical characteristics of the latter allow for hearing improvements over and above the results achieved by hearing aids. None of the audiologists who provided information to the CMA responded that they would consider the use of hearing aids as a substitute for FM systems/ALDs, and most third parties considered that FM systems/ALDs were either complements to hearing aids or served a different purpose.
22. In addition, while the Parties did not distinguish between ALDs and FM systems,⁴ several third parties commented that FM systems were a sub-segment within the ALD category⁵ and that FM systems were the more advanced products. They noted in particular that FM systems enhanced speech over a distance and filtered out disturbing background noise. Third parties told the CMA that, if the most appropriate product for a hearing-impaired person is an FM system, then in response to a small price rise, the audiologist would not recommend to substitute this product for another type of ALD. The substitutability between FM systems and other ALDs is considered further for the different customer types below.
23. On the supply side, although all hearing aid manufacturers also provide some kind of ALD or FM system, the CMA noted that not all FM systems and ALD manufacturers also produce hearing aids. One competitor⁶ that explored this possibility was not able to introduce a range of hearing aids as the costs of set-up, marketing and testing were high. Moreover, the conditions of competition in the hearing aid segment are different from the FM systems

⁴ For this reason, the CMA has referred to FM/ALDs when referring to the Parties' submissions in this decision.

⁵ Other types of ALDs include, for example, amplified telephones and doorbells.

⁶ [REDACTED]

segment. The CMA's investigation indicated that the main customer in the UK hearing aid segment is the NHS, whereas the main customers for FM systems and ALDs are local authorities, who buy these products independently from the NHS. In the case of ALDs other than FM systems, the CMA notes that there are a wider range of products and a much larger number of companies manufacturing different types of ALDs compared to FM systems.

24. The CMA has therefore, on a cautious basis and given that the overlap between the Parties is in FM systems, considered the impact of the Merger on FM systems separately, although the CMA notes that in particular in the retail segment (see below) other types of ALDs may form some constraint.

Distinction between customer types

25. The CMA may sometimes define relevant markets for separate customer groups if the effects of the merger on competition to supply a targeted group of customers differ from its effects on other groups of customers, and require a separate analysis.⁷
26. The CMA considered whether sales of FM systems should be split into separate segments. For example, local authorities buy FM systems for children in schools while retailers serve the adult segment.
27. The Parties submitted that the same equipment to address a hearing impairment can be used for both children and adults, and that there is no distinctive difference between products used by children or adults. The Parties also submitted that, although they considered that the market definition should include all hearing aid devices or at least all the FM/ALD segment, factors which suggest that there are distinct segments within a market for the supply of FM/ALDs include:
- Sales negotiations for retailers including independent retailers are conducted on an individual basis, with promotional support also provided. Sales negotiations differ for sales to local authorities, with competitive tendering occasionally but increasingly being used.
 - Sales to local authorities are funded by the public sector, whereas the retail segment is private and end-consumers pay for their products directly.

⁷ *Merger Assessment Guidelines*, paragraph 5.2.28.

- FM/ALDs supplied to local authorities are also predominantly for paediatric use as opposed to the private segment, where the products are purchased predominantly by adults.
 - In general, the FM/ALD product is bought by a local authority to assist a child in a group educational situation (eg a classroom). In the retail segment, the product is also more frequently bought to assist an adult in one-to-one meeting situations (or with a small number of attendees).
 - There are some differences in the service level between the segments. Sales to local authorities are often offered with introductory and ongoing support from the FM/ALD producer in terms of explanations of how the products should be used by children and the schools. Sales support for sales made by retailers is generally limited to the explanation given by the hearing aid retailer to the customer at the point of sale.
28. Third parties also made a distinction between the paediatric segment and the adult segment. As set out below, the CMA identified differences in these two segments in terms of the range of products, and the set of competitors operating in them, as well as other specific issues that arise in each of these segments.

Sales to local authorities for use in schools

29. If an FM system is recommended for a child with a hearing impairment, the local authority would normally cover this need from a specific budget for hearing equipment for use in the classroom. The decision on the specific product that should be bought is made by the educational audiologists and/or teachers of the deaf in each local authority.
30. Third parties commented that most FM systems were targeted at the education segment, as they were the preferred product in this segment as they could be considered as an educational tool and were important for language development. In contrast, in the retail segment, where users were mostly adults, other products (eg remote microphones) were promoted in addition to FM systems.
31. This is consistent with the views gathered during the CMA's market investigation. The majority of local authorities contacted did not consider other ALDs as alternatives to FM systems in the case of a small but significant non-transitory increase in price (SSNIP).⁸

⁸ See *Merger Assessment Guidelines*, from paragraph 5.2.11.

32. The Parties provided internal documents which suggest that there are separate local authority/public segments,⁹ and that in the local authority segment only a subset of FM systems and ALD manufacturers have products suitable for a classroom environment. As a result of its market testing, the CMA is aware that many ALDs, including some FM systems, are considered to be less suited to the education segment, and that some manufacturers consider entry to be more difficult. This is reflected in the fact that the known suppliers to local authorities include only a subset of the FM system suppliers with sales in the UK (as set out in the competitive assessment below).

Sales to retailers

33. Neither Phonak nor Comfort Audio sell FM systems directly to final users, but sell to retailers directly or via distributors. The sales made by retailers are primarily focused on adult customers.
34. The CMA's investigation showed that for adult users FM systems may be required for attending conferences, lectures, meetings at the workplace or for use at home. Since the needs of the end-user are diverse, other ALDs may be suitable. In general, the end-user's decision will be influenced by audiologists or assessors, recommending the most suitable solution for the hearing-impaired person according to their type of hearing loss, their age, lifestyle and needs. End-users then buy the recommended products from retailers (mostly online) or private audiologists.
35. The Parties and third parties commented that in addition to FM systems, many hearing aid manufacturers were now offering wireless accessories that give customers better access to phone, television and voice over distance using remote microphones. Third parties told the CMA that although these accessories do not use FM technology, they can be suitable alternatives for certain customers. In particular, they said that some remote microphones have similar capabilities compared to FM systems and can address the noise and distance issues with hearing aids in certain circumstances. Also, for many customers, especially older customers, FM systems are more complex to operate and they prefer accessories that are easier to use.
36. The Parties submitted that some adult end-users will be able to access public funding for FM systems. For example, students in higher education can access funding via the Disabled Student Allowance (DSA) offered by Student Finance England, Student Finance Wales, the Student Awards Agency for Scotland or the NHS. These funds provide cover for specialist equipment (up

⁹ [REDACTED]

to £5,162), such as FM systems, for part- and full-time students. Access to Work is a similar scheme which provides financial support in the workplace required by adults with disabilities, health or mental health conditions.¹⁰

37. For both the Access to Work and DSA schemes, user requirements are determined by independent assessors. Assessors are required to seek three quotes from different retailers in order for the funding application process to be successful when the price of equipment is above £500.¹¹ The DSA scheme has a publicly available list of 19 certified retailers that supply the equipment funded (DSA Quality Assurance Group – DSA-QAG).¹² The CMA understands that there is a similar list of approved suppliers for the Access to Work scheme.
38. Retailers participating in the Access to Work and DSA schemes sell products from a number of manufacturers, and have no restrictions on the brands or types of products they choose to sell. These retailers will also sell products to final users who buy these products privately. The CMA therefore does not consider it appropriate to subdivide the retailer segment further for the Access to Work and DSA schemes.

Conclusion on the product scope of the frame of reference

39. As set out above, the Parties overlap in the provision of FM systems (with only a minimal overlap in the provision of other ALD products). While the Parties submitted that FM/ALDs form part of a wider market for hearing aid solutions, the majority of third party respondents did not consider hearing aids to be in the same market as FM systems/ALDs, and considered that FM systems/ALDs were complements to hearing aids or served a different purpose. Further, several third parties noted that for some customers, such as local authorities for use in schools, FM systems are not a substitute for other ALD products. In addition, the CMA found differences between the local authority (for use in schools) and retailer (for use mostly by adults) segments that indicate that the impact of the Merger may be different in each of these segments.
40. On the basis of the evidence set out above, the CMA therefore considers it appropriate, on a cautious basis, to assess the impact of the Merger on separate frames of reference for the sale of FM systems to local authorities for use in schools, and to retailers for private use. However, it was not

¹⁰ www.gov.uk/access-to-work/overview.

¹¹ www.gov.uk/government/uploads/system/uploads/attachment_data/file/255818/pg-access-to-work-needs-assessment.pdf , http://www.dsa-qag.org.uk/component/com_docman/Itemid,258/gid,271/task,doc_download/.

¹² Nineteen suppliers, with at least eight supplying FM/ALD systems.

necessary for the CMA to determine conclusively whether these separate segments constitute distinct relevant product markets.

Geographic frame of reference

41. The Parties submitted that the market is at least national and possibly wider (European-wide or worldwide). The Parties consider that the hearing aid solutions market (including FM/ALDs) may be global in scope because suppliers of hearing aid solutions use distributors to sell products worldwide and end-users can purchase the products directly over the Internet. However, the Parties acknowledged that there are some aspects that differ from country to country, such as distribution channels, public procurement and national reimbursement systems.
42. The CMA's investigation showed that:
- Local authorities are the most frequent customers, and will only buy from suppliers with presence in the UK, since they require frequent technical support, training and customer service
 - List prices are set at the UK level
 - Phonak provided internal documents¹³ that shows marketing and sales strategies for the UK. In particular, [✂]
 - FM systems require optimisation specific to each customer. Private customers need to go to an audiologist to fit the FM system
43. The CMA considers that the above evidence points to a national market for the supply of FM systems. Therefore, while the CMA has not found it necessary to conclude on the exact frame of reference because, as set out below, it did not need to reach a conclusion on SLC, applying a cautious approach it has assessed the Merger on a UK-wide frame of reference.

Counterfactual

44. The CMA assesses the Merger's impact relative to the situation that would prevail absent the merger (that is, the counterfactual). In practice, the CMA generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, the continuation of the pre-merger

¹³ [✂]

conditions of competition is not realistic or there is a realistic prospect of a counterfactual that is more competitive.¹⁴ In this case, there is no evidence supporting a different counterfactual, and the Parties have not put forward arguments in this respect. Therefore, the CMA considers the prevailing conditions of competition to be the relevant counterfactual.

Competitive assessment

Horizontal unilateral effects

Supply of FM systems to local authorities for use in schools

Shares of supply

45. The Parties submitted that shares of supply for FM/ALDs were difficult to estimate, as there was little public information available. In addition, where the receiver and transmitter parts of the FM/ALDs are entirely integrated into other devices, the Parties stated that the value of the FM/ALDs becomes even more difficult to assess.
46. The Parties submitted that [X]% of Phonak's ALD and FM systems' sales in the UK are direct sales to local authorities for use in schools, with a further [X]% sold through its distributor Connevans, and the remaining [X]% sold directly to retailers or through Internet sales. [X] In total, taking into account Phonak direct sales and Connevans sales to local authorities, the CMA estimates that around [X]% of Phonak sales in the UK (£[X] million) are ultimately to local authorities.
47. Comfort Audio sells its products in the UK through distributors P C Werth and Gordon Morris, which then sell the products on to retailers, local authorities and end-users directly. Comfort Audio estimates that its sales to local authorities represent approximately [X]% of its sales in the UK (£[X] million).
48. The Parties estimated their sales to local authorities based on their own sales and estimates of their distributors' sales to local authorities. The Parties estimated competitors' sales figures from their market experience. As a result of its market investigation, the CMA also received third party estimates of sales to local authorities for 2013.
49. Table 1 below shows the Parties' and third parties' estimates of sales and shares of supply of FM systems to local authorities.

¹⁴ See *Mergers Assessment Guidelines*, paragraph 4.3.5 et seq.

TABLE 1 Sales of FM systems to local authorities in 2013

	<i>Parties' estimates</i>		<i>CMA estimates</i>	
	<i>Revenue</i> £m	<i>Share</i> %	<i>Revenue</i> £m	<i>Share</i> %
Phonak	[redacted]	[60–70]	[redacted] ¹⁵	[redacted]
Comfort Audio	[redacted] ¹⁶	[5–15]	[redacted] ¹⁷	[redacted]
Combined	[redacted]	[70–80]	[redacted]	[80–90]
GNReSound	-	-	[redacted]	[redacted]
Oticon	[redacted]	[5–15]	[redacted]	[redacted]
Connevens	[redacted] ¹⁸	[5–15]	[redacted]	[redacted]
Conversor	-	-	[redacted]	[redacted]
Total (million)	[<£3]	100	[<£3]	100

Source: Phonak/Comfort Audio and CMA calculation based on third party estimates.

50. Phonak's sales figures include direct sales to local authorities as well as sales through its distributor (Connevens). Comfort Audio's sales figures cover only sales through its distributors since it does not make direct sales in the UK. Both sets of estimates (sales figures estimated by the Parties and the CMA estimates) include a mark-up over wholesale costs for sales via distributors.
51. The CMA considers that these estimated shares of supply for sales to local authorities, at a post-Merger level of around [70–90]% with an increment of around [5–15]%, point to prima facie concerns that the Merger may give rise to unilateral effects in the supply of FM systems to local authorities.
52. Given these prima facie concerns, the CMA has considered evidence on the extent of competition that would be lost between Phonak and Comfort Audio, and the strength of remaining constraints on the Parties' behaviour.

Closeness of competition between the Parties and their competitors

Parties' views

53. The Parties do not consider themselves as each other's closest competitors. They submitted that their products have different characteristics, since Comfort Audio's FM systems have 'round the neck' receivers, while Phonak's FM systems mainly have 'ear level' receivers.¹⁹ In addition, the Parties submitted that design features of their products were different and distinctive.
54. However, the Parties' internal documents²⁰ show that both Comfort Audio and Phonak compare their own range of products for the local authority segment with each other's range, as well as with the products of Oticon.

¹⁵ The CMA considers that [redacted]

¹⁶ [redacted]

¹⁷ See footnote 15 above.

¹⁸ This figure does not include Connevens' sales as Phonak's distributor.

¹⁹ For example, the FM system is integrated into the hearing aid or headphones.

²⁰ [redacted]

These documents indicate that in the local authority segment, Phonak regards [REDACTED] as direct competitors. Other products considered as potential competition were [REDACTED]. However, in internal documents Phonak considered these products were [REDACTED].²¹

55. The Parties submitted that significant competition will remain in the local authority segment post-Merger. The Parties stated that GN ReSound²² was a recent new entrant into the local authority segment and commented that the Merger would, as a result, see a reduction from at least five competitors to four in the segment (ie Connevans, Oticon and GN ReSound, in addition to the merged firm). The Parties also submitted that the presence of Widex and Conversor and Siemens, as potential entrants, represented a strong competitive fringe capable of exerting a significant pricing constraint on the Parties' behaviour. However, since the evidence obtained by the CMA indicates that these currently have no sales of FM systems in the UK, these are more appropriately considered in the section on barriers to entry below rather than as current competitors to the Parties.

Views of third parties

56. Third parties commented that, in general, the choice of product will be determined by the local authorities' budget, the quality of sound, design, the cost of the equipment, the cost of repairs, and a child's specific needs. From the CMA's market investigation it appears that all FM systems offer similar sound quality and are effective in addressing the problems of background noise and distance in classrooms. However, local authorities have additional considerations, for example the children's age²³ and the technical support received from the supplier when selecting the product to purchase. In addition, many local authorities will buy FM systems from more than one manufacturer in order to provide children with the appropriate solution according to their age and hearing loss.
57. Third parties expressed concern that the Merger would increase Phonak's strength in the local authority segment. One of these further mentioned that local authority customers were risk averse, and would not switch to other providers due to concerns that this would impact the language development of children. Another mentioned that switching can be difficult due to the lack of interoperability between different brands of FM systems. This third party was

²¹ [REDACTED]

²² The Parties submitted that GN ReSound has started to target the Local Authority segment, offering a remote microphone, combined with an integrated hearing aid and wireless receiver.

²³ See paragraph 62 below.

also concerned that the current choice of FM systems was already limited, and that the Merger would further restrict choice.

58. The CMA's investigation indicated that whilst switching seems to be limited (the majority of local authorities that responded to the CMA's market investigation have not considered switching), there were some examples of local authorities switching to Comfort Audio from Phonak or Connevens (its own FM systems rather than in its role as distributor of Phonak's systems). The reasons given to the CMA for switching include aesthetics (important for some age groups), compatibility with other equipment (eg cochlear implants that were not compatible with Phonak) or interference with other wireless systems.
59. The CMA's market testing provided little information about local authority responses to price changes, although some local authorities, when presented by the CMA with a hypothetical price increase, said that they would probably look around for other possible suppliers. The Parties submitted that prices have not changed over the last two years, and that Phonak had not changed the prices of its products in response to product launches from its competitors. However, while a local authority commented that it would look for other suppliers if price increases were not justified by improvements in the product, another local authority commented that it had in fact accepted a higher price for the product when it changed to Phonak's new Roger FM system.
60. Further, three audiologists said that, in response to a SSNIP, they would probably look for another provider. One thought his budget would allow the absorption of a 5% price increase but that if prices were increased by 10%, he would look for alternative suppliers, and another said that if prices increased, the result could be that fewer children would have access to FM systems.
61. The majority of the local authorities' educational audiologists that responded were aware of the three main FM systems suppliers in this segment (ie each of the Parties and Connevens). In two local authorities, the educational audiologists were also aware of Oticon, although they did not buy from this supplier. Third parties also confirmed that the use of competitive tendering is increasing, although currently uncommon.
62. Several competitors in the supply of FM systems in both the local authority and the retail segment told the CMA that the Parties were close competitors. Third parties commented further that there were some differences between the Parties' FM systems (which were characterised as more discreet) on the one hand and Connevens' products (which were characterised as better suited to younger children due to their robustness) on the other. Third parties considered that the existence of the two products (Phonak and Comfort

Audio) allowed customers choice, and that one of the risks of the Merger would be to lose the uniqueness of Comfort Audio.

Conclusion

63. Based on both the Parties' estimates and third party information, the Parties will have a combined share of supply of around [70–90%] for the local authority segment, with an increment of around [5–15]%. Comfort Audio is [X], with two other suppliers, Oticon and Connevans, also being present in the segment.
64. Although the CMA's investigation indicated that switching seems to be limited in this segment at present, there were some examples of local authorities switching from Phonak or Connevans to Comfort Audio.
65. Although the Parties considered that GN ReSound should be considered as a constraint, entry of this supplier to the local authority segment has been too recent for the CMA to have sufficient evidence to assess its effectiveness. However, the CMA considers that the Parties will continue to face some constraint from competing suppliers of FM systems in this segment, which may be strengthened by an increased use of competitive tendering by local authorities.
66. In conclusion, on the basis of the evidence available, the CMA considers that after the Merger Phonak and Comfort Audio: will have a very high market share; will be, by far, the largest supplier; are close competitors for sales of FM systems to local authorities (as indicated by internal documents and third party comments); and that the constraints from other companies in this segment are still limited at present. As a result, the CMA cannot rule out that there is a realistic prospect that the Merger will result in an SLC in the supply of FM systems to local authorities. However, as set out below, it does not find it necessary to conclude on this point.

Supply of FM systems to retailers

67. There are two main types of retailers that sell the Parties' FM systems:
 - online retailers, who sell FM systems, ALDs and other products, some of whom will be qualified suppliers under the Access to Work or DSA schemes
 - private audiologists, which can be audiology clinics or retail chains

Shares of supply

68. The Parties initially estimated that the value of the retail segment for 2013 was around £[~~3~~] million. However, based on information gathered during its market investigation, the CMA considers that this is likely to be an over-estimate of the value of the segment. Using the Parties' figures and data provided by third parties, the CMA estimates the value of sales to retailers to be around £[<3] million in 2013.²⁴

TABLE 2 Sales of FM systems to retailers in 2013

	<i>Estimates derived from information provided by the Parties²⁵</i>		<i>Estimates derived from third party responses</i>	
	<i>Revenue £m</i>	<i>Share %</i>	<i>Revenue £m</i>	<i>Share %</i>
Phonak	[3]	[3]	[3]	[3]
Comfort Audio	[3]	[3]	[3]	[3]
Combined	[3]	[3]	[3]	[3]
GN ReSound	[3]	[3]	[3]	[3]
Oticon	[3]	[3]	[3]	[3]
Siemens	[3]	[3]	[3]	[3]
Widex	[3]	[3]	[3]	[3]
Starkey	[3]	[3]	[3]	[3]
Connevens	[3]	[3]	[3]	[3]
Conversor	[3]	[3]	[3]	[3]
Others	[3]	[3]	[3]	[3]
Total	[3]	100	[<3]	100

Source: CMA estimates based on information from the Parties and third parties.

*[~~3~~].

69. Comfort Audio sells only through distributors, and some of these sales will be made direct to the end-user. The CMA understands that sales through Comfort Audio's distributors, and those Phonak sales through distributors, include retail margins (in the same way as in the calculations for Table 1 above).
70. The CMA's estimates of sales, based on information from the Parties and third parties, result in combined shares of supply for the Parties of around [35–45]%, with an increment of around [10–20]%. The estimates based on information provided by the Parties suggest lower shares, but the CMA considers that these are less reliable as they are made up of the Parties' estimates of third party sales.

²⁴ The main difference between the CMA's estimate and that of the Parties is [~~3~~].

²⁵ The Parties did not provide the estimates by competitor in the retail segment. They provided the retail segment's market value of £[~~3~~] million. The Parties provided estimated shares of supply for the total market for competitor's, and estimated sales for the local authority segment, which allowed the CMA to estimate the shares in the retail segment.

71. Given the uncertainty over the Parties' combined shares, the CMA has considered evidence on the extent of competition remaining in the retail segment.

Parties' views

72. The Parties submitted that practically all manufacturers of hearing aid devices also offer FM systems. Therefore, they stated that there will still be a significant number of major competitors post-Merger, able to provide strong competition to the Parties. According to the Parties, these companies include:

- GN ReSound, who, the Parties submitted, was considered to be in a leading competitive position
- the William Demant Group, which includes Oticon and Benetton, and which was considered to have a strong position in the UK due to its supply of hearing aids to the NHS
- Widex, which offers FM systems under the brand names Dex and Scola
- Connevans, which designs its own products and also acts as a distributor for Phonak
- Bellman & Symfon, which provides FM systems under the Domino brand
- Conversor, again UK based, which offers a line of FM systems

Views of third parties

73. In the retail segment, the main concerns of third parties were related to the increased strength of Phonak and the potential loss of choice for customers.

74. Third parties told the CMA that users tended to buy the same brand wireless accessories and FM systems as their hearing aids, and that if they have used a product in the past, they are generally reluctant to switch away from it. Third parties also told the CMA that price is very important in the private segment, where customers have to meet the full cost of the product.

75. Information from the Parties and third parties indicates that in addition to the FM systems, many hearing aid manufacturers were offering other ALDs, such as wireless accessories to give customers better access to phone, TV and voice over distance using remote microphones. Third parties told the CMA that although these accessories do not use FM technology, they can be suitable alternatives for certain customers in the retail segment.

76. Several third parties in the retail segment that responded to the CMA's market testing raised concerns about the Merger. These concerns included the creation of a significant market share, and the Parties' increased marketing capacity following the Merger. Third parties considered that product choice, already limited, may be restricted further should Phonak not continue with Comfort Audio's products. One third party expressed concerns that the Merger would influence research and development in this sector.

Summary and conclusion

77. The CMA notes that the Parties' estimated combined share of supply (at around [35–45]%) is significantly smaller in the retail segment compared to their shares of supply to local authorities. This is consistent with third parties' views, who told the CMA that FM systems sales in the UK were mainly focused on the local authority segment. However, the merged firm will be significantly larger than each of its competitors.
78. The CMA understands, as a result of its market investigation, that retailers usually sell products from a variety of manufacturers, and that there are no exclusive contracts. In the case of the Access to Work and DSA schemes, retailers will have some degree of influence on the products that assessors recommend.
79. There is very limited information on customer switching in this segment. As mentioned above, the CMA's investigation indicated that there is a degree of brand loyalty from the end-user. Purchasers tend to be adults, and the decision on which product to buy is largely determined by the DSA and Access to Work assessors' or a private audiologist's recommendations.
80. In conclusion, on the basis of the evidence available, the CMA considers that Phonak and Comfort Audio will have a significant share of supply. In contrast with the local authority segment, the range of products and suppliers in the retail segment is wider than that in the local authority segment, and therefore the end-consumer potentially has a greater choice of products. The CMA notes that the Parties propose the integration of the two ranges to create a wider range of products to address all hearing needs. However, the merged entity will be the largest supplier in the retail segment. As a result, the CMA cannot rule out that there is a realistic prospect that the Merger will result in an SLC in the supply of FM systems to retailers. However, as set out below, it does not find it necessary to conclude on this point.

Vertical issues

81. The Parties and third parties all noted that most hearing aid manufacturers were vertically integrated with retail chains. Third parties considered vertical integration to be the main barrier to entry for supply to the retail segment, since a high proportion of retail dispensing is owned by manufacturers²⁶ where other suppliers are typically limited to 10% of total volume. As this is a pre-existing concern, this has been considered under barriers to entry below.
82. However, the CMA notes that on the retail level, Sonova, Phonak's parent, is a 51% shareholder in a JV with Alliance Boots, the 'David Ormerod/Boots' JV, renamed in February 2014 to Boots Hearingcare Limited. Comfort Audio, on the other hand, has no activities at the retail level. The CMA considered if the Merger would increase the ability or incentive of Phonak to sell its FM systems exclusively through Boots Hearingcare, or to exclude competitors from this retail channel.²⁷

Parties' views

83. Parties submitted that at the retail level, there were approximately 1,300 retail stores in the UK through which FM systems can be purchased, and that FM systems could also be purchased over the Internet.
84. The Parties submitted that Boots Hearingcare Limited has a limited share of the total retail market for hearing aids, some [redacted]% by volume in 2013. The CMA did not receive any information about Boots Hearingcare's share in the supply of FM systems, but the CMA notes the Parties' submission that Boots Hearingcare sells products from a number of suppliers, [redacted]. The Parties submitted that this is unlikely to change post-Merger and the merged Parties have no intention or ability to sell their products through Boots Hearingcare exclusively, or to cease FM systems supplies to other retailers. The Parties submitted that [redacted].²⁸

Views of third parties

85. No third parties raised concerns about potential exclusivity agreements between the Parties and Boots Hearingcare Limited post-Merger.

²⁶ William Demant – 100% Hidden Hearing, Sonova – 51% of Boots Hearing Care, Widex – 100% Bloom Hearing.

²⁷ *Mergers Assessment Guidelines*, paragraph 5.6.6.

²⁸ [redacted]

Summary and conclusion

86. The CMA notes that there are a number of retailers selling FM systems, including vertically integrated online retailers, audiologists and independent retailers, many of them selling through Access to Work and DSA. Although Phonak could stop selling its products through retailers other than Boots Hearingcare Limited, the incentive to do so is low, as it would restrict sales through other complementary retail channels such as audiologists and Access to Work qualified suppliers.
87. In addition, although Boots Hearingcare could sell only Phonak FM systems, there are other retail channels available to competitors. The CMA notes that Boots Hearingcare is not currently used by competitors as one of their main retail channels. The retail channels that are currently available to competing manufacturers are not affected by the Merger.
88. The CMA therefore considers that the Merger does not raise competition concerns from vertical effects.

Barriers to entry and expansion

89. The CMA has considered whether the prospect of supply-side responses in the form of entry and/or expansion could prevent an SLC. When assessing possible supply-side responses, including entry, expansion and repositioning, the CMA will consider whether the response would be (i) timely, (ii) likely, and (iii) sufficient.²⁹
90. The Parties submitted that it was not difficult for actual or potential competitors to start supplying, or to expand supply of, FM systems as part of their offering of hearing aid solutions, as the technology used to manufacture FM systems is similar to that used for the hearing aid devices. The Parties estimated that the investment required to enter the FM/ALDs segment is in the order of [X]% of the turnover that the company would generate and that Phonak generally [X] a year worldwide³⁰ in FM/ALDs.
91. The Parties said that the FM systems need to comply with the radio regulations for each country. The approval process is relatively quick, taking some four weeks. The Parties also submitted that there were a number of actual or potential suppliers of components for FM systems, the assembly of the products can be easily outsourced or expanded through hiring new personnel, and such personnel did not need any specific education or specific

²⁹ *Merger Assessment Guidelines*, paragraph 5.8.3.

³⁰ Phonak's worldwide turnover for year ending March 2014 was £1,279 million.

skills. Phonak submitted that it changed suppliers from time to time, in particular when it released a new generation of product.

92. The Parties gave GN ReSound and Bellman & Symfon as examples of successful entry in the UK market, and also said that Comfort Audio, a small company with limited resources and an outsourced production process, managed to capture an approximate [REDACTED]% share of supply by volume in the UK after starting to supply its products in the UK in 2004/05 through distributors.
93. However, third parties noted a number of barriers to entry in the FM systems segment, some of them applicable only to the local authority or the retail segment, and others applicable across both.
94. The overall small size of the segment was considered a barrier to entry by some, since achieving the volume of sales to make entry cost effective could be an issue as FM systems were not mainstream retail products. Other third parties thought that the main barrier to entry was that there were a number of established players. However, in terms of capacity constraints, competitors said they have not faced any capacity restrictions that limited their growth in the FM systems segment.
95. The local authority segment was considered to be more self-contained and therefore easier to market to. However, third parties said that given the high market share of Phonak, with Comfort Audio also taking a significant market share, they did not consider investment would provide a worthwhile return. Third parties also told the CMA that local authorities were risk averse and that it is difficult to persuade them to try a new product. Local authorities commented that the process of switching is slow, as it requires trialling new products, staff training, and the need to build a stock of spares for new products.
96. The Parties pointed to GN ReSound as a new entrant to the local authority segment. The CMA may consider that small-scale entry by a producer of differentiated goods may be insufficient, even when the entry may be the basis for later expansion, for example when entry into a niche market may be possible, but the niche product may not necessarily compete strongly with other products in the overall market and so may not constrain incumbents.³¹ In the case of GN ReSound, on the basis of the evidence available, [REDACTED], the CMA considers, [REDACTED].³² Therefore, the CMA believes that there is insufficient

³¹ *Merger Assessment Guidelines*, paragraph 5.8.10.

³² [REDACTED]

evidence that expansion by GN ReSound will be timely, likely and sufficient so as to prevent a realistic prospect of an SLC.

97. The Parties referred to Widex, Conversor and Siemens as potential entrants in the local authority segment. However, there is insufficient evidence available to the CMA that these firms are sufficiently likely and timely entrants into this segment.
98. With regard to access to retailers, as noted above most hearing aid manufacturers are vertically integrated with retail chains. Third parties considered vertical integration to be the main barrier to entry for supply to the retail segment, since a high proportion of retail dispensing is owned by manufacturers³³ where other suppliers are typically limited to 10% of total volume.
99. While this may constitute a barrier to expansion for the smaller companies, this cannot be regarded as an effect of the Merger since it existed pre-Merger and the Merger has not exacerbated the situation since neither Comfort Audio nor its distributors are vertically integrated with a retailer. However, these vertical issues may still form a barrier to expansion by smaller competitors and therefore mean that potentially an SLC could not be mitigated.
100. In conclusion, therefore, the CMA considers, in view of third party comments, that there may be barriers to entry in the FM systems segment that imply that the prospect of new entry is not timely, likely and sufficient to constrain the behaviour of the merged entity in the short term. However, it was not necessary for the CMA to reach a conclusion on this point, as set out below.

Third party views

101. As a result of its market investigation the CMA received concerns from several third parties. Third party views have been reflected above where appropriate.

Conclusion

102. As set out above (see paragraphs 66 and 80), the CMA cannot rule out that the test for reference may be met in this case. However, it has not been necessary for the CMA to reach a definitive conclusion in this respect because the CMA considers it appropriate to exercise its discretion to apply

³³ William Demant – 100% Hidden Hearing, Sonova – 51% of Boots Hearing Care, Widex – 100% Bloom Hearing.

the markets of insufficient importance ('de minimis') exception to the duty to refer, as set out below.

Exceptions to the duty to refer

103. The CMA's duty to refer under section 33(1) of the Act is subject to certain discretionary exceptions, including the exception under section 33(2)(a) relating to markets of insufficient importance (the 'de minimis' exception), and the exception under section 33(3)(b) read with section 73(2) relating to undertakings in lieu of reference.³⁴
104. As the annual value of the affected market in this case is significantly below £10 million, the CMA has considered whether it should apply the 'de minimis' exception under section 33(2)(a) of the Act. As the CMA's general policy is not to apply this exception where clear-cut undertakings in lieu of reference could be offered by the Parties, the CMA has also considered whether such undertakings would be available if the duty to refer were met.
105. During the course of the investigation, the Parties stated that they would be willing to waive their procedural rights to a full investigation, including an issues letter and an issues meeting, to the extent that the CMA would apply the 'de minimis' exception to the duty to refer, and without prejudice to the Parties' views on whether the duty to refer was met. Since, as set out below, the CMA decided to apply the 'de minimis' exception, it did not send an issues letter to the Parties.³⁵

Availability of undertakings in lieu

106. The CMA will not generally exercise its discretion to apply the 'de minimis' exception where clear-cut undertakings in lieu of reference could be offered by the Parties to resolve the competition concerns identified. The CMA's judgement in this respect is an 'in principle' one that does not depend on any actual offer of undertakings in lieu.³⁶
107. The CMA considered whether there was a clear-cut undertaking in lieu available in this case. The Parties submitted that sales to local authorities for the local authority segment represent [X] of Comfort Audio's business (approximately [X]% of its sales). The Parties do not consider that a clear-cut structural remedy exists to address the CMA's potential concerns within the

³⁴ See *Exceptions to the duty to refer and undertakings in lieu of reference guidance* (OFT1122, December 2010) ('**Exceptions guidance**') as adopted by the CMA (see Annex D to *Mergers: Guidance on the CMA's Jurisdiction and Procedure*).

³⁵ *Exceptions guidance*, paragraphs 2.51–2.53.

³⁶ *Exceptions guidance*, paragraphs 2.18–2.27.

local authority segment, other than divesting what amounts to a substantial proportion of the acquired business that would be tantamount to a prohibition. In addition, the Parties submitted that this is a ‘foreign-to-foreign’ transaction with Comfort Audio’s distribution of products to the UK [X] there was no tangible ‘UK part’ of the Merger.

108. The CMA therefore considers that the divestment of either of the Parties’ FM systems business may be tantamount to prohibiting the Merger as regards its impact in the UK, in particular as it would amount to divesting a substantial proportion of the acquired business. The CMA therefore considers there is significant doubt that this divestment would meet the ‘clear-cut’ standard, meaning that the CMA does not consider undertakings in lieu to be available ‘in principle’.³⁷
109. On the basis that the CMA believes there is no clear-cut undertaking in lieu available, the CMA has proceeded to examine whether to exercise its ‘de minimis’ exception in this case.

Application of the ‘de minimis’ exception

110. In this case, the total market value is less than £10 million. Based on its market investigation, the CMA estimates the annual market size for the local authority and retail segments combined to be approximately £[X] million. As noted above, the CMA considers that its competition concerns were significantly stronger in the local authorities segment, which has an annual market value of approximately £[<3] million, than in the retail segment, which has an annual market value of approximately £[<3] million.
111. In its assessment of whether it is appropriate to apply the ‘de minimis’ exception in this case, the CMA has also considered other factors besides the size of the market. The CMA notes in this respect that Comfort Audio is a relatively small supplier with total UK sales of £[X] million. In addition, although the Merger gives rise to competition concerns in the local authority segment, the Parties will continue to face some constraint from competing suppliers of FM systems in this segment, which may be strengthened by the increased use of competitive tendering by local authorities. Further, the CMA considers that its level of concern is relatively low in the retail segment, which makes up nearly half of the total value of the affected market, given that the Parties will continue to face a significant constraint from several competitors in this segment.

³⁷ *Exceptions guidance*, paragraph 2.27.

112. The CMA has also considered the risk that using the 'de minimis' exception in this case may create an expectation that mergers involving comparable competitive conditions and similar competition concerns would also not be referred to Phase 2 on the basis of the CMA exercising its discretion to apply the 'de minimis' exception. The CMA considers that there is only a limited risk of this given the specific facts of this case.
113. On balance, having taken account of all relevant factors in the round, the CMA considers that the public cost of a reference would be greater than the impact of the Merger on consumers. The CMA therefore considers that, to the extent that its duty to refer may be met, it is appropriate to exercise its discretion to apply the 'de minimis' exception in this case.

Decision

114. The Merger will therefore **not be referred** to Phase 2 pursuant to section 33(1) of the Act.

Director of Mergers
Competition and Markets Authority
17 September 2014