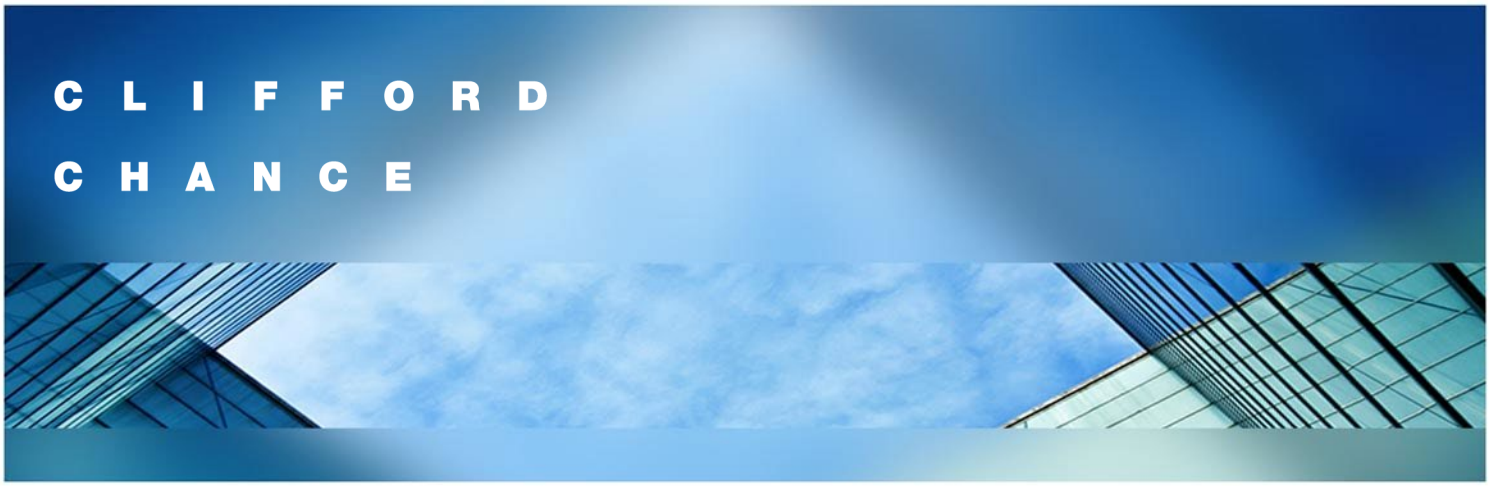

RECENT CMA HEALTHCARE & LIFE SCIENCES MERGER CASES

Healthcare & Life Sciences remains an important area of focus for the UK's Competition & Markets Authority (**CMA**). Over the years, the CMA has brought high-profile enforcement cases in the pharmaceutical space, on which the vast majority Clifford Chance has advised. Moreover, the CMA continues to investigate Healthcare & Life Sciences mergers, of note in recent years its investigations in Roche / Spark and Illumina / PacBio. This focus on mergers has continued over the past year; this briefing considers three such merger cases, being Cochlear / Oticon Medical, Bestway / Lexon and Asurex, and UnitedHealth / EMIS. While UnitedHealth / EMIS is still progressing through its phase II process, the CMA has provisionally cleared the transaction.

Key issues

- Investigating mergers in the Healthcare & Life Sciences space remains an important focus for the CMA.
- This briefing considers three recent / active CMA merger investigations – Cochlear / Oticon Medical, Bestway / Lexon and Asurex, and UnitedHealth / EMIS.
- Horizontal theories of harm were examined in the first two cases, whereas the latter case considered vertical theories of harm.
- Potential competition remains an important focus for the CMA.
- The CMA remains willing to intervene. Cochlear / Oticon Medical resulted in a partial prohibition, Bestway / Lexon and Asurex required 7 divestitures, and UnitedHealth / EMIS remains in a Phase II process, albeit the latter has been provisionally cleared.

Introduction

While much of the recent focus on Healthcare & Life Sciences mergers has related to vertical theories of harm, the first two cases considered below, Cochlear / Oticon Medical and Bestway / Lexon and Asurex, concerned more 'traditional', horizontal, theories of harm. Indeed, in Bestway / Lexon and Asurex, a case primarily involving pharmacies, the CMA engaged in a familiar local area analysis, and kept reasonably faithful to its approach and findings in the 2016 case of Celesio / Sainsburys.

The third case, UnitedHealth / EMIS, does however continue the trend of vertical theories of harm being examined in Healthcare & Life Sciences merger cases. Moreover, an important part of the analysis in UnitedHealth / EMIS related to potential competition (in the supply of population health management services), and potential competition was also relevant in Cochlear / Oticon Medical (as regards the evolution of Active bone conduction solutions). Potential competition was an important aspect of Illumina PacBio, and we expect for potential competition to remain an important feature of the CMA's analysis in Healthcare & Life Sciences mergers.

Cochlear / Oticon Medical

Background

Cochlear, the acquirer, is active in the manufacture and supply of hearing devices, with a particular focus on cochlear implants (**CI**) and bone conduction

solutions (**BCS**). Demant, the seller, was active in developing, manufacturing, and supplying hearing implants (both CI and BCS) through Oticon Medical. The transaction related to the acquisition of Oticon Medical by Cochlear.[1]

The CMA's assessment focussed on the supply of BCSs in the UK, since the CMA found that Oticon Medical had a low share of supply in the provision of CIs and that it was a weak competitor.

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

Substantive analysis

The CMA found that the merger was a '3-to-2' (the other BCS competitor being MED-EL) and that it would be expected to lead to a reduction in choice, quality, and innovation, and increased prices.[2] To reach a '3-to-2' analysis, and in line with the CMA's approach to considering the appropriate frame of reference, the CMA focussed its analysis on the supply of BCS products and excluded other hearing solutions[3] from the frame of reference. As part of this, the CMA recognised that Cochlear's internal documents referred to providers of other hearing solutions as competitors but found that Cochlear's BCS competitors were considered in greater detail and that Oticon Medical's internal documents only made very limited references to companies active in the supply of other hearing solutions.

Within the '3-to-2' paradigm, the parties argued that the market was moving from Passive to Active BCSs and that Oticon Medical does not have an Active BCS. However, the CMA considered that the evidence from clinics and from the parties' internal documents shows that Passive BCS products would continue to be prescribed to a significant percentage of patients over the next two to three years, and therefore remained an important nexus of competition. It also noted that Active BCS has drawbacks, including requiring more invasive surgery and being less powerful than Passive BCS. Within the Passive BCS segment, the CMA found that the parties were each other’s closest competitor, and that therefore the merger would likely lead to a reduction in competition in Passive BCS.

For Active BCS products, the CMA found that Cochlear is the largest of the only two existing suppliers of Active BCS products in the UK. However, the CMA advanced a potential competition theory of harm. In particular, the CMA considered that the evidence from Oticon Medical shows that the development of Sentio, Oticon Medical’s new Active BCS product, is progressing, and that both parties considered that, if launched, Sentio would compete with Cochlear’s Active BCS product. Moreover, Cochlear internal documents showed that it was already responding to the threat posed by Sentio.

[1] The transaction was also referred to the European Commission via the Article 22 process, like the Illumina/Grail transaction (albeit the Cochlear / Oticon Medical met merger control thresholds in some EU Member States; this investigation is ongoing) and is being reviewed by the ACCC.
[2] In addition to the points considered below, a key question was whether Oticon Medical would have exited the market absent the merger. The CMA rejected this as an appropriate counterfactual. It went through the test for assessing exiting firms, including conducting various forms of detailed financial modelling, and ultimately concluded that Oticon Medical would have continued under the ownership of Demant, or otherwise would have been sold to an alternative purchaser.
[3] E.g. hearing aids, reconstructive or middle ear surgery, middle-ear implants, CROS hearing aids, and non-surgical products.

As to other hearing solutions, the CMA found that they imposed only limited competitive pressures. This was based on survey evidence from clinics, but also because BCS products are generally prescribed after standard hearing aids failed (with middle-ear implants only being used as a backup to BCS products).

Result

The CMA therefore found a substantial lessening of competition (**SLC**) in the supply of BCS products in the UK. The CMA considered prohibiting the transaction in its entirety. However, it ultimately concluded that prohibiting only the acquisition of the BCS business, with the acquisition of the CI business being allowed to proceed, would be an effective and proportionate remedy.

Bestway / Lexon and Asurex

Background

Bestway, the acquirer, owns Well, which operates a retail pharmacy chain of approximately 750 pharmacies, as well as an online pharmacy. Bestway has broader operations in the pharmaceutical sector, supplying wholesale pharmaceutical services through its Bestway Medhub and Wardles businesses.

Bestway acquired Lexon, which operates 46 retail pharmacies in the UK under the Knights Pharmacy brand and an online pharmacy, Chemist.net. Lexon also operates a 'short-line' wholesale pharmaceutical business in the UK, supplies certain software products to pharmacies, and operates certain other businesses within the pharmaceutical sector.[4]

The transaction completed on 14 April 2023 and was then called in by the CMA. On 23 May 2023, the parties informed the CMA that they believed the transaction gave rise to a realistic prospect of an SLC for retail pharmacies in certain local areas in the UK. Accordingly, the CMA followed its recent practice of "fast tracking" the phase I process to allow for remedies (in the form of undertakings in lieu of a reference to phase II (**UIL**)) to be agreed. This allowed for the case to proceed at pace: the UILs were provisionally accepted on 20 June 2023, just over two months from the transaction being called in.

Substantive analysis

The substantive analysis focussed on a 'traditional' horizontal theory of harm arising from local overlaps in the provision of retail pharmacies. As part of this, the CMA engaged in familiar local area analysis.

The CMA accepted, consistent with its 2016 Celesio / Sainsburys decision, that the product frame of reference should be all retail pharmacies, noting that on the supply side, retail pharmacies are the only suppliers of over-the-counter medicines, prescription only medicines, and pharmacy services. As regards the geographic market, the CMA decided to use the catchment areas adopted for non-supermarket pharmacies in Celesio / Sainsburys, noting that its market testing revealed no reason to depart from that decision. As is usual for local area analyses, the CMA used different catchment areas for different types of locations: the catchment for urban areas was 1.4 miles, whereas very rural had catchment areas of 3.6 miles.

[4] At the same time, Bestway also Asurex, a wholesaler of branded perfumes trading as Knights Fragrances and primarily supplies perfumes to pharmacies and department stores. The CMA did not focus on the Asurex transaction, which is therefore not considered further in this briefing.

When analysing its horizontal theory of harm for retail pharmacies, the CMA found that the main parameter of competition for retail pharmacies was convenience, since regulations restricted the ability of pharmacies to compete on price and quality. However, rather than analyse competition on this basis, and in line with CMA merger guidelines, the CMA adopted a phase I decision rule to filter local areas where there was a realistic possibility of an SLC. This decision rule was to find SLCs where: (A) the parties have a combined distance weighted share of stores[5] of at least 35% following the merger, with an increment of 5% from the merger; or (B) the parties are: (i) either each other's geographically closest competitor; or (ii) there is only one competitor closer than the other merging party and where the parties have at least a 30% combined share of stores with an increment of 5% from the merger.

Result

The result of the application of the CMA's phase I decision rule was that the CMA found SLCs in 12 local areas.[6] To remedy this, Bestway has proposed to undertake to sell 7 Well pharmacies to pre-approved purchasers. The CMA is currently consulting on these proposed undertakings.

UnitedHealth / EMIS

Background

UnitedHeatlh / EMIS is currently going through a phase II investigation. On 11 August 2023, the CMA issued its Provisional Findings, stating that the CMA is presently minded to clear the transaction. The target in this case, EMIS, is active in a range of IT healthcare solutions, including primary care electronic patient record (**EPR**) systems via its EMIS Web brand. EMIS Web allows GPs to manage appointment bookings, conduct patient consultations, and update, store, and share patient records. The CMA found that the market should be split between primary and secondary care EPRs, as the EPR systems for each care level are designed differently and have different use cases. GPs consider primary care EPR systems as essential to running a practice. Moreover, over 50% of GPs in the UK use EMIS Web as their EPR system.

The acquirer, UnitedHealth (**UH**), is a large US healthcare insurance, healthcare, and health data analytics business. At the GP level, it offers medicines optimisation (**MO**) software (i.e. software to ensure prescriptions are effective and cheap to the NHS) and population health management (**PHM**) services (which use data analytics to improve health outcomes). The CMA found that UH's MO software, ScriptSwitch, focussed specifically on outcome and cost optimisation (as opposed to more general optimisation), which should be considered as part of a separate and narrower frame of reference. Moreover, there was only one other company, First Databank (**FDB**), that provided such MO software. Both ScriptSwitch and FDB's MO software integrates with the primary care EPR systems so that they can provide GP users with prescribing recommendations.

Substantive analysis

In its phase I decision, the CMA found that the merger could provide the parties with the ability and incentive to limit competitors' access to EMIS Web's systems (but not entirely), and that this would be profitable; a so-called

[5] I.e. the CMA did not deploy a fascia count analysis.
[6] For the overlap between the parties' wholesale pharmaceutical businesses, in contrast to Celesio / Sainsburys, the CMA's frame of reference was limited to short-line wholesalers. However, the CMA applied a national geographic scope, since both parties offer national wholesale services. On this basis, the parties' combined share of supply was 10-20%. The CMA found that this did not raise competition concerns.

"partial input foreclosure strategy". The reason why the CMA did not pursue a total foreclosure theory of harm was because it considered total foreclosure would not be possible given various NHS rules and standards. However, in its Provisional Findings for its phase II investigation, the CMA found that a partial input foreclosure strategy would not give rise to an SLC:

- As regards MO software, the CMA found GPs require their MO software to be integrated with their EPR systems[7]; for EMIS Web, such integration is negotiated between EMIS and the MO supplier. EMIS Web also has market power in primary care. The CMA's concern was that post-merger EMIS could disadvantage other MO software providers, particularly FDB, by worsening integration with EMIS Web or the EMIS Web interface, or by otherwise raising costs. However, the CMA found that the gains from such a strategy may be limited, as customers may also switch from EMIS Web. Moreover, the NHS could use its standards, and other informal routes, to negate any potential gains from pursuing such a strategy. Moreover, UH's internal documents did not suggest that it was considering such a strategy.
- In relation to PHM services, the CMA found that the present state of the market is such that suppliers could, for the most part, obtain their necessary data via bulk extracts from NHS Digital or from EMIS Web (in a manner EMIS was required to supply via NHS mandated APIs). Given this, UH cannot engage in a partial foreclosure strategy. Moreover, when examining a potential competition theory of harm, the CMA found that, going forward, there was only mixed evidence as to whether custom integration could become more important. The NHS's frameworks would be able to protect against price increases, and that those frameworks will be modernised to further mitigate against data access risks.

Conclusion

The cases considered in this briefing show that the CMA remains focussed on examining Healthcare & Life Sciences deals, and that it is interested in all aspects of the sector. In its press release for Cochlear / Oticon Medical, the CMA noted that its investigation coincides with "*its strategic commitment to ensuring its intervention and remedies take into account those people who may need particular help to be protected from harm*", which is part of its Annual Plan 2023/2024. It can be expected that the CMA will reference this commitment in other Healthcare & Life Sciences cases, and that it will continue to focus on this sector.

This notwithstanding, the cases examined in this briefing suggest that the CMA is looking to act with some predictability and proportionality. The theories of harm examined are not novel (particularly in Cochlear / Oticon Medical and Bestway / Lexon and Asurex); in Bestway / Lexon and Asurex, the CMA's analysis largely mirrored the analysis it followed seven years ago in Celesio / Sainsburys. While remedies were required in the two cases that reached decisions, none of the cases resulted in total prohibitions, and UnitedHealth / EMIS looks set to be cleared unconditionally.

[7] E.g. because it was important to: have a single landing page to select apps; reduce clicks; and deploy native formats.

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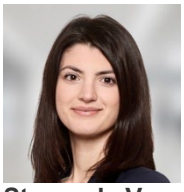

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