

Anticipated acquisition by Celesio AG of Sainsbury's Supermarkets Limited UK Pharmacy Business

Decision on relevant merger situation and substantial lessening of competition

ME/6558/15

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 11 December 2015. Full text of the decision published on 28 January 2016.

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

SUMMARY

1. Celesio AG (**Celesio**), through its subsidiary Lloyds Pharmacy Limited (**Lloyds**), has agreed to acquire the in-store community pharmacy business and hospital pharmacy business of Sainsbury's Supermarkets Limited (**Sainsbury's**) (the **Merger**). Lloyds and Sainsbury's are together referred to as the **Parties**.
2. The Competition and Markets Authority (**CMA**) considers that the Parties' enterprises will cease to be distinct as a result of the Merger, that the turnover test is met and that accordingly arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
3. The CMA has assessed the impact of the Merger in the retail supply of (i) prescription-only medicines, (ii) pharmacy medicines and (iii) pharmacy services to end-customers in local areas in the United Kingdom (**UK**) (together, referred to as '**pharmacy retailing**'). The CMA assessed the impact of the Merger in these frames of reference together. The CMA also assessed the impact of the Merger in the supply of outpatient dispensing (**OPD**) services to hospitals (essentially, the provision of a pharmacy in a hospital) in England. In addition, there is a vertical relationship due to the

presence of Celesio's subsidiary, AAH Pharmaceuticals Limited (**AAH**), in the wholesale distribution of prescription-only and pharmacy medicines and Lloyds and Sainsbury's presence in the retail pharmacy sector.

4. In relation to pharmacy retailing, the CMA first considered whether there continues to be scope for competition as the sector is partly regulated. The CMA concluded that there is non-price competition in the form of quality and service parameters (eg location and convenience, opening times, availability of stock, additional products and services) and price competition in relation to pharmacy medicines. Accordingly, the CMA considered that there is scope for the Merger to have an appreciable effect on competition in relation to pharmacy retailing.
5. In conducting a competitive assessment at the local level, the CMA applied a filter in order to reduce the number of areas requiring an in-depth analysis. The CMA applied a share of supply filter based on GP prescription data for each Lloyds and Sainsbury's store for which this information was available and produced a reliable outcome. For the remaining stores, the CMA used either a fascia count filter (for Lloyds stores) or a share of store filter (for Sainsbury's stores).
6. This methodology resulted in 78 local areas that failed the filters and therefore raised prima facie concerns. The CMA conducted a more detailed local analysis of certain local areas that failed the filters in order to determine the magnitude of these concerns. For each of these local areas, more detailed analysis of the local area confirmed the prima facie concerns identified.
7. The CMA therefore believes that the Merger gives rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects in the retail supply of prescription-only medicines, pharmacy medicines and pharmacy services to end-customers in these 78 local areas.
8. In the 45 working day statutory timetable for its investigation, the CMA was unable to form a view on whether the Merger gives rise to a realistic prospect of an SLC in local areas around [X] Lloyds stores and [X] Sainsbury's store. These are stores that passed the fascia count filter but may have done so on the basis of including fascia that are not effective competitors or stores that passed the share of supply filter but had particular features which raise potential competition concerns (for example, a 3-to-2 fascia reduction or very high combined shares of supply despite a smaller increment). In essence, the CMA was, on the basis of the limited information available to it for its investigation, unable to construct filters which reliably excluded areas that did not give rise to competition concerns. Within the constraints of the phase 1 process, the CMA has not been able to reach a positive conclusion in relation

to whether the Merger gives rise to a realistic prospect of an SLC in these areas. However, the CMA believes that an SLC might prove to be likely on further and fuller examination of the position.

9. In relation to the supply of OPD services to hospitals, the CMA found that Lloyds and Boots are the two main competitors, and that there are several smaller competitors, including Sainsbury's. Sainsbury's may have provided a significant constraint on Lloyds in the past although that constraint appears to have recently diminished to some extent. The Merger would result in the loss of that constraint, and there are a limited and diminishing number of competitors that are capable of replacing that constraint.
10. Given the CMA has concluded that the Merger gives rise to a realistic prospect of an SLC in relation to in the supply of pharmacy retailing, it has not found it necessary to conclude whether the Merger gives rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of OPD services to hospitals.
11. The CMA also considered whether competition concerns would arise post-Merger as a result of foreclosure of downstream retail pharmacy competitors from the merged entity's wholesale distribution (ie input foreclosure). The CMA found that, at the local level, the merged entity's incentive to pursue an input foreclosure strategy depends on its downstream market position relative to rivals in each local area. The CMA considers that the change in the merged entity's incentives to pursue such an input foreclosure strategy post-Merger may be significant with regard to only those local areas where horizontal effects concerns arise.
12. The CMA therefore considered that it is not necessary to conclude whether it is or may be the case that the Merger may be expected to result in an SLC as a result of input foreclosure given the CMA's conclusion in relation to horizontal unilateral effects in the supply of pharmacy retailing.
13. Given the CMA's conclusion that the Merger gives rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in the retail supply of prescription-only medicines, pharmacy medicines and pharmacy services to end-customers in local areas, the CMA is considering whether to accept undertakings under section 73 of the Enterprise Act 2002 (**the Act**). The Parties have until 18 December 2015 to offer an undertaking in lieu of reference that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Merger to phase 2 pursuant to sections 33(1) and 34ZA(2) of the Act.

ASSESSMENT

Parties

14. Celesio is an international pharmaceutical wholesaler and retailer which is ultimately owned by McKesson Corporation. Lloyds is a wholly-owned subsidiary of Celesio and operates 1,542 Lloyds pharmacies across the UK. Lloyds also has a shareholding in [X] consortia pharmacies and operates [X] contracts providing OPD services to hospitals. Celesio owns AAH, which is a wholesaler of pharmaceutical products in the UK.
15. Sainsbury's operates 277 pharmacy stores, generally within or next to Sainsbury's supermarkets throughout the UK.¹ The target business will only be active in the sale of prescription-only medicines, pharmacy medicines and pharmacy services (ie commissioned services). Sainsbury's supermarket business will continue to purchase and sell general sales list products independently of the target pharmacy business. Sainsbury's also provides OPD pharmacy services under [X] contracts to hospitals. The UK turnover of Sainsbury's in the year ending 15 March 2015 was around [X].

Transaction

16. The Parties entered into a Business Sale Agreement (**BSA**) and a Cooperation Agreement on 29 July 2015. Lloyds will acquire Sainsbury's in-store community pharmacy business and hospital pharmacy business by means of the BSA. The Parties entered into a Cooperation Agreement to govern the nature of the ongoing relationship as the pharmacy stores, which will be rebranded as 'LloydsPharmacy', are located within or next to a Sainsbury's supermarket.

Jurisdiction

17. As a result of the Merger, the enterprises of Lloyds and Sainsbury's will cease to be distinct.
18. The UK turnover of Sainsbury's exceeds £70 million and the turnover test in section 23(1)(b) of the Act is satisfied.

¹ In addition, Sainsbury's provides OPD services at Guy's Hospital and St Thomas' Hospital and has a community pharmacy licence for these locations that allows them to supply both patients and non-patients.

19. The CMA 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.
20. The Merger meets the thresholds under Council Regulation (EC) 139/2004 (the EC Merger Regulation) for review by the European Commission. The Parties submitted a reasoned submission to the European Commission on 4 August 2015 requesting pre-notification referral to the CMA under Article 4(4) of the EC Merger Regulation. The CMA informed the European Commission that it agreed with the referral request and considered the Merger capable of being reviewed in the UK under the Act. On 8 September 2015 the European Commission announced its decision to refer the Merger to the UK for review.
21. The preliminary assessment period for consideration of the Merger under section 34A(2) of the Act started on 9 September 2015, an issues meeting was held with the Parties on 17 November 2015 and the statutory 45 working day deadline for a decision is 11 December 2015 (including an extension to the preliminary assessment period under section 34A(5) of the Act).

Counterfactual

22. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers the CMA generally adopts the prevailing 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, it considers that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions as between the merging parties.²
23. In this case, there is no evidence supporting a different counterfactual than the prevailing conditions, and the Parties and third parties have not put forward arguments in this respect. Therefore, the CMA considers the prevailing conditions of competition to be the relevant counterfactual in this case.

² *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, from paragraph 4.3.5. The *Merger Assessment Guidelines* have been adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, Annex D).

Background

24. The Parties are both active in the retail pharmacy sector. Retail pharmacies generally sell four types of products:
- (a) Prescription-only medicines (or ethicals): pharmaceutical drugs that require a prescription and are dispensed by a pharmacist. Retail prices are set by the NHS;
 - (b) Pharmacy medicines (or P-medicines): pharmaceutical drugs that do not require a prescription but can only be dispensed by a pharmacist;
 - (c) General sales list (GSL) medicines (or over-the-counter medicines): medicines that can be bought from pharmacies, supermarkets and other retail outlets without a prescription or the supervision of a pharmacist;
 - (d) Non-pharmaceutical products: products such as toiletries, beauty products and other consumer goods.
25. In addition to these products, pharmacies are commissioned to provide a wide range of services which can be broadly categorised as:
- (a) Essential services: core services that must be offered by all pharmacies (eg dispensing medicines and appliances, repeat prescriptions);
 - (b) Advanced services: services that can be provided by pharmacies once accreditation requirements have been met (eg medicine user reviews, new medicine services);
 - (c) Locally commissioned services: services that are commissioned to meet specific local needs (eg stop smoking service, diabetes service).
26. Pharmacies in the UK are subject to specific regulatory and licensing requirements and market entry or expansion is controlled.³ Under the relevant regulations, providers must demonstrate that a new store is necessary or desirable to secure adequate provision of pharmacy services. In 2005 these regulations were loosened in England by the introduction of certain exemptions, resulting in significant growth in the number of pharmacies. In 2012 these exemptions were abolished which led to reduced growth in the number of retail pharmacies.⁴

³ The CMA notes that arrangements are different in England, Northern Ireland, Scotland and Wales, however, this does not result in different conclusions in respect of this merger investigation.

⁴ The number of internet pharmacies continued to grow. However, based on the number of prescriptions, they still have a relatively small presence in the UK.

27. The Parties submitted that the retail pharmacy regulatory framework means that there is limited scope for Merger effects. In particular, they told the CMA that there is limited scope for price competition as between [50–100]% of the Parties' total revenues relate to price-controlled prescription-only medicines. In addition, the Parties submitted that there is limited scope for competition on non-price factors as minimum requirements are set by the NHS and CCGs, eg pharmacies must stock a full range of prescription-only medicines and fulfil prescriptions with 'reasonable promptness', and changes in opening hours require regulatory approval. The Parties did, however, note that there is room for non-price competition on 'residual variables', for instance, regarding home delivery of prescriptions, waiting times and opening times.
28. The CMA notes that previous merger investigations and other reports relating to the retail pharmacy sector have found that there is significant scope for competition:
- (a) In 2003, the OFT market investigation into the control of entry regulations and retail pharmacy services in the UK (which led to the 2005 entry control reforms) found a relationship between local concentration and the quality of service (ie opening hours, consultation areas and home delivery).⁵ In 2010, the Retail Pharmacies Market Study Evaluation⁶ reviewed the impact of the 2005 entry control reforms. It found that competition had increased in response to new entry since the 2005 reforms. The report includes qualitative evidence that existing pharmacies improved their premises, staffing, hours (including linking to local surgery prescribing hours) and the offering of collection and delivery services in order to retain customers in the face of new entry;
- (b) In *Boots/Alliance Unichem*⁷ there was evidence from the merger parties' internal documents that both parties monitored price and service quality variables. Possible aspects of competition mentioned in Boots' consumer research documents also included: product availability, store layout, ease of shopping and shopping environment. At a local level, waiting times for obtaining a prescription and the provision of deliveries seemed to be key measures of competition. Evidence from the merger parties' internal documents also suggested that new entry would usually prompt some competitive response;

⁵ The control of entry regulations and retail pharmacy services in the UK, a report of an OFT market investigation, January 2003.

⁶ DotEcon, Evaluating the impact of the 2003 OFT study on the Control of Entry regulations in the retail pharmacies market, March 2010.

⁷ ME/2134/05 Boots plc/Alliance Unichem plc, 6 February 2006.

- (c) In *Lloyds/IPPC*⁸ third party responses indicated that retail pharmacies monitored competitor activity and compete, to some extent, across a range of factors such as: price, product range, promotions, range of services, opening hours, quality of advice, pharmacy appearance and layout.
- (d) In *CGL/Lothian*⁹ parameters of competition were specified as being the provision of consultation space, offer of home delivery, collection of prescriptions (from a GP), prescription waiting times (availability of prescribed medicines), price competition on non-ethical medicines, provision of enhanced facilities/service and opening times.
29. On the basis of such evidence the UK competition authorities have previously concluded that a reduction in the number of alternative pharmacy providers in a local area could bring about a meaningful reduction in competition with regard to price competition on pharmacy medicines and non-price competition across a range of quality and service parameters.
30. In this case, the CMA considered whether there continues to be significant scope for competition in the retail pharmacy sector. Third parties told the CMA that quality aspects are important determinants of customers' choice between pharmacies and noted that competitors generally compete in terms of location and convenience (also in relation to GPs' location), opening times, availability of stock and additional products and services (eg delivery services, monitored dosage systems). Other important factors are waiting times, layout of the stores, customer experience and quality of advice. Pricing of non-prescription products was also mentioned as an element of competition.
31. Some competitors submitted that new entrants had significantly impacted their business and some submitted that they responded to new entry by ensuring or improving their services. One of these competitors said that entry within one mile of their store had a substantive impact and there was a growing impact from supermarkets and other pharmacies in retail parks located between 1.5 and 2 miles from their store as these pharmacies reached maturity. Another competitor told the CMA that its analysis showed a significant decline in prescription items in the first year following the entry of a competitor and specifically mentioned new entry by supermarkets and independents which opened close to GPs. One competitor did not monitor new entry.

⁸ ME/3007/07 Lloyds Pharmacy Limited/Independent Pharmacy Care Centres plc, 22 June 2007.

⁹ ME/3933/08 Co-operative Group Limited/Lothian Borders & Angus Co-operative Society Limited, 6 March 2009.

32. The CMA undertook an econometric analysis to assess whether and to what extent entry or exit of pharmacies affected prescription volumes of Lloyds' and Sainsbury's stores.¹⁰ In particular, the CMA tested how entry by different pharmacy store types (in particular, supermarkets, small and large multiples) and within different distance bands (in particular, 0 to 1 mile, and 1 to 6 mile) affected dispensing volumes at Lloyds and Sainsbury's pharmacies.
33. The econometric analysis showed that [✂]. The decline in prescription volumes following new entry is consistent with pharmacies competing on the relevant parameters of competition to retain/attract customers.
34. The CMA also reviewed the Parties' internal documents, including several customer surveys. These show that location, availability of medicines, speed of services and opening times are the most important factors for customers in choosing a pharmacy. These documents indicate that the Parties have studied in detail how they perform relatively to other competitors on these parameters of competition. [✂]
35. Based on the above, the CMA considers that there is significant scope for competition in the retail pharmacy sector with regard to non-price competition across a range of quality and service parameters and price competition on pharmacy medicines. Accordingly, the CMA considers that there is scope for the Merger to have competitive effects.

Frame of reference

36. 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 merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account, where relevant, in its competitive assessment.¹¹
37. The Parties overlap in the retail supply of i) prescription-only medicines, ii) pharmacy medicines and iii) pharmacy services to customers in the UK. The Parties also overlap in the supply of OPD services to hospitals. In addition, there is a vertical relationship due to the presence of Celesio's subsidiary

¹⁰ The model used data on the volume of prescription items dispensed each quarter over a five year period by each Lloyds and Sainsbury's store.

¹¹ [Merger Assessment Guidelines](#), paragraph 5.2.2.

AAH in the wholesale distribution of prescription-only and pharmacy medicines and Lloyds and Sainsbury's presence in the retail pharmacy sector.

Retail pharmacy

Product scope

38. The Parties submitted that the approach to product scope adopted by UK competition authorities in previous cases is appropriate in this case. The Parties also noted that, since those cases, there have been developments in the sector, in particular the growth of online pharmacies, but did not consider that there have been sufficient changes to suggest an alternative approach to the frame of reference.
39. The UK competition authorities¹² previously found little demand-side substitution between prescription-only medicines and pharmacy medicines. On the supply side, they found that there are differences in pricing as the price for prescription medicines is set nationally by the NHS whereas pharmacies set their own retail prices for pharmacy-only medicines. The UK competition authorities have not previously considered it necessary, when assessing mergers between retail pharmacy retailers, to define narrower frames of reference for individual prescription-only medicines, pharmacy medicines or pharmacy services.
40. The CMA investigated whether it would be appropriate in this case to depart from the well-established frames of reference for the retail pharmacy sector, but did not find any evidence to suggest that a different definition of the product scope would be justified in this case. In particular, the CMA considered whether to include retail supply via online pharmacies in the product frame of reference, but, consistent with the Parties' submission, did not find evidence of sufficient changes in the sector to justify its inclusion at this time.
41. For the reasons set out above, the CMA therefore considers that there are separate product frames of reference for the retail supply to end-consumers of (i) prescription-only medicines, (ii) pharmacy medicines and (iii) pharmacy services to customers.
42. The CMA considers that the conditions of competition across these frames of reference are similar based on the range of medicines and services offered by pharmacies. For this reason, and notwithstanding that price effects are not

¹² MMC UniChem/Lloyds Chemists and GEHE AG/Lloyds Chemists, ME/2134/05 Boots plc/Alliance Unichem plc, 6 February 2006.

relevant for prescription-only medicines, the CMA has assessed the impact of the Merger in these frames of reference together.

Geographic scope

43. The Parties submitted that these products and services should be assessed at both a national and local level. This is in line with the UK competition authorities' previous decisions.
44. In *Boots/Alliance Unichem*, the OFT considered that there may be an element of national competition in pharmacy retailing. For instance, on the supply side, there are national chains, and pricing decisions as well as advertising and promotion campaigns may have a national dimension.
45. The CMA considers that competition in pharmacy retail supply to end-consumers takes place locally given that demand is local. Although the key parameters of competition may be set at the local or the national level, any effect of the Merger on these parameters, whether local or national ones, depends on the competitive constraints removed or remaining at the local level. The CMA takes these effects into account in the competitive assessment. Therefore, the CMA has not found it necessary to define a national geographic frame of reference.
46. In relation to local markets, the Parties submitted that a one mile radius around each of the Lloyds stores and a 10 minute drive time around each of the Sainsbury's stores is an appropriate starting point for the definition of catchment areas. The Parties suggested a different catchment area for the Sainsbury's stores to reflect the fact that they are located within or next to a larger Sainsbury's grocery store, and therefore can be expected to be drawing customers from a wider catchment area consistent with grocery store catchment areas. They stated that their suggested catchment areas are consistent with the UK retail pharmacy and grocery store decisional practice. The Parties also submitted that a 10 minute drive time for Sainsbury's pharmacies and a 1 mile radius around Lloyds stores is in line with catchment areas (based on the location of 80% of customers) calculated for a sample of Sainsbury's and Lloyds pharmacies. The CMA confirmed that within the sample, the average Sainsbury's catchment was a [X] minute drive time and the average Lloyds catchment was [X] miles.
47. In previous pharmacy mergers, the UK competition authorities have generally used a one mile radius around each of the pharmacy stores as the appropriate catchment area. The one mile radius has been flexed on

occasion.¹³ However, none of these mergers involved supermarket pharmacies. In previous grocery store mergers, 10 and 15 minute drive times have been considered for urban and rural areas, respectively, for one-stop shop grocery stores.¹⁴

48. Information received by the CMA from third parties indicates that most competitors attract the majority of their customers from between 1 and 3 miles in urban areas. For rural areas, competitors submitted catchment areas between 2 and 10 miles. Most competitors were unable to comment on whether different types of pharmacies compete over smaller or greater distances. One competitor indicated that it competes with supermarket pharmacies over a relatively greater distance compared to other types of pharmacies. Most competitors did not consider that there would be a difference in the relevant distances for prescription-only medicines and pharmacy medicines.
49. The CMA considers that the evidence submitted by the Parties on their 80% customer catchment areas is broadly consistent with Lloyds and Sainsbury's stores drawing the majority of their customers from, respectively, within a 1 mile radius, and 10 and 15 minute drive time isochrones for urban or rural areas. This evidence is also broadly consistent with third party feedback.
50. Based on the above, the CMA considers that local geographic frames of reference can be defined using the catchment areas set out above as a starting point (ie a 1 mile radius for Lloyds stores and 10 and 15 minute drive times for urban or rural areas, respectively, for Sainsbury's stores). The CMA has taken into account the strength of the various competitive constraints within these catchment areas and competitive constraints from outside these catchment areas, where relevant, in the competitive assessment.

Supply of OPD services to hospitals

Product scope

51. The Parties submitted that they do not consider that the supply of OPD services to hospitals constitutes a separate product market from the retail supply of medicines. They mentioned that any retail pharmacy could bid for an OPD contract and that they also face competitive constraints from in-house NHS providers.

¹³ Eg ME/3007/07 Lloyds Pharmacy Limited/Independent Pharmacy Care Centres plc, 22 June 2007, paragraphs 32-34.

¹⁴ The Parties submitted that all of Sainsbury's pharmacies are located within a one-stop-shop (ie a store with a net sales area in excess of 1,400 square metres).

52. The UK competition authorities have not considered these services in previous merger investigations. The CMA notes that outsourcing of OPD services by hospitals is a development which started in 2007.
53. The supply of OPD services to hospitals is based on publicly tendered OPD contracts of limited duration. Information from the Parties and third parties showed that not all retail pharmacies participate in tenders for OPD contracts. Furthermore, the information available to the CMA indicates that only a handful of pharmacies regularly bid for OPD contracts, and of those only three have been successful this year. The evidence suggested that the supply of OPD services to hospitals presents distinct features from the retail supply to end-consumers by community retail pharmacies and that the competitive dynamics differ.
54. Although the CMA understands that many hospitals have not outsourced their OPD services, of those hospitals that have, some expressed concerns that their future choice of OPD services supplier would be reduced as a result of the Merger. Most hospitals responding to the CMA's enquiries did not consider self-supply to be a viable option. One hospital specifically mentioned that it would not consider bringing OPD services back in-house as the service offered by specialist providers is much better.
55. Based on the evidence above, the CMA considers that a separate product frame of reference for the supply of OPD services to hospitals is appropriate. The extent to which NHS Trust subsidiaries¹⁵ participated in tenders is taken into account in the competitive assessment to the extent relevant.

Geographic scope

56. The Parties submitted that the frame of reference should be national in scope as all retail community pharmacies in the UK are able to compete. The Parties are only aware of OPD contracts being put out to public tender in England, although they state that this may change.
57. The UK competition authorities have not previously considered geographic market definition in the supply of these services.
58. Third party evidence indicates that competitors are generally able to compete for OPD contracts throughout England.

¹⁵ NHS Trust subsidiaries are subsidiaries which are specifically set up by an NHS Trust for the provision of pharmacy services on the same basis as a third party provider.

59. On the basis of this evidence, the CMA considers that the geographic frame of reference for the supply of OPD services to hospitals is England.

Conclusion on frames of reference

60. For the reasons set out above, the CMA has considered the impact of the Merger in relation to the following frames of reference:
- (a) The supply of prescription-only medicines to end-customers in local areas;
 - (b) The supply of pharmacy medicines to end-customers in local areas;
 - (c) The supply of pharmacy services to end-customers in local areas; and
 - (d) The supply of ODP services to hospitals in England.

Competitive assessment

61. The CMA assessed the Merger against the following theories of harm:
- (a) Horizontal unilateral effects in the retail supply of prescription-only medicines, pharmacy medicines and pharmacy services in local areas;
 - (b) Horizontal unilateral effects in the supply of OPD services to hospitals in England; and
 - (c) Vertical effects arising from the foreclosure of downstream retail pharmacy competitors to the merged entity's wholesale supply of prescription-only medicines and pharmacy medicines (input foreclosure).

Horizontal unilateral effects in pharmacy retailing

62. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged entity profitably to raise prices or degrade quality on its own and without needing to coordinate with its rivals.¹⁶ Horizontal unilateral effects are more likely when the merger parties are close competitors. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC in relation to horizontal unilateral effects in pharmacy retailing.

¹⁶ [Merger Assessment Guidelines](#), from paragraph 5.4.1.

63. In merger investigations involving a large number of local overlaps it is common practice for the CMA to use a filtering methodology in its phase 1 investigation to exclude from further assessment areas where it is clear that there is no realistic prospect of an SLC. In many cases, this reduces the number of areas requiring an in-depth analysis.¹⁷
64. As explained in more detail below, in the present case, the CMA identified a total of 763 overlap stores.¹⁸ As this number of overlap areas was beyond the number in which the CMA could realistically carry out a more in-depth assessment within the confines of a phase 1 investigation, the CMA applied primary filters to identify areas that may give rise to prima facie competition concerns.
65. Below, the CMA first sets out the evidence from internal documents and third party views on the closeness of competition between the Parties and the competitive constraints that they face. The CMA then explains the primary filters that have been used. The CMA's findings on closeness of competition and competitive constraints informed the design of the primary filters.

Closeness of competition and competitive constraints

Parties' submission

66. The Parties submitted that they are not close competitors because of their differentiated offering in relation to (i) opening hours, [✂] The Parties also told the CMA that they operate differentiated retail formats as Lloyds pharmacies are typically located relatively close to GPs on high streets or in town centres, whereas Sainsbury's pharmacies are typically located on out-of-town retail parks with an accompanying car park and the benefits of a one-stop-shop for pharmacy and grocery products.
67. The Parties submitted that other rivals are closer competitors to each of the Parties than the Parties are to each other. They indicated that Boots' retail format is a hybrid between a supermarket and community pharmacy. The Parties also mentioned Well, Rowlands, Tesco, Day Lewis, Asda, Morrisons, regional multiples and independent pharmacies as competitors whose presence varies by local area.

¹⁷ See for example [Commentary on retail mergers](#) (OFT1305/CC2com2, March 2011, adopted by the CMA as set out in *Mergers: Guidance on the CMA's jurisdiction and procedure*, Annex D), paragraph 2.4.

¹⁸ This figures includes Sainsbury's OPD services at Guy's Hospital and at St Thomas' Hospital.

Internal documents

68. The CMA assessed internal documents provided by the Parties in order to understand how closely the Parties compete and the Parties' competitors:
- (a) One of Sainsbury's internal documents setting out the reasons for the sale of its retail pharmacy business mentions [REDACTED] and [REDACTED] as its largest competitors.
 - (b) Two internal documents submitted by Sainsbury's state different strengths and weaknesses of different types of pharmacies [REDACTED].
 - (c) Sainsbury's submitted a customer survey¹⁹ which scored each provider based on factors that customers value most (ie location, availability of medicines, speed of dispensing prescriptions and opening times). [REDACTED]
 - (d) Lloyds submitted results of a customer survey which was conducted to benchmark future performance.²⁰ Results show which providers customers would choose for:
 - (i) Prescriptions: [REDACTED] and
 - (ii) Health services: [REDACTED]
 - (e) Lloyds also submitted research providing insights into the different reasons why consumers chose a particular pharmacy. [REDACTED]

Third parties

69. Several competitors told the CMA that closeness of competition between the Parties varies by local area. Examples were mentioned where the Parties are close competitors as they are located particularly close to each other. One competitor said that the Parties are not particularly close competitors as their business models are different, noting that Lloyds focuses on serving GPs and smaller communities with a traditional high street model pharmacy and Sainsbury's serves the convenience population with late trading hours and free parking in many of their locations.
70. Another competitor considered that there would not be an adverse impact on competition as a result of the Merger. However, one competitor considered that the Merger would reposition Lloyds to be nearer high streets/retail parks

¹⁹ Report June 2015. Customer survey conducted [REDACTED] interviews, amongst Sainsbury's stores shoppers in locations [REDACTED].

²⁰ Report January 2015. Online survey amongst [REDACTED] people from research panel, nationally representative, all live within postcode catchment areas of Lloyds stores. [REDACTED]

and another competitor considered that there may be reduced competition in areas where the Parties are both currently active. Another third party stated that in some localities Lloyds will be a dominant player and there was a risk of less competition.

Conclusion

71. Based on the evidence set out above, the CMA considers that, although their competitive offering is to a certain extent differentiated, the Parties compete against each other. In particular, internal documents show that the Parties closely monitor each other and customer surveys indicate that, while there are points of service differentiation between the Parties, they also both score well on convenience of location as a key indicator.
72. The Parties also face competitive constraints from other pharmacies such as national chains (eg Boots, Well), regional multiples, independents and other supermarket pharmacies.²¹ The CMA considers that the extent to which the Parties and third parties compete varies in each local area. The CMA also notes that there is a wide spectrum of constraint imposed by independent pharmacies and within that category there is substantial differentiation. Accordingly, the constraint imposed by independent pharmacies may vary considerably by local area.

Primary filters

Summary

73. The CMA used a 1 mile radius to define the catchment area around each Lloyds store and a 10 minute drive time to define the catchment area for Sainsbury's stores in urban areas and a 15 minute drive time to define the catchment area for Sainsbury's stores in rural areas. An overlap was identified if a Lloyds pharmacy was situated within Sainsbury's catchment area.
74. The application of these filters resulted in the identification of 546 Lloyds stores that overlap with at least one Sainsbury's store and 217 Sainsbury's stores that overlap with at least one Lloyds store, resulting in a total of 763 overlap stores.

²¹ The CMA did not find any evidence, based on the Parties' and third party submission and internal documents, that GP dispensers, consortia pharmacies and internet pharmacies compete strongly with the Parties. However, the CMA found that it was not possible to exclude these from the share of supply calculations (or consortia pharmacies from the fascia counts). Due to their low share of supply and the expected low number of consortia pharmacies, the CMA considered that their inclusion did not significantly impact the filtering results.

75. The CMA applied the following filtering methodology to the overlap stores:
- (a) A 'share of supply filter' based on GP prescription data was used for each Lloyds and Sainsbury's overlap store for which the share of supply information was available and produced a reliable filter outcome. This filter used a 40% or greater combined share of supply with an increment of at least 10%, and was applied to 572 of the overlap stores (407 Lloyds stores and 165 Sainsbury's stores);
 - (b) A 4-to-3 'fascia count filter' was used for the remaining 139 Lloyds stores for which share of supply information was not available or not produce a reliable outcome; and
 - (c) A 'share of store filter' based on a 40% or greater combined share of stores with an increment of at least 10% was used for the remaining 52 Sainsbury's stores for which share of supply information was not available or did not produce a reliable outcome.²²
76. Below the CMA explains:
- (a) First, the Parties' submissions in respect of filtering;
 - (b) Secondly, the share of supply filter. This includes an explanation of the extent to which the share of supply methodology could be adopted in this case and why a combined share of 40% with an increment of 10% threshold was employed;
 - (c) Thirdly, the fascia count filter for Lloyds stores. This includes an explanation of why a 4-to-3 reduction threshold was employed;
 - (d) Fourthly, the share of stores filter for Sainsbury's stores. This includes an explanation of why a store count filter was used for Sainsbury's stores (rather than a fascia count filter); and
 - (e) Finally, the results of the primary filtering methodology.

Parties' submission

77. The Parties submitted three different approaches to the CMA during the course of the investigation.
78. First, in the Merger Notice, the Parties submitted a 3-to-2 fascia reduction (including treating independently-owned pharmacies as separate fascia) as

²² This included one Sainsbury's store that was not yet open and therefore could not be subjected to a share of supply filter.

the primary filter, based on a one-mile radius around each Lloyds store and a 10 minute drive time around each Sainsbury's store, but identified an overlap only if there was a Lloyds store within one mile of the Sainsbury's store. This resulted in 14 local areas where the Merger would result in a 3-to-2 or 2-to-1 fascia reduction.

79. In addition, the Parties carried out a more in-depth assessment of each of these 14 local areas based on geography, location of customers, prescription data, closeness of competition, and number of items dispensed. The Parties submitted that the Merger would not result in an SLC in any of those local areas.
80. During its investigation, the CMA sent the Parties an Issues Letter setting out its potential concerns with the Merger. The Issues Letter set out the CMA's filtering methodology which shared the same basic features of the filter summarised above in paragraph 77, except that, instead of a 40% combined share of supply with an increment of at least 10%, a 35% combined share of supply with an increment of 5% was used. This would effectively reflect a 4-to-3 fascia reduction if one assumes three equal remaining competitors. This filter, combined with the fascia reduction and share of store filters where the share of supply filter was not available or reliable, resulted in [X] local areas for which the CMA had potential competition concerns.
81. Due to the large number of potential problematic areas, the CMA was unable within the 45-working day statutory timetable to carry out a more detailed analysis for each of those areas. Subsequently, the CMA considered whether it might be appropriate in the present case to increase the thresholds to a 40% or greater combined share of supply with an increment of at least 10%. This was in particular to take into account the fact that some parameters of competition are regulated in this market (see paragraphs 26 to 35) and the asymmetry in the size of the Parties in local areas.²³
82. In response to the CMA's Issues Letter, the Parties proposed to first run a 3-to-2 fascia count filter on all overlap Lloyds and Sainsbury's stores as follows:
 - (a) for Lloyds overlapping stores, including all rivals within one mile and all supermarkets and Boots retail park rivals within a six mile distance;

²³ The CMA notes that, if customers within a GP catchment switched between rivals in response to price/quality changes in proportion to their shares of supply, then the diversion to the smaller merger party from the other implied by an increment of around 5% would typically be low except where the other merger party itself has a high share of supply.

(b) for Sainsbury's overlapping stores, including all rivals located within 10 and 15 minute drive time for urban and rural areas respectively.

83. For those areas that fail this filter, the Parties argued that the CMA should apply a filter of 50% or greater combined share of supply with an increment of at least 10% (based on GP prescription data) to Lloyds and Sainsbury's stores in England (where GP prescription data is readily available).²⁴ For stores in Northern Ireland, Scotland and Wales, they proposed applying a 50% or greater combined share of stores with an increment of at least 10%. This resulted in nine local areas that failed the filters, five fewer than was identified in the Parties' Merger Notice.
84. Finally, following the Issues Meeting, the Parties proposed a 4-to-3 fascia count as the primary filter, based on a one-mile radius (and also using a two-mile radius as a sensitivity check) around each Lloyds store and 10 and 15 minute drive times from each Sainsbury's store (for urban and rural areas, respectively). They also identified areas where the Parties are geographically each other's closest competitors. This resulted in 59 local areas where the Merger would result in a 4-to-3, 3-to-2 or 2-to-1 fascia reduction. In addition, the Parties commented on the use of GP catchment areas and shares of supply. This is discussed below in paragraphs 93 to 95.

Share of supply filter

85. In previous retail pharmacy cases, the UK competition authorities have used a fascia count filter as a starting point for the competitive assessment.²⁵ The CMA notes that there was no share of supply data available in those cases, whilst in the present case GP prescription data was available in relation to pharmacies in England. In general, the CMA considers that both fascia counts and shares of supply can be used as initial indicators of the market power held by suppliers and of the competitive impact of a merger. As such, depending on the information available, they have both been used as filters in previous investigations.
86. Fascia counts typically treat all competitors in the competitor set as being equal, while shares of supply reflect the different sizes of various competitors and, as such, provide more information about their relative strengths. The

²⁴ The Parties also addressed the multiple GP issue (see paragraphs 90 to 92) by excluding pharmacies that are at a more than 'typical' distance from the focal branch.

²⁵ The rationale was two-fold: first, a fascia test takes account of the fact that stores under common ownership may be standardised in terms of competitive parameters, such as prices and service levels, and second, it provides a shorthand measure for the economic presumption that a common owner will internalise competition between its retail outlets so as to maximise profits. However, the OFT also recognised that in some circumstances fascia analysis results in under-reporting potential problem areas where the parties are particularly close competitors, since a fascia approach treats all (included) competitors as being equal.

CMA considers that this is an important consideration in this case, both in relation to the Parties and their competitors. In particular, the CMA notes that many Sainsbury's stores have a relatively small share of supply within their local areas and the same applies to many independent pharmacies. In these situations, a fascia count may overstate the competitive strength of these stores.²⁶ Accordingly, in this case, the CMA has used shares of supply for its filter.

87. The GP prescription data has been used to develop shares of supply as follows:
- (a) NHS England publishes data showing, separately for every GP in England and each month, the pharmacies that dispense prescription-only medicines written by the GP. This data has been used by the CMA to identify the GPs that capture 80% of Lloyds and Sainsbury's prescription customers ('GP catchment area') for Lloyds and Sainsbury's overlap stores ('focal stores') in England;²⁷
 - (b) GP catchment areas were constructed by ranking GPs in terms of their importance (by prescription volumes) to the focal stores and by identifying the GPs that account for at least 80% of prescriptions at the focal stores from between April and June 2015;²⁸
 - (c) Subsequently, shares of supply were calculated upon the GPs that make up the GP catchment area (ie the number of prescription items originating from these GPs that pharmacies within the GP catchment area dispensed). Therefore, these included all pharmacy stores that dispensed prescriptions originating from these GPs, but only the prescriptions dispensed from those GPs rather than all prescriptions dispensed by the store.
88. The CMA understands that some GPs (around 25%) are part of wider GP groups (ie with more than one branch) and the data on the number of prescriptions written by each GP practice used to construct the GP catchment

²⁶ The CMA notes that a fascia count would also overstate the competitive strength of Sainsbury's in the local area given its low shares of supply. However, given that other stores may also be overstated, the net overstatement is ambiguous and less reliable than the picture presented by the share of supply data which is available in this case.

²⁷ As explained in paragraphs 90 to 92, in some instances, shares of supply were considered potentially unreliable and in these instances an alternate filter was used instead. This data was also not available within the timeframe of the phase 1 investigation for GPs in Northern Ireland, Scotland and Wales.

²⁸ The CMA notes that this approach is slightly different from the approach generally taken by UK competition authorities when defining 80% customer catchment areas, where customers are ranked by relative distance to the focal store. In this case, the Parties advised that the available data on GP locations contained inaccuracies and it would therefore be more suitable to include GPs in order of importance to the focal pharmacy. The CMA considered that the Parties' proposed approach can be expected to produce broadly similar catchment area results to an approach based on ranking by relative distances as pharmacies will tend to draw most customers from their geographically closest GPs.

area is not split out for each GP branch. Where a GP catchment area contains a GP with multiple branches, the share of supply calculation may therefore take account of volumes dispensed by pharmacies outside the catchment area under consideration.

89. When a catchment area includes a GP that is part of a wider GP group, the CMA considers that the share of supply calculation is potentially misleading. This may be with regard to the estimate of the Parties' overall share of supply within the catchment or the increment. In those instances, the CMA has used an alternative method to filter out areas that are unlikely to raise concerns (see paragraphs 97 to 100 below).²⁹
90. In some cases, the CMA found that, even taking into account the presence of a GP with multiple branches, on the most cautious basis the Parties would still pass the share of supply filter. The CMA considers that in these cases the GP data is appropriately reliable for a primary filter and no further filter has been applied.
91. Following the Issues Meeting, the Parties submitted that GP catchment shares are not reliable estimates of shares of supply, with their principal arguments being that (i) GP catchment areas would not capture demand based on customer location and (ii) shares of supply within the GP catchments will over-represent the pharmacy on which the catchment is focused as they are based on GPs ranked by relative importance to the focal pharmacy. They argued that these issues meant that a fascia reduction filter would be more appropriate.
92. The CMA considers that GP catchment areas capture demand based on customer location to the extent that most patients will live (or work) within the vicinity of their GP. Consequently, the GP catchment of a pharmacy will provide a reasonable proxy for the area over which the Parties compete for the majority of their customers.
93. In relation to the argument that shares of supply within the GP catchments will over-represent the pharmacy on which the catchment is focused, the CMA notes that catchment areas centred on the Parties' stores are a standard approach used in merger investigations involving a large number of local

²⁹ If a catchment includes a GP with multiple branches, the CMA considered that the most cautious approach to calculating the Parties' combined market share would be to assume that any volumes attributed to the Parties at that affected GP arise entirely in the branch located in the catchment, and all volumes attributed to other pharmacies arise in the branch located outside of the catchment. When calculating the increment on the most cautious basis, the CMA adopted a similar approach, but this time assuming that all volumes attributed to the increment pharmacy arose at the branch inside the catchment, and all other volumes (including those of the other merging party) arose from outside of the catchment.

markets.³⁰ As explained above in paragraph 89, the CMA considered that an approach based on ranking GPs by importance (by prescription volumes) is expected to produce similar results to an approach based on ranking GPs by distance and that GP location is a reasonable proxy for the focal store's demand location. As such, the CMA considers that its methodology does not necessarily bias upwards the share of prescriptions of the focal pharmacy compared to an approach based on ranking GPs by distance.

94. As discussed above, the CMA initially employed a 35% combined share of supply threshold with a 5% increment. However, the CMA increased the thresholds to a 40% or greater combined share of supply with an increment of at least 10%, to take into account the fact that some parameters of competition are regulated in this market (see paragraphs 26 to 35) and the asymmetry in size of the Parties in local areas.

Fascia count filter for Lloyds stores

95. Where it was not possible to calculate shares of supply because the data was unavailable or the shares of supply information produced an outcome which was unreliable, the CMA used a fascia count filter for the Lloyds stores. In line with precedent, the Parties' internal documents, the Lloyds customer catchment area analysis and the CMA's econometric analysis, the CMA treated all rival pharmacies within one mile of the Lloyds store as being an effective competitor. The CMA considered that when a Sainsbury's store was located further than one mile away from a focal Lloyds store it would be appropriate to include rival supermarkets that are a similar distance from the focal Lloyds store as effective fascia.³¹
96. The CMA considered that the Merger gives rise to prima facie competition concerns when it results in a fascia reduction of 4-to-3 or less.

Share of stores filter for Sainsbury's stores

97. For the Sainsbury's stores, the CMA has applied a share of stores filter (based on count of stores) when GP prescription data was unavailable or the shares of supply information produced an outcome that was unreliable. The CMA considers that it is more appropriate to apply a share of store filter than

³⁰ [Merger Assessment Guidelines](#), paragraphs 5.2.22 and 5.2.25 and [Commentary on retail mergers](#), paragraph 2.2.

³¹ More specifically, if the distance between the focal Lloyds and closest Sainsbury's is between 1 and 2 miles, all pharmacy fascia within 1 mile and supermarket pharmacy fascia up to 2 miles of the Lloyds store have been taken into account as competing fascia. If the distance between the Lloyds and closest Sainsbury's is between 2 and 6 miles, all pharmacy fascia within 1 mile and supermarket pharmacy fascia up to 6 miles of the focal Lloyds store have been taken into account as competing fascia.

to apply a fascia count filter in this specific case, because Sainsbury's customer catchment areas are relatively wide and can typically encompass a relatively large number of rival stores owned by different fascia. Also, a consumer that may be willing to travel relatively far to visit a Sainsbury's pharmacy may not be willing to travel to each rival fascia within the catchment. Therefore, in this instance, a fascia count is unlikely to be informative for assessing the effects of the Merger.

98. Consistent with the share of supply thresholds, the CMA initially considered a combined share of stores of 35% or greater with an increment of at least 5% within 10 and 15 minute drive times from the Sainsbury's store in urban and rural areas, respectively, and finally took as the relevant filter a combined share of stores of 40% or greater with an increment of at least and 10% for the reasons set out in paragraph 96.

Results of filtering

99. The primary filters produced the following results:
- (a) 23 local areas around a Lloyds store and three local areas around a Sainsbury's store failed the combined share of supply filter of 40% or greater with an increment of at least 10%;
 - (b) 47 areas around a Lloyds store failed the 4-to-3 or less fascia count filter;
 - (c) five local areas around a Sainsbury's store failed the combined share of stores filter of 40% or greater with an increment of at least 10%.
100. In total, 78 local areas failed the filters and therefore raise prima facie concerns.

Local analysis

101. The CMA conducted a more detailed local analysis of certain local areas that failed the filters in order to determine the magnitude of the concerns. Due to the significant number of overlaps that failed the filter, the CMA considered the presence of any mitigating factors which could eliminate the prima facie concerns identified and enable the CMA to conclude that the Merger will not give rise to a realistic prospect of an SLC in that local area.
102. The CMA focused on 43 local areas in which (i) Lloyds stores failed the share of supply filter and the Merger resulted in a 4-to-3 fascia reduction or greater (ie 5-to-4, and so on), (ii) Lloyds stores failed the fascia count filter and the Merger resulted in a 4-to-3 fascia reduction where the Parties' stores overlapped within 2 miles or a 3-to-2 (or worse) fascia reduction where the

Parties' stores overlapped between 2 to 6 miles, (iii) Sainsbury's stores failed the share of supply or share of store filter. This sample included areas that failed the filters by a smaller margin and were selected on the basis that, if concerns remained in those areas following a more detailed analysis, then concerns would also remain in those areas that were higher on the spectrum of concerns.

103. In its more detailed local analysis, the CMA took the following evidence into account, where available:
- (a) the Parties' combined shares and increment;
 - (b) the strength of competitors based on shares of supply per store and per fascia and on the number of fascia;
 - (c) the geographic proximity of the Parties' stores in each local area; and
 - (d) geographic features presented on maps (roads, town centres etc.) which may impact on competitive dynamics in the local area.
104. The CMA's more detailed analysis of the local areas confirmed the prima facie concerns identified in all of the local areas. The analysis showed a wide variation in terms of combined shares of supply, which vary from [40–80]% and in the level of increment, which varies from 10% to 30% among those Lloyds stores assessed using the share of supply filter. These high shares of supply and the increments indicate that the Merger would result in a substantial increase in market power for the merged entity. In addition, in several instances, independent pharmacies were very small competitors in terms of prescription volumes, and therefore were considered unlikely to impose a significant constraint on the Parties. The CMA also found that the Parties are frequently located very close to each other.³²
105. Based on this information, the CMA believes that it is or may be the case that the Merger may be expected to result in an SLC in each of these 78 local areas that failed the filters.
106. In addition, the above-mentioned local analysis revealed that over half of the areas assessed against the share of supply filter which had high combined shares (and therefore raised more significant competition concerns) also contained high fascia counts (ie with between four and 11 rivals remaining post-Merger). These areas would have passed the 4-to-3 fascia test in the absence of share of supply data. In many of these areas, the CMA found that

³² For instance, around half of the Lloyds overlap stores the CMA looked at in more detail were within 1 mile from the closest Sainsbury's store.

independent pharmacies are very small competitors in terms of share of GP prescriptions. The CMA found, for example, that many independents had shares of supply of [0–5]%. This indicated to the CMA that the fascia included in the competitor set for the fascia count filter were not reliably effective competitors in each local area. As such, some or all Lloyds overlap stores that passed the fascia count filter may have done so on the basis of included fascia that are not effective competitors.

107. Based on those findings, in relation to the [X] Lloyds overlap stores that passed the fascia count filter, the CMA has not been able to reach a positive conclusion in relation to whether the Merger gives rise to a realistic prospect of an SLC in relation to these stores. However, the CMA believes that there is considerable uncertainty in relation to these areas and that an SLC might prove to be likely on further and fuller examination of the position.
108. Furthermore, as a sensitivity check, the CMA has also considered in more detail those Lloyds and Sainsbury's stores that passed the share of supply filter of a 40% combined share of supply with an increment of at least 10% threshold but failed a filter of a 35% combined share of supply with an increment of at least 5%. This analysis shows that, of the [X] Lloyds stores and [X] Sainsbury's stores assessed in more detail, there are [X] local areas where the Merger would result in a 3-to-2 fascia reduction and [X] local areas with very high combined shares of supply of between 60% and 80% (and with increments between 5% and 10%). These particular features indicate that the Merger gives rise to prima facie competition concerns in these local areas, despite them having passed the share of supply filter.
109. Accordingly, in relation to these [X] areas,³³ the CMA has not been able to reach a positive conclusion in relation to whether the Merger gives rise to a realistic prospect of an SLC. However, the CMA believes that there is considerable uncertainty in relation to these areas and that an SLC might prove to be likely on further and fuller examination of the position.

Conclusion on horizontal unilateral effects

110. The CMA therefore believes that it is or may be the case that the Merger may be expected to result in an SLC as a result of horizontal unilateral effects in relation to the retail supply of prescription-only medicines, pharmacy medicines and pharmacy services to end-customers in the 78 local areas listed in Annex 1.

³³ In four areas the Merger would result in a 3-to-2 fascia reduction as well as very high combined shares of supply.

111. In addition, the CMA has not been provided with, and within the timetable of the phase 1 process has not been able to gather, sufficient evidence to reach a definitive conclusion in relation to the local areas listed in Annex 2.

Countervailing constraints

112. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no substantial lessening of competition. In assessing whether entry or expansion might prevent a substantial lessening of competition, the CMA considers whether such entry or expansion would be timely, likely and sufficient.³⁴

113. The Parties submitted that pharmacies are subject to specific regulatory and licensing requirements and market entry is strictly controlled in the UK. It stated that there have been three significant developments over the last five years:

(a) 100 hours and retail park exemption:³⁵ in 2012 these exemptions were abolished and this has resulted in reduced growth in the number of new pharmacy openings (ie fewer entrants);

(b) Internet pharmacies: there has been a steady growth of internet pharmacies. The Parties named Pharmacy2U.co.uk, ExpressChemist.co.uk and ChemistDirect.co.uk as the leading internet pharmacies; and

(c) Acquisition by Bestway Group of the Co-operative Group's pharmacy business. As a result of this acquisition the Co-operative pharmacy business was rebranded as Well Pharmacies in 2015.

114. Neither the removal of the 100 hours and retail park exemptions or the acquisition of Co-op by Bestway are evidence of entry or expansion which would mitigate the initial effect of the Merger on competition.

115. The CMA notes the presence of internet pharmacies and considers it likely that they will increase their market shares. However, the GP prescription data shows that their shares are currently very small (ie 0% to 1% in most local areas) and the CMA has found no evidence from internal documents that

³⁴ [Merger Assessment Guidelines](#), from paragraph 5.8.1.

³⁵ The 100 hours and retail park exemption allowed for new pharmacy licences to be granted without a need to provide a local Health and Wellbeing Board's Pharmaceutical Needs Assessment. These exemptions were first introduced in 2005 and resulted in significant growth in the number of pharmacies.

internet pharmacy expansion will be timely, likely and sufficient to mitigate any SLC arising.

116. For the reasons set out above, the CMA believes that entry or expansion would not be sufficient to prevent a realistic prospect of an SLC as a result of the Merger. The CMA did not find any evidence on countervailing buyer power which would be sufficient to prevent an SLC.

Horizontal unilateral effects in the supply of OPD services to hospitals

Shares of supply

117. The Parties submitted information on the number of OPD contracts entered into by third party providers since 2007. Lloyds has won [X] OPD contracts and Sainsbury's [X] OPD contracts. In total, [X] OPD contracts were won by third parties. The majority of hospital trusts do not outsource OPD services to third parties.

Table 1: Estimated shares of OPD services to hospitals won in England

	<i>Number of contracts</i>	<i>%</i>
Lloyds	[X]	[40–50]
Sainsbury's	[X]	[0–5]
Combined	[X]	[50–60]
Boots	[X]	[20–30]
Well	[X]	[5–10]
Pharmaxo	[X]	[5–10]
Rowlands	[X]	[0–5]
Trust subsidiary	[X]	[0–5]
Healthcare at Home	[X]	[0–5]
Total	[X]	100

Note: based on bids won in 2007-2015.

118. Table 1 shows that, based on the number of contracts that have been open to competition since 2007, the Parties have a combined share of supply of OPD services to hospitals of [50–60]% with an increment of [0–5]% arising from the Merger. The Parties' main competitor is Boots with a [20–30]% share of supply. The CMA notes that in the last three years Lloyds has won [X] contracts ([X] of all contracts tendered over the period) and Sainsbury's [X] contract ([X] of all contracts tendered).
119. The CMA considers that the Parties' combined share of supply raises prima facie competition concerns in relation to horizontal unilateral effects in the supply of OPD services to hospitals.

Closeness of competition and competitive constraints

Parties' submissions

120. The Parties submitted that Lloyds was initially a strong competitor for these contracts, but has since 2012 suffered a decline in the number of contracts awarded per year, and Sainsbury's has only been awarded [REDACTED] in the last three years. Boots represents a strong constraint and Well and Rowlands will continue to constrain the merged entity as well as the Trust subsidiaries.

Bidding data

121. Both Parties provided an overview of all OPD tenders that each of them participated in during the last three years (2013-2015). The Parties stated that they were unable to indicate who the other bidders were. Sainsbury's provided a 'best guess' of other bidders.
122. Sainsbury's bidding data showed that [REDACTED].
123. The Parties' data on successful bids for the period 2007 until 2015 shows that Lloyds and Boots won the majority of contracts within the last three years (ie 2013, 2014 and 2015). In 2015, Boots was more successful than Lloyds. Out of the [REDACTED] contracts tendered in the last three years, Boots won [REDACTED] contracts, Lloyds won [REDACTED] contracts, a Trust subsidiary won [REDACTED] contracts, and Rowlands, Well and Sainsbury's each [REDACTED].

Third parties' submissions

124. Third party submissions showed that on [REDACTED].³⁶ [REDACTED]. Several hospitals considered the Parties to be close competitors and some were concerned that the Merger would reduce competition.
125. The CMA notes that most hospitals still supply OPD services themselves. However, most hospitals responding to the CMA's enquiries, which outsource their OPD services, did not consider self-supply to be a viable option. One hospital specifically mentioned that it would not consider bringing OPD services back in-house as the service offered by the specialist provider is much better.
126. One competitor told the CMA [REDACTED].

³⁶ [REDACTED]

Conclusion

127. The evidence indicates that Lloyds and Boots are the two main competitors in the supply of OPD services, with a small number of smaller competitors including Sainsbury's. Sainsbury's has provided a significant constraint in the past, winning [X] contracts, although that constraint appears to have recently diminished to some extent as Sainsbury's has [X] contract in the last three years. The Merger would result in the loss of that constraint, and there are a limited and diminishing number of competitors that are capable of replacing that constraint. Given the CMA has concluded that the Merger gives rise to a realistic prospect of an SLC in relation to the retail supply of prescription-only medicines, pharmacy medicines and pharmacy services to end-customers it has not found it necessary to conclude whether the Merger gives rise to a realistic prospect an SLC as a result of horizontal unilateral effects in relation the supply of OPD services to hospitals in England.

Vertical effects

128. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer or a downstream competitors of the supplier's customers. In this case, as noted above, Celesio is active in the wholesale supply of pharmaceuticals to retail pharmacies, through its subsidiary AAH, and both Lloyds and Sainsbury's are active in pharmacy retail.
129. In the present case, the CMA considered whether a realistic prospect of an SLC would arise as a result of the Merger through input foreclosure. In particular, the CMA considered whether, post-Merger, AAH may increase the price of pharmaceuticals it supplies to rival pharmacy retailers (or deteriorate the quality of the service provided or stop supplying) in order to divert sales to its own retail business and, ultimately, harm the ability of its downstream rivals to compete.
130. One third party expressed concerns relating to input foreclosure. In particular, it was put to the CMA that the Merger may give the Parties an increased incentive to foreclose downstream competitors from access to the wholesale supply of prescription-only and pharmacy medicines.
131. The Parties submitted that AAH would not have the ability and incentive to engage in a foreclosure strategy, and noted that there are two other significant national wholesalers (ie Boots Alliance and Phoenix) as well as several regional wholesalers. At the retail level, Lloyds has around [10–20]% share of retail supply of pharmacy products and services to end-customers at

the national level and Sainsbury's has a corresponding share of around [0–5]%. At a local level, the Parties' shares of supply vary significantly.

132. The CMA considers that, although AAH has a significant position in the wholesale supply of pharmaceuticals, there are two other significant national wholesalers to which retailers can switch to and a number of regional wholesalers. As such, the merged entity may only have a limited ability to foreclose downstream rivals.
133. In addition, the CMA considers that the Merger will not significantly impact the merged entity's incentive to pursue a foreclosure strategy at a national level due to the small national increment at the retail level.
134. At the local level, the merged entity's incentive to pursue an input foreclosure strategy depends on its retail market position relative to rivals in each local area. The CMA considers that the change in the merged entity's incentives to pursue such an input foreclosure strategy post-Merger is only likely to be significant with regard to those local areas where horizontal effects concerns arise.
135. The CMA considers that it is not necessary to conclude whether it is or may be the case that the Merger may be expected to result in an SLC as a result of input foreclosure given the CMA's conclusion in relation to horizontal unilateral effects in pharmacy retailing.

Third party views

136. The CMA contacted customers, competitors and suppliers of the Parties. In addition, the CMA contacted central government organisations, local commissioning groups, regulatory authorities and trade associations in England, Wales, Scotland and Northern Ireland. Some competitors and local commissioning groups raised concerns regarding a reduction of competition and consumer choice between retail pharmacies in local areas. One central government organisation was concerned that Lloyds may relocate acquired pharmacies out of Sainsbury's and could reduce their opening hours with adverse effect on consumer access to pharmaceutical services.
137. In addition, several other third parties raised concern in four local areas of the UK. Two areas, [redacted] and [redacted], were flagged as local areas of concern although the CMA's analysis suggests that there are no competition concerns in relation to these areas. [redacted] and [redacted] are two areas flagged as problematic where the CMA identified stores that do fail the filters.

138. Some hospitals raised concerns in relation to a lessening of competition following the Merger in relation to OPD services. One third party raised concerns as discussed in paragraphs 132 to 137. No other third parties raised concerns about the Merger.
139. Third party comments have been taken into account where appropriate in the competitive assessment above.

Conclusion on substantial lessening of competition

140. Based on the evidence set out above, the CMA believes that it is or may be the case that the Merger may be expected to result in a substantial lessening of competition as a result of horizontal unilateral effects in relation to the supply of prescription-only medicines, pharmacy medicines and pharmacy services to end-customers in local areas.

Decision

141. Consequently, the CMA believes that it is or may be the case that the Merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.
142. The CMA therefore considers that it is under a duty to refer under section 33(1) of the Act. However, the duty to refer is not exercised pursuant to section 33(3)(b) whilst the CMA is considering whether to accept undertakings under section 73 of the Act in lieu of a reference. Pursuant to section 73A(1) of the Act, the Parties have until 18 December 2015 to offer an undertaking to the CMA that might be accepted by the CMA under section 73(2) of the Act. If the Parties do not offer an undertaking by this date, if the Parties indicate before this date that they do not wish to offer an undertaking, or if pursuant to section 73A(2) of the Act the CMA decides by 29 December 2015 that there are no reasonable grounds for believing that it might accept the undertaking offered by the Parties, or a modified version of it, then the CMA will refer the Merger for a phase 2 investigation pursuant to sections 33(1) and 34ZA(2) of the Act.

Sheldon Mills
Senior Director Mergers
Competition and Markets Authority
11 December 2015

ANNEX 1 Local areas where the CMA found a realistic prospect of an SLC

Local areas around Lloyds stores

[✂]

Local areas around Sainsbury's stores

[✂]

ANNEX 2 Local areas where the CMA has not been able to conclude

[✂]

Local areas around Lloyds stores

[✂]

Local areas around Sainsbury's stores

[✂]