ANTICIPATED ACQUISITION BY CELESIO AG OF SAINSBURY'S SUPERMARKETS LIMITED UK PHARMACY BUSINESS

Statement of Issues: Response of the Parties

10 February 2016

In their initial submission of 19 January 2016 (**Initial Submission**), Celesio AG (**Celesio**) and Sainsbury's Supermarkets Limited (**Sainsbury's**; together, the **parties**) have previously commented on many of the potential concerns identified in the CMA's Statement of Issues published on 26 January 2016 (**SoI**). This response to the SoI therefore aims to summarise or cross-refer to the points made in the Initial Submission, and to supplement with new material where this has been possible in the time available. In particular, this response collates new evidence on the parties' differentiation (much of it from the data and market questionnaire responses), further evidence on the lack of any issue in relation to P-med pricing, and comments on the issue of GP proximity in the light of the typically quite different shopping missions of the parties' respective customers.

Further supplementary evidence and accompanying submissions may follow as soon as practicable.

Capitalised terms and abbreviations used in this response to the SoI are as defined in the Initial Submission, unless otherwise stated.

The markets in which the parties operate

1 Product market

As explained in the Initial Submission (see Part G, section 1), the parties take no issue with the settled approach of UK competition authorities to product market definition in the retail pharmacy sector, which is consistent with the product market definition the CMA has set out in its SoI.

In particular, the parties agree with the CMA that market definition and the competitive effects analysis largely overlap (since they will both be driven by considerations of the "closeness" of substitution between the parties' offers and those of alternatives). As set out in the Initial Submission, the parties are highly differentiated, and are thus not close competitors when examined across a large range of dimensions relevant to the "closeness" of their respective retail offers; indeed, they operate in different segments of the retail pharmacy sector – the supermarket and community/high-street segments. That said, while this is highly relevant to their differentiation (i.e., closeness of competition), it would not be meaningful to take this one step further and consider the parties to operate in separate markets.

The CMA notes in its SoI that the target business will be active in the sale of prescription-only medicines, pharmacy-only medicines and pharmacy services and that Sainsbury's will continue to purchase and sell GSL products independently of the target business. In light of this, as stated in the Initial Submission, while the parties agree with the CMA's approach of focusing its product category analysis on prescriptions and P-med sales, and excluding GSLs from the product market under direct analysis, the CMA should place appropriate

emphasis not only on: (i) the fact that P-meds account for **[✂]**; but also (ii) the fact that, **[✂]**, the prices of a number of popular P-meds are constrained by competition from GSL products.

2 Geographic market

The parties agree that the operation of pharmacies in the UK is the most appropriate geographic market for the CMA to consider when assessing its theories of harm in respect of retail pharmacies.[1]

Notwithstanding the UK-wide approach mentioned, and the fact that the parties are two national pharmacy chains of 1,542 and 277 outlets, respectively, the parties also agree that the CMA should consider the prospect of adverse effects flowing from a loss of competition at the local level.

2.1 Local effects in the context of a regulated sector and the parties' differentiation

However, as set out in the Initial Submission and expanded further below, there are a number of important factors that influence the degree to which local adverse effects are foreseeable, in circumstances where:

- the bulk of retail pharmacy sales volumes (prescriptions) are price-regulated;
- **[✂]**;
- the parties are not close national competitors (a point which is implied by the absence of any national horizontal theory of harm in the SoI, reflecting the parties' modest national market share data of **[10-20]**% combined – with an increment of **[0-5]**%);[2]
- non-price parameters are largely regulated; and
- the parties are not close competitors in respect of incremental service offerings beyond regulated minima (e.g. on convenience of location, opening hours, etc).

The cumulative weight of these factors means that forensic efforts to examine the local concentration data in this case are unlikely to be particularly fruitful because, while share data and fascia counts are a somewhat reliable predictive guide to local competitive effects in some markets, they are not a reliable guide to the likely adverse effects at the local level for this particular Transaction.[3]

[1] However, the parties would note the different geographic market relevant for OPD services: outsourcing of OPD services is limited to England at present, and this is likely to remain the case given the regulatory landscape in the devolved jurisdictions. The relevant geographic market within which to assess OPD services is therefore likely to be England rather than the UK as a whole (although, for present purposes, the definition of the market can be left open, as Sainsbury's is not a close rival to Lloyds in OPD tenders).

[2] Market share data for 2014, Verdict UK Pharmacy Report (2015), retail pharmacy shares (p 31).

[3] With respect to how the CMA might assess the geographic area over which competition takes place at a local level, please see the parties' views set out in the Initial Submission (Part G, section 2.1 and section 3) on the local retail overlap analysis and interpretation of "local overlap" results which took place in Phase I.

2.2 GP surgery proximity is of radically different relevance to Lloyds and Sainsbury's

Generic position relevant to mergers within the community pharmacy segment

In the SoI, the CMA notes that it considers the proximity of a pharmacy to customers and GP surgeries plays a "key role" in customer choice of which pharmacy to visit, and that competition between the parties and their competitors is therefore dependent on the distance between pharmacies.

The parties agree that this is generically true: one of the key non-price factors for customers in choosing a pharmacy – and a critical driver of prescription volumes – is convenience of location. As to the relevance of the proximity of a pharmacy to one or more GP surgeries to its "convenience" proposition: this is very important for a dedicated community pharmacy operator such as Lloyds and its closest competitors in format/location (independents, Boots, Rowlands, Well, etc), a fact which, Lloyds believes, was readily apparent during the site visit.

Position relevant to assessing the competitive impact of the Transaction

It will be common ground that the CMA's analysis should not be generic to a typical pharmacy sector merger, but instead tailored to the Transaction, which is clearly not a merger between two high street/community pharmacy chains.

As noted in earlier submissions, the parties are not remotely close competitors for locations.[4] Sainsbury's customers, in contrast to those of Lloyds, are more likely to be travelling further, and more likely by car, to reach a Sainsbury's supermarket, typically located outside the town centre (with convenient car parking not usually associated with high street locations), where they will do their grocery shopping and complete an adjunct pharmacy transaction while they are in store. Again, the parties trust that this emerged from the respective stores seen during the CMA's site visit in **[✂]**. Accordingly:

- For Lloyds' customers, a typical customer journey is a dedicated shopping mission to visit a pharmacy. For example, a customer might walk from a GP surgery with their prescription in hand, to the pharmacy that is nearest – or in any event within a fairly short walking distance – to that surgery (e.g. across the road, in the case of the **[✂]** store visited by the CMA, and the independent rival located in the same parade of shops). Alternatively, a Lloyds customer may visit their regular pharmacy – again for the express purpose of collecting a prescription product – having had their prescription sent to that pharmacy via the EPS or through the pharmacy's collection service.
- For Sainsbury's, it would be at best atypical that a customer walks directly from a GP surgery to the large supermarket (consider, for example, the journey on foot to the **[✂]** store) and conducts a pharmacy visit driven independently of the larger supermarket retail offer. It would be equally atypical for a Sainsbury's customer to visit a Sainsbury's supermarket for the dominant purpose of collecting a prescription product, in circumstances where they have had their prescription sent to the in-store pharmacy via the EPS or through the pharmacy's collection service; the customer's primary shopping mission is still likely to be a *grocery* shop (or in any event, and unlike a Lloyds customer, a combination of a grocery shop and a pharmacy visit).

[4] See Part H, section 3.1 on the parties' differentiated locations and formats.

From the supply side, for Sainsbury's, the decision of where to situate its larger supermarkets (capable of including a pharmacy) is (as a matter of common sense) driven by the interests of its wider groceries business. A number of factors are taken into account as part of this process, including (but not limited to) **[✂]**.

As also explained at the site visit, Sainsbury's added the largest number of pharmacies to its estate during the 100-hour exemption era, **[✂]**. This was in keeping with the overall retail offering of close competitors **[✂]**, again with the benefit of the 100-hour exemption.

Conclusion

Accordingly, while both parties may have locations that are in their own unique sense "convenient" for the customers they target, what is significant for the competitive effects analysis (and overlapping question of market definition) is that the nature of the "convenience" offered by each of the parties is very different, to match (or cater for) the different missions of their typical customers.

Lloyds' high street/traditional community pharmacy stores offer convenience of location for customers on a dedicated pharmacy shopping mission (often arriving on foot following a visit to a GP surgery), whilst Sainsbury's in-store supermarket locations are convenient for existing customers of Sainsbury's groceries business who are on a groceries-led shopping mission and wish to combine this with a pharmacy transaction (typically arriving by car).

Whilst it is inescapable that prescription dispensing is an important aspect of any pharmacy business, the importance of proximity to a GP surgery is clearly not common to the merging parties. In fact, the situation could not be more different: this factor is critically important to one party (Lloyds), and irrelevant to store location choice for the other (Sainsbury's). This, and the fact that:

- the parties' customer catchment profiles reflect different size areas and journeys (**[✂]**); and
- the Sainsbury's pharmacies that overlap with a Lloyds pharmacy, on average, draw on **[✂]** GPs to obtain 80% of their prescriptions, compared with **[✂]** for Lloyds,

means that if GP surgery proximity and GP surgery data are to serve a useful purpose in analysing the competitive effects of the Transaction, they must be used in a way that takes into account the parties' fundamental differences (and the full implications of Sainsbury's supermarket pharmacy model).

The SoI goes on to state that the CMA will test whether GP location is a good proxy for customer location, and whether delivery of prescriptions from GPs has an impact on the analysis. Without prejudice to the force of the above points, each of these is considered further below.

2.3 GP location

In the joint response to the market questionnaire submitted to the CMA by the parties on 1 February 2016, the parties explained that, while the GP/pharmacy prescription data available from the NHS can provide useful directional evidence on the strength of competition between Sainsbury's and Lloyds relative to other rivals (and, in this regard, emphasises the point that Lloyds and Sainsbury's are not close competitors), it is not

possible to use these data to produce an accurate approximation of a customer catchment area.[5]

In particular, the so-called "80% GP catchment" area is not a good approximation to the customer catchment area of a pharmacy for a number of reasons, including:

- that the geographical nexus between a patient's home and their GP's location is increasingly tenuous, in particular as a result of the deregulation of GP boundaries in recent years, with all GPs in England being free to register new patients who live outside their practice boundary area since 5 January 2015;
- while a GP's location may be one relevant factor in a patient's decision over which pharmacy to use, it is only *one* relevant factor, and many patients (e.g. those with repeat prescriptions or using the EPS) may travel to the pharmacy from their home or workplace; and
- as discussed above, for Sainsbury's, as a supermarket pharmacy, the notion of using GP catchments as an approximation for customer catchment areas is particularly inappropriate.

Consistent with the points made above, the parties' joint response to the market questionnaire submitted on 1 February 2016 contained an empirical analysis showing a lack of meaningful correlation between GP and customer "catchment" sizes: see the response to Question 20 (Sainsbury's) / 18 (Lloyds), pages 11-12.

Moreover, catchments are not an end in themselves – in reality, their purpose is to facilitate the calculation of market shares (or "shares of supply"). This is problematic not only because the GP catchment area approach is a "false friend" of true customer catchments, as explained above, but also because market shares create, in these circumstances, the problem of "false precision":[6] the belief that they help precisely calibrate issues of loss of competition at local level, and most importantly, reflect the scope for adverse effects at local level.[7] But, for the reasons set out below in the section on closeness of competition, prescription volume shares reveal nothing about market power over prescription prices (as they might do if there was unregulated and local-level pricing), and are a poor predictor of adverse effects (i.e. as proxies for adverse effects on something other than prescription prices).

The parties would welcome the opportunity to discuss these issues further with the economist team at the CMA.

2.4 Delivery of prescriptions from GPs

From the perspective of patients, there are two ways in which prescriptions may be "delivered" from GP surgeries: namely, via the EPS, or through collection services offered by pharmacies.

[5] See, in particular, the response to Sainsbury's Question 20 / Lloyds Question 18.

[6] The parties also note the complications involved in dealing with GPs with branches when analysing GP-based catchment areas. The parties would welcome the opportunity to discuss the technicalities of this topic further with the CMA, before it engages on any further analysis based on GP-based catchment areas.

[7] As stated in the Initial Submission, the CMA's Merger Guidelines explain that it is an expectation of likely adverse effects that is key in determining whether to characterise a loss of competition, if any, as a "substantial" lessening of competition.

The trend in take up of EPS and whether this varies across regions in the UK was addressed in the parties' joint response to the market questionnaire submitted to the CMA by the parties on 1 February 2016.[8] As explained in that response, the take up of EPS in England has been significant and, as of October 2015, 37% of all prescriptions dispensed were being dispensed through EPS.

Both EPS and collection services remove the need for the customer to physically make the journey to the pharmacy to drop off their prescription (although the customer will often still come into the pharmacy to collect their prescription, if they are not also using a home delivery service).

It is also worth noting that, even where a patient has nominated a particular pharmacy to receive their prescriptions through the EPS, they are still able to collect their EPS prescriptions from any other EPS pharmacy. The EPS requires prescriptions to be sent electronically from the GP to the NHS, and while the nominated pharmacy is able to dispense that prescription without needing the express consent from the customer on each occasion (in order to have it ready for them as required), it is also possible for another pharmacy to electronically retrieve any EPS prescription from the NHS and dispense the relevant product(s) at the patient's request.

The differences between the parties' repeat prescription collection and delivery services are detailed in the Initial Submission (Part H, section 3.7).

3 Constraints

The SoI states that the CMA will assess the constraints from products both inside and outside the relevant market, and that exercised by:

- other pharmacies;
- internet pharmacy services;
- GP and hospital pharmacies (including OPD services); and
- other wholesale suppliers.

3.1 Constraints from products outside the relevant market

In terms of constraints from products outside the relevant market, it is important to note, as mentioned above, that the prices of some P-meds can be constrained by the sales of GSL products. As explained in the Initial Submission and as was evident during the site visit, some P-meds are substitutable with GSL products (those which are either the same product in a smaller pack size or a similar product to treat the same symptoms), and customers may therefore in some cases switch between these equivalent products (see Part C, section 2.4). Moreover, in most cases, **[✂]**.

3.2 Constraints from other pharmacies

With respect to the constraints imposed by other pharmacies, the parties have described the relevant competitive landscape in their Initial Submission (see Part D), including the constraints imposed by independent pharmacies, large national chains (such as Boots, Well, Rowlands, Day Lewis, Cohens and Superdrug), smaller or regional multiples, other supermarket pharmacies and online pharmacies.

[8] See the response to Sainsbury's Question 19 / Lloyds Question 17.

The Initial Submission also demonstrates that the parties are not important competitive constraints on each other, with Lloyds being far more constrained by other community pharmacies (including large national chains such as Boots and Well, as well as independents, which represent a vibrant and growing part of the UK pharmacy sector). Conversely, for Sainsbury's, the in-store pharmacy networks of Tesco, Asda, and Morrisons, as well as Boots' "retail park" stores, are much closer competitors in terms of format (with a similar emphasis on combining the wider retail convenience of a supermarket shop – or retail park visit – with the opportunity to make an adjunct pharmacy transaction) and how they are perceived by customers.

3.3 Constraints from GP pharmacies

As noted in the Initial Submission, there are 1,233 dispensing doctors in the UK who dispense approximately 6% of prescriptions based on volume of product purchased.[9] Dispensing services provided by doctors in some areas may therefore be an important constraint on the parties, at least in relation to prescription products, as customers may be accustomed to collecting their prescription from the GP immediately after their consultation.

3.4 Constraints from hospital pharmacies

For a discussion of the OPD sector, please refer to the Initial Submission, Part I.

OPD pharmacies do not typically exert a constraint on community pharmacies, as they are restricted from supplying to patients who do not hold a prescription from the hospital itself (unless an OPD pharmacy also holds a community pharmacy licence, which is the case for some OPD pharmacies).

3.5 Constraints from other wholesale suppliers

The parties' views on the vertical effects that may result from the transaction are set out in the Initial Submission, Part J.

Assessment of the competitive effects of the acquisition

4 Counterfactual

The Initial Submission (Part F, section 2.1) and Sainsbury's individual response to the market questionnaire[10] explain in more detail what Sainsbury's preferred strategy absent the Transaction would have been. Ultimately, the parties submit that this case does not turn on the counterfactual, and that it is not necessary to determine the most likely scenario absent the Transaction, in order to conclude that the parties are not close competitors, and that the Transaction will not likely result in a substantial lessening of competition at any level.

5 Theories of harm

As set out in the Initial Submission, the prospect of adverse post-merger effects on the parties' customers is remote, due to a compelling combination of two individually important factors: (i) the prevalence of government regulation on price, quality, range and service;

[9] Initial Submission Part C, section 6.12.

[10] As submitted on 2 February 2016: see Sainsbury's response to Question 6.

and (ii) the high degree of differentiation of the parties' offer in relation to the variables on which competition can and does (to some extent) take place.

The evidence is overwhelmingly clear that there is no national issue and that, at a local level, the parties are not close competitors. The degree of differentiation between the parties is discussed in the Initial Submission (see Part H, section 3), and further evidence on this point is set out below. Additionally, the extent of regulation that exists in the pharmacy sector, which has been set out in the Initial Submission (Part C, section 6), will limit the merged entity's ability to vary its product and service offerings to the detriment of consumers.

5.1 Unilateral horizontal effects at a local level

The CMA has indicated its intention to assess whether the removal of one party as a competitor, in some (or all) of the areas where the parties are geographically close competitors, could provide the *incentive* for the parties to increase prices or worsen non-price elements of their offering. As discussed further below, the available evidence suggests that the Transaction is unlikely to create any such incentive (and, even if such an incentive was to exist, the parties would be highly restricted in their *ability* to successfully act on it).

5.1.1 The parties are not close competitors on a variety of measurable criteria

Lloyds and Sainsbury's have highly differentiated pharmacy offerings, as has been noted to the CMA in several previous submissions (in particular, see the Initial Submission, Part H, section 3). The material that the parties have provided to the CMA in response to its data questionnaires offers further evidence of the measurable ways in which the parties differentiate themselves. Set out below are a number of examples of points of differentiation:[11]

- **Staff profile. [✂]**. See Table 1 below.

Table 1: Percentage of total staff hours covered by locums for individual stores[12]

	Mean	Min	Max
Lloyds	[✂]	[✂]	[✂]
Sainsbury's	[✂]	[✂]	[✂]

Source: Lloyds and Sainsbury's data (see the enclosed spreadsheet, filename: "*Locum Hrs by store*")

At a higher level, each party also has a very different approach to the staffing of their retail pharmacy operations teams. **[✂]**

- **Opening hours.** Sainsbury's pharmacies are open considerably longer, on average, than Lloyds' pharmacies, **[✂]**. On average, Sainsbury's pharmacies are open for 92 hours per week (and all Sainsbury's pharmacies are open for 70 hours or more per week), as compared to 55 hours per week across Lloyds' locations. Additionally, 99% of Sainsbury's pharmacies (276 of 277) are open on Sundays, whereas only 8% of Lloyds' pharmacy locations are open on Sundays.

[11] Unless otherwise noted, means reported are simple averages across stores.

[12] Excludes Sainsbury's OPD pharmacies. Information for Lloyds is missing on locum hours for store number 7528 and on both locum and regular staff hours for store 840. Summary statistics based on 1520 stores.

- **Pharmacy size.** Lloyds' pharmacies are, on average, more than **[✂]** the size of Sainsbury's dedicated pharmacy areas, **[✂]**.[13] In addition to a **[✂]**, this difference in average pharmacy size is an important part of the reason why **[✂]**.

- **Home delivery service.** The **[✂]** of Lloyds' pharmacies offer home delivery, **[✂]**.

- **Customer profile mix.** Sainsbury's customers are much more likely to be "walk-in" customers, and have their prescriptions filled while they wait or, far more typically, do their grocery shopping in the main supermarket store area. **[✂]** of Sainsbury's customers are "walk-ins" (or, more appropriately in Sainsbury's case, "walk-ups"), as compared to **[✂]** at Lloyds. Lloyds' customers, on the other hand, are much more likely to be collecting prescriptions that have come directly to Lloyds, either through the EPS or via a collection from a GP's office, with **[✂]** of prescriptions being delivered in this way. Table 2 below summarises the method of prescription delivery for both parties across all stores (where comparable information was provided).

Table 2: Method of prescription delivery, store averages of items for both parties[14]

Method	Sainsbury's	Lloyds
Electronic	**[✂]**	**[✂]**
Walk-in	**[✂]**	**[✂]**
Collection	**[✂]**	**[✂]**

Source: Lloyds and Sainsbury's data submitted in response to the data questionnaire.

- **Prescription volumes per store.** Lloyds' branches, on average, dispense substantially more prescriptions than do Sainsbury's pharmacies, averaging about **[✂]** per month in English locations during the period from January to October 2015, as compared to an average of nearly **[✂]** items per month across Sainsbury's pharmacies in England during the same period.[15]

- **Density of prescription volumes in the surrounding area:** The relatively low number of items dispensed by a typical Sainsbury's pharmacy relative to a typical Lloyds pharmacy should be considered in combination with the fact that the typical Sainsbury's pharmacy is providing those prescriptions to customers drawn from a much wider geographic area (on average, it takes a radius of **[✂]** miles for Lloyds to capture 80% of its customer base, compared with a radius of **[✂]** miles, on average, for the stores in relation to which Sainsbury's data has been requested by the CMA in Phase II).[16] This means that the average area over which Sainsbury's prescriptions are drawn is over **[✂]** larger than for Lloyds which, in turn (combined with the average prescription levels per store), suggests that a typical Sainsbury's pharmacy dispenses on average only around **[✂]** as many prescriptions per square mile as a typical Lloyds store (assuming the sample selected by the CMA is representative).

[13] **[✂]**.

[14] Sainsbury's figures not available for its Charlton Riverside, Guys' Hospital and St Thomas' Hospital pharmacies. Excludes 13 Lloyds branches where Lloyds indicated that data were inaccurate. Lloyds' collection figures are calculated as total items less electronic and walk-in. Items that were delivered using Lloyds' home delivery service cannot be split out from items categorised as electronic and collection.

[15] Source: calculations based on NHS prescription database.

[16] Which in itself is a lower average than for the Sainsbury's stores analysed in greater detail in Phase I.

- **P-meds as proportion of total store revenue.** P-med sales comprise a **[✂]** of revenues at Sainsbury's pharmacies than at Lloyds' stores. On average, Sainsbury's pharmacies derive **[✂]** of revenues from P-med sales, as compared to **[✂]** at Lloyds (where prescriptions comprise the vast majority of revenues): see Table 3 below.

Table 3: Percentage of pharmacy revenues attributable to P-meds

	Sainsbury's	Lloyds
Average	**[✂]**	**[✂]**
Min	**[✂]**	**[✂]**
Max	**[✂]**	**[✂]**

Source: Lloyds and Sainsbury's data (see the enclosed spreadsheet, filename: "*NHS Items & Sales*")

5.1.2 Incentive to increase the prices of P-meds

As explained in the Initial Submission (see Part H, section 2.2), there is no prospect of adverse price effects in relation to P-meds at the local level, because:

(a) **[✂]**

(b) **[✂]**

(c) **GSL competition will remain unaffected.** In relation to some (i.e. typically the most popular) P-med products, competition from GSL products (which are often an exact equivalent in a smaller pack size, or a substitutable product treating the same symptoms) will be unaffected, as Sainsbury's will retain its independent GSL offering in the main store.[17]

(d) **Conclusion.** For these reasons, the suggestion that the parties are "close" competitors in P-med pricing in any local areas cannot be substantiated. Moreover, under the "SLC test", a local price-centric theory of harm in relation to P-meds would need to establish a likelihood of adverse price effects in P-meds as a result of the loss of close rivalry on P-med pricing at either the national or local level. As the facts do not begin to fit the theory at either national or local level, this theory of harm clearly has no merit. Indeed, given the equal absence of a plausible theory on regulated prescription prices, it is difficult to see how any theory of harm based on unilateral effects relating to product prices at a local level could be borne out.

5.1.3 Incentive to increase the prices of some pharmacy services

Details of how the parties are paid for the pharmacy services they offer are provided in the Initial Submission (Part C, section 2.7), and in the parties' individual responses to the market questionnaires.[18] The CMA notes in its SoI that there is tendering for some pharmacy services, and that others are private services. The merger will not result in incentives to increase prices for either NHS services or private services, for the reasons set out below.

NHS services

The majority of NHS services are provided free to consumers; it is the NHS who pays the pharmacy for delivering these services. In relation to "essential" and "advanced" NHS

[17] Subject to very limited exceptions, as described in the Initial Submission (see Part C, section 2.4 and footnote 10).

[18] See Sainsbury's response to Questions 8 and 16, submitted on 2 February 2016 and Lloyds' response to Questions 6 and 14, submitted on 4 February 2016.

services, there is no scope for the parties to increase the fee they are paid for delivering these services, as these are set and paid by the NHS.[19] The competitive conditions for Lloyds in respect of NHS service provision would therefore not materially change as a result of the Transaction.[20]

Private services

Private services, such as private prescriptions, flu vaccinations or wellness checks, are paid for by the patient, with prices set by the provider. Sainsbury's offers some private services (such as Wellness checks, Healthy Living Plans, flu vaccination services (non-NHS) and Stop Smoking services) but has been constrained in promoting these effectively due to limited resources.[21] Lloyds' pharmacies also provide private services for patients (such as flu vaccinations where patients are ineligible under the NHS) and, in some circumstances, provide free services to build loyalty with patients (such as diabetes testing and blood pressure testing). These broader brand/trust drivers for free service provision will not change as a result of the Transaction.

[✂].[22] Combined, these factors make it highly unlikely that there would be any increased incentive post-merger for Lloyds to raise the price of private services **[✂]**.

Regarding the pricing for private *prescriptions* in particular, it is also clear from Lloyds' internal documents that the parties do not consider themselves to be close competitors. **[✂]**.

5.1.4 Incentive to worsen quality, range or other elements of service offering

The merger will not result in incentives to worsen quality, range, staff numbers / expertise or any other non-price variable; rather, the merger will result in an improvement to quality, range and services on offer across the Sainsbury's pharmacy estate, as a result of Lloyds' specialist expertise.

As explained in the Initial Submission,[23] the parties are not close competitors in relation to non-price variables which are capable of being materially affected by competition between pharmacy rivals, and there is no reason to think that the presence of the other party at the local level in overlap areas is driving a superior service or quality offer that the Transaction would adversely affect. Notably, the Transaction could not lessen local competition below the regulated service standards which are required of all pharmacies (as defined and mandated by the NHS), and in other respects:

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[19] This is also true for the vast majority of "enhanced" or "locally commissioned" services. Locally commissioned services can generally be provided by any pharmacy, so long as it: (i) has a pharmacist with the requisite training to deliver the relevant service; and (ii) enters into a contract with the local commissioner for the provision of that service. Pricing for the provision of enhanced services is generally fixed by the local commissioner, although for a very, very small proportion of enhanced services in certain areas (in Lloyds' experience, significantly less than 10% of all bids, extensions and renewals), the local commissioner may call for tenders with a variable price element. There are typically a large number of alternative bidders for any such tendered local service (including independent pharmacies and the various national and regional chains discussed in the Initial Submission). Moreover, **[✂]**.

[20] See the Initial Submission, Part C, section 2.7, and Sainsbury's individual response to the CMA's market questionnaire (Question 8), as submitted on 2 February 2016.

[21] As explained in the Initial Submission, Part H, section 3.8.

[22] For example, private prescription sales represented **[✂]** of Sainsbury's prescription revenues from P11 2014/15 – P7 2015/16, and represented **[✂]** of Lloyds' total sales of all retail pharmacy prescriptions for calendar year 2015. Private services sales are estimated to have accounted for less than **[✂]** of Sainsbury's pharmacy revenues in 2015, and although Lloyds do not hold separate data on private services revenues, they believe these would account for an insignificant proportion of their total revenue.

[23] See Part H, section 3.

- **Opening hours.** The parties do not compete closely in relation to opening hours. **[✂]** By contrast, **[✂]**. The difference in strategy is evidenced by the differences in opening hours and days that have already been noted in section 5.1.1 above.
- **Store location.** In relation to location, which is discussed above as being one of the paramount non-price factors for customers in choosing a pharmacy, the parties are not remotely close competitors and thus the Transaction will not soften competition in this area.
- **Product range. [✂]**. Prescription stocks are determined by local need. **[✂]**
- **Service/advice levels.** It is intended that the Transaction will increase the quality and range of customer service/advice at Sainsbury's outlets, which will include **[✂]**. One of the key drivers of customer/patient satisfaction with their pharmacy service is knowing/getting advice from a pharmacist they know/are familiar with; **[✂]**.

  Under Lloyds' model, **[✂]**. While there will obviously be a transitional period, Lloyds' intention post-merger is to **[✂]**.

5.1.5 Incentive to close stores (insofar as permitted by regulation)

[✂]

5.2 Unilateral effects from loss of competition for NHS outsourcing contracts

As discussed in Part I of the Initial Submission, the Transaction will not create incentives for the merging parties to worsen their bids for the provision of OPD services to NHS hospitals.

5.3 Vertical effects from a change in downstream incentives on Celesio's wholesale business

As discussed in Part J of the Initial Submission, the Transaction will have no impact on Celesio's downstream incentives with respect to its wholesale business.

Countervailing factors

In the parties' view, it is not necessary to consider countervailing factors in any detail, as no SLC arises from the merger. Notwithstanding this starting point, some preliminary observations are provided below in relation to each of the two areas identified in the SoI.

6 Competitor entry and expansion

As discussed in the Initial Submission and in the parties' individual responses to the CMA's market questionnaire,[24] new entry in recent years has been generally restricted by the 2013 Regulations. The main exception to this trend concerns distance selling pharmacies, which are likely to continue to grow.

Expansion is likely to be possible in some areas, however, and the parties have provided evidence of this where available. As set out in an attachment to the parties' joint response to the common questions in the CMA's market questionnaires submitted on 1 February

[24] See Initial Submission, Part C, section 6; Sainsbury's individual market questionnaire response to Question 1, submitted on 2 February 2016; and Lloyds' individual market questionnaire response to Question 1, submitted on 4 February 2016.

2016 (see filename: "**[✂]**"), independent pharmacies are a large and dynamic competitor set, not only when viewed on the basis of a current snapshot and on past performance (market statistics confirm a growth in the volume of prescriptions dispensed by independent pharmacies relative to market share),[25] but also on a forward-looking basis, in terms of their large share of total licence applications.

7 Efficiencies

As discussed in more detail in the Initial Submission, the merger will give rise to a number of efficiencies, many of which will directly benefit customers.

[25] Based on analysis of NHS Business Services Authority data (England).