

Linklaters

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

INITIAL SUBMISSION OF THE PARTIES

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PART A. INTRODUCTION

- Celesio.** Celesio AG (“**Celesio**”) operates a “community pharmacy” network of more than 1,500 outlets across the UK, including “high street” as well as GP-surgery formats, under its *LloydsPharmacy* (“**Lloyds**”) brand. It also operates a number of hospital pharmacies. Lloyds offers the dedicated service expertise, store proposition and location, and therefore consumer brand perception, of a specialist retail pharmacy operator. In keeping with this model, NHS-regulated prescriptions and pharmacy services payments constitute around [X]% of Lloyds’ revenues.
- Sainsbury’s.** Sainsbury’s Supermarkets Limited (“**Sainsbury’s**”) has its core business in the grocery sector. In 277 (or just under half) of its large supermarkets,¹ Sainsbury’s operates an own-brand in-store pharmacy as one element of its wider food, non-food and services offering. In these 277 large stores, NHS prescription transactions account for less than [X]% of store totals (excluding fuel). Sainsbury’s also operates four hospital pharmacies. Within its retail pharmacy operation, NHS regulated prescriptions and services account for around [X]% of Sainsbury’s revenues.
- Transaction.** [X] On 29 July 2015, Sainsbury’s and Celesio (“the **parties**”) agreed to the transfer of Sainsbury’s pharmacy business (the “**target business**”) to Celesio for a purchase price of £125 million (the “**Transaction**”). In essence, the Transaction will enable Celesio to “*enter the supermarket/grocery sector*”² segment of the retail pharmacy market, and bring under common control Lloyds specialist small-store network and the target business, which is built around in-store pharmacy counters at large supermarkets.
- NHS-regulated revenues and GSL context.** In contrast to retail norms, the vast majority of Lloyds’ and target business’ revenues are “regulated” prescription income whose pricing/reimbursement levels are NHS-stipulated (as noted above). At the same time, in relation to prices of *unregulated* products, Sainsbury’s general sales list (“**GSL**”) products stocked on regular supermarket shelves are excluded from the Transaction,³ and are ones on which Sainsbury’s stores will continue to compete independently in the context of a broader competitor set. The Transaction therefore cannot affect regulated prices, and will not adversely affect competitive GSL prices.
- The parties’ highly-differentiated retail offer.** In principle, the question of the possible retail competitive impact of the Transaction remains relevant for the small proportion of revenue each party derives from in pharmacy-only medicines (“**P-meds**”) and for certain non-price aspects, such as convenience of location. However, as to rivalry outside or beyond regulated parameters, the parties are situated at opposite ends of the UK’s broad retail pharmacy competitor set, operating, as noted, in the “community” vs. “supermarket” segments, respectively. As such:

they have very different **customer acquisition strategies** pitched at different consumer shopping missions – Lloyds is a dedicated pharmacy business [X], whilst Sainsbury’s is, above all else, a supermarket chain, [X];

¹ The majority of Sainsbury’s pharmacies are located in supermarkets that are larger than 30,000 sqft (total size of store rather than sales area).

² McKesson, Project Hippo, Board of Directors Meeting, June 16, 2015, slide 2.

³ GSL products do not form part of the target business, save for [X]. Further details on the position in relation to GSL products are provided in Part C sections 2.3 and 2.4 and Part F section 4.

the parties consequently situate themselves in quite different **locations**, typically high street/GP surgery vs. edge-of-town/retail park, with differentiated retail **formats** (and overall store sizes) and opening hours; and

their “specialist pharmacy” vs. “non-specialist” **propositions** are, accordingly, perceived differently by customers, each bracketed with various third party rivals (e.g., Sainsbury’s with *other* supermarket brands in contrast to Lloyds with independents and other specialist or “community”/high street brands).

Moreover, unlike community players such as Lloyds, [REDACTED]. As a consequence, Lloyds and Sainsbury’s each face third party rival outlets who, on all relevant criteria, are closer competitors to either party than the parties are to each other (as explained further below).

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 and service; and (ii) the high degree of differentiation of the parties’ offer (clear from the wealth of consistent evidence that the parties are not close competitors) in relation to the variables on which competition can and does take place.

- **“Community pharmacy” under a “supermarket roof”: the Transaction’s rationale.** The absence of harmful effects on customers is also not reflected in – indeed is the antithesis of – the parties’ rationale for the Transaction. The Transaction intends to create a unique “best of both worlds” offer: Lloyds, as a specialist pharmacy operator, with its superior service/advice offering and reputation (which Sainsbury’s could never replicate alone), will become part of a large Sainsbury’s grocery store offering, with its one-stop grocery/pharmacy convenience and easy access (i.e., with the long opening hours and car-parking facilities of a large supermarket). The parties believe that this joint pharmacy/supermarket proposition will benefit customers and shareholders alike, by:

- [REDACTED];
- [REDACTED];
- [REDACTED]; and
- [REDACTED].

In addition to the direct consumer proposition, [REDACTED] which does not point towards significantly less rivalry; on the contrary, any impact on rivalry with market leader, Boots, among other competitors, would point towards this Transaction being *pro*-competitive, not anti-competitive.

- **Conclusion.** For the above reasons, the parties do not foresee – and have not foreseen, in the course of pursuing the Transaction – any potential for customer “harm” (i.e. anti-competitive effects). On the contrary, this endeavour is based upon the strong expectation that *Lloyds-within-Sainsbury’s* will be an attractive proposition for customers now, and better able – as envisioned by the NHS/government as both customer and regulator – to offer the pharmacy and healthcare service that UK consumers will require in future.

PART B. EXECUTIVE SUMMARY

In the UK retail pharmacy sector, Boots is the leading national operator ([20-30]% market share), while Lloyds has an [10-20]% share, and Sainsbury's, as one of four supermarket pharmacy chains, has only a [0-5]% national share. The sector is also characterised by a strong and active cluster of independent and smaller chain players – overall, the independent (around [40-50]%) and smaller chain segments ([10-20]%) have retained their high combined share (around [50-60]%) of the total UK retail pharmacy market. Against this backdrop, it is clear that the Transaction involves a very modest increment and a modest combined share, at a national level.

The parties' share data are hardly suggestive of a merger of particularly important competitors to one another. Further, the initial common sense starting point is only reinforced by the available documentary, empirical and economic evidence, which is entirely consistent with a lack of close competition. Even the modest market shares of the parties may thus *overstate* the competitive constraint that they impose on each other.

Moreover, as has routinely been recognised in previous Enterprise Act merger cases, the competitive effects analysis is simplified in the context of the regulated pharmacy market, in the sense that the scope for adverse effects is far more limited than is normally the case (in *every* local market). This is because the classic parameters of competition – such as pricing of prescription medicines ([~~§~~]) – are *not* capable of being adversely affected by the Transaction.

As for those residual unregulated variables on which rivals in the market do compete, the parties face strong competitors, but are not particularly close or important competitors *to each other*. For these reasons, there is no credible prospect of adverse merger effects, even at any local level, on consumers in any market.

In particular:

- **The parties do not behave in a manner consistent with them being particularly close competitors.** The CMA will find that the weight of internal documentary and economic evidence available reinforces the intuitive starting point: in the ordinary course of business, the parties' respective pharmacy businesses do *not* target primarily the same customers, and the parties do *not* act in any way consistent with being close competitors with similar brands.
- **The parties offer differentiated customer propositions and are perceived differently by consumers.** Celesio's *Lloyds* brand was developed for – and remains aimed at – consumers engaged in “community” or traditional high street pharmacy visits, and its brand is perceived as such, while the *Sainsbury's* pharmacy brand proposition is aimed at providing customers with a convenient pharmacy service alongside their grocery shopping needs (and is self-evidently not a specialist pharmacy brand in origin or perception). On virtually every variable or angle that may be considered in a retail merger – brand, format, location, typical opening hours, service reputation, customer perceptions of strengths and weaknesses, et al – it is not possible to single out the two parties as being similar and as closely substitutable for any (subset) of customers. On the contrary, the parties are highly differentiated, with their only commonalities being driven by market-wide standard regulation, to which all competitors must adhere (e.g. prescription prices, service requirements and governance standards) in order to be pharmacy operators at all.
- **Consequently, a variety of third party rivals are closer respective competitors to each party – in terms of typical location, format and consumer perception – than Lloyds and Sainsbury's are to each other.** [~~§~~]. It is also consistently apparent from the

parties' ordinary-course consumer survey evidence that the parties' customers do not perceive the parties to be close substitutes.

- For Lloyds, relative to Sainsbury's and other supermarket operators, **independents** and **smaller chains** at a local level are closer competitors to the traditional community/high street format and location of Lloyds stores, which most customers would be expected to reach on foot or by public transport. Classic pharmacist-owned-and-operated independents tend not only to be in convenient locations to GP surgeries but, given their livelihood will likely depend on loyal customers, focus on patient relationships and a reputation for service quality within the local community; and, of course, they are *not* "more expensive" on "retail price" prescriptions. More recently, many independents and smaller chains have been aggressively rolling out electronic prescription take-up. Another notable feature of the independent and smaller chain segments is the extensive use of large "buying groups". Such groups allow for improved gross margins by reducing input costs, and provide (individually) smaller competitors with access to marketing support and a range of other pharmacy management services, which allows them to compete on an equal footing with their larger rivals.
- For Lloyds, **Boots**, **Well**, **Rowlands** and other national high street chains are also closer competitors to the Lloyds high street format and location than is Sainsbury's. Whilst the majority of Boots' UK estate of 2,510 stores are high street/community format (resulting in part from its acquisition of 958 UniChem community pharmacies in 2006),⁴ Boots' stores tend to sit "between" Lloyds and the supermarket competitor set in terms of consumer perceptions, due to the fact that Boots tends to stock a broad range of other (non-pharmacy-specific) goods, in addition to their traditional pharmacy offer.
- Conversely, for Lloyds, the **supermarket pharmacy sector** in aggregate (i.e. all of Tesco, Asda, Morrisons and Sainsbury's) is not a particularly close competitor set; the overall set's areas of relative strength (relative weakness for Lloyds) focus on grocery shop convenience and opening hours and, critically, there is no compelling reason by which one can isolate Sainsbury's as the closest of these four (distant) competitors to Lloyds within this segment.
- Finally, for Sainsbury's, and relative to Lloyds, the in-store pharmacy networks of **Tesco**, **Asda**, and **Morrisons**, as well as **Boots** retail park stores, are closer competitors in format and perception to Sainsbury's (all of the supermarket pharmacies share a reputation for being less strong than the high street/community rivals – such as Lloyds – on pharmacist expertise and pharmacy services). Moreover, most customers reach this competitor set by car, as their stores are typically located at the edge of a town or built-up area and are more difficult to reach by foot or public transport (and for the most part, they do not offer home delivery for pharmacy products).

⁴ See OFT, Anticipated acquisition by Boots plc of Alliance UniChem plc, 6 February 2006, para. 2.

- **No conceivable local adverse impact on product prices.** Whilst the evidence is overwhelmingly clear that there is no national issue and that at a local level the parties are not typically, or on average, close competitors, the degree of concentration varies across local markets. While desktop measures of concentration have been important tools in previous Enterprise Act pharmacy cases, none of these prior cases had the benefit of the more nuanced and extensive examination possible in Phase II, in which the need to establish likely adverse effects can (and must) move the analysis beyond simple filters based on concentration measures (whether fascia counts, shares of supply, or otherwise). Indeed, CMA guidelines indicate clearly that an expectation of *adverse* effects for customers is “key” to assessing whether a merger gives rise to a *substantial* lessening of competition (“SLC”).⁵ Taking the most obvious variables in turn, and in summary:
 - **No adverse price impact in prescription medicines.** The Transaction can have *no* detrimental impact on pricing in *any* local market, or nationally, in respect of the most important product class by value and volume – revenues from NHS regulated prescription medicines and services account for around [X]% of Lloyds’ and [X]% of Sainsbury’s respective revenues – as it will not alter the price regulation and reimbursement regime in force.
 - **No plausible price impact in P-meds.** There is no prospect of adverse price effects in relation to P-meds because: (a) in relation to many (i.e. typically the most popular) products, competition from General Sales List (“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;⁶ (b) there is no incentive to change pricing from the [X]; and (c) [X].
 - **No plausible price impact in GSL products.** Likewise, there is no prospect of adverse price effects in relation to GSL products, not least because the Transaction scope, with limited exceptions, excludes GSL products, on which Sainsbury’s is free to compete as before via the grocery aisles of its stores where GSL stock keeping units are normally stocked. In addition, the competitor set for all GSL products is much wider than the pharmacy competitor set, and the parties are also not close competitors within this wider set.
- **No realistic and material adverse local impact on non-price parameters.** The Transaction will likewise not be likely to adversely affect non-price parameters at a local (or national) level.
 - **Convenient locations.** First, one of the paramount non-price factors for customers in choosing a pharmacy, and the critical driver of prescription volumes, is *convenience of location*, but the parties are not remotely close competitors for locations. Smaller-format high street operators such as Lloyds (independents, Boots, Well, Rowlands, Day Lewis, etc.) with typically [X] can flex location over time to (re)locate closer to GP surgeries and improve convenience, but supermarket operators with larger stores

⁵ The CMA’s Merger Assessment Guidelines explain that “... a merger that gives rise to an SLC will be *expected* to lead to an *adverse* effect for customers. Evidence on likely adverse effects will therefore play a *key role* in assessing mergers.” (OFT1254/CC2 rev, para. 4.1.3, emphasis added.)

⁶ Subject to very limited exceptions, described in Part C section 2.4 and footnote 10 below.

and longer leases are far more anchored to their existing locations. Moreover, supermarket operators do not face the same “location choice” equation as dedicated pharmacy operators; the location of a supermarket will be driven by the interests of the wider grocery business, and not determined by reference to one niche in-store category (i.e., pharmacy). The Transaction will not therefore soften competition in relation to convenience of location.

- **Opening hours and other regulated services parameters.** Second, it is clear that the Transaction could not lessen local competition below the regulated service standards required of all pharmacies (even if, for the sake of argument, it was assumed the parties wished to do so), in a market where even flexing *opening hours* – to take a variable of importance to consumers – is subject to NHS/public sector consent. In any case, the parties do not compete closely in relation to opening hours: [REDACTED].
 - **Prescription and P-med product range.** Third, [REDACTED]. Prescription stocks are determined by local need, and indeed all pharmacies receive twice daily deliveries of prescription products from two or more wholesalers, reducing the need at retail level to keep a broad range of irregularly-demanded products in-store. [REDACTED].
 - **Pharmacist advice and service.** Fourth, it is intended that the Transaction will increase the quality and range of *customer service/advice* at Sainsbury's outlets, which will include [REDACTED], thereby improving the service and satisfaction of the customers who use the Lloyds pharmacy inside a Sainsbury's.
- **Any retail consumer benefits achieved are merger-specific.** Lloyds clearly could not have accessed the in-store locations of Sainsbury's supermarkets but for the Transaction, and its reputation and specialist pharmacy expertise will give consumers the “best of both worlds” in this respect, which could not realistically be offered by Sainsbury's itself absent the Transaction.
 - **The Transaction does not remove an important rival to Lloyds in future tenders for NHS hospital pharmacy (OPD) contracts.** Lloyds and Boots have both been successful bidders for OPD contracts to operate pharmacies situated within NHS England hospitals, with Boots in particular leading this segment in recent years, having won the most OPD contracts ([REDACTED]) in the past three years. [REDACTED]. The loss of one such bidder, from among a broad set of both past winners *and* credible potential bidders, including sponsored NHS trust bidders, can have no material impact on the competitiveness of OPD tenders.
 - **There are no plausible vertical foreclosure issues.** The parties' respective shares of [10-20]% and [0-5]% at national level rule out any plausible concerns as to ability or incentive to engage in customer foreclosure at *national* (let alone *local*) level in the post-Transaction period, as rival wholesalers do not depend on Sainsbury's (*total*, let alone *local*) volumes for their competitiveness.

Equally, there will be no impact on Celesio/AAH's inability to engage in input foreclosure, even at local level: not only do branded manufacturers supply UK wholesalers only on contractual conditions that they offer uniform national service (i.e., they prevent any discrimination risk against retail operations of rival wholesale groups), but AAH's incentives not to attempt such a strategy will remain unaffected: manufacturer exclusivity

arrangements ensure that all integrated UK wholesale/retail players depend on each other to be able to supply end-consumers with all relevant medicines. Moreover, for all non-exclusive products, retail customers all deal with multiple suppliers and can readily switch.

Conclusion

In summary, the parties submit that the Transaction cannot be expected to result in a substantial lessening of competition on any basis. The Transaction is not only a unique combination that straddles the retail pharmacy and grocery markets, but is arguably unique in recent years as a Phase II UK merger control case in the retail sector: by combining parties that together have such a modest ([10-20]%) share at national level and are also in every other way modest competitors – and not even superficially close rivals – in terms of customer (brand) perception, retail format and typical location.⁷

Indeed, the parties welcome the development of further Phase II survey and other evidence by the CMA that speaks to the issue of merger effects rather than simple concentration indicia, in the sincere expectation that additional robust evidence will be consistent with their commercial experience, and corroborate existing evidence that: (a) the parties are not close competitors; (b) the merger will bring benefits to consumers; and (c) adverse local effects are not an intended – or indeed unintended or incidental – consequence of the merger.

⁷ Retail chain cases involving the UK high street referred for Phase II merger control scrutiny have, typically, combined brands that appear to be close or very close, and are associated with similar national chains with similar in-store retail propositions, and often store locations, that appear to target the same types of customers, with obvious points of differentiation to most if not all third party rivals. Some examples include *Poundland/99p* (characterised by the CMA on referral as two of only three national “large single-price-point retailers”), *Pure Gym/The Gym* (the top two leading national low-cost gym chains), *Sports Direct/JJB Sports* (two of three major national sportswear chains), *Thomas Cook/Co-op* (the top two high street travel agent chains), *Holland & Barrett/Julian Graves* (two leading specialist health-store chains) and *Game/Gamestation* (the top two national PC game store chains).

PART C. THE UK COMMUNITY PHARMACY SECTOR

1 Introduction

Customers may visit a retail/community pharmacy for a number of different reasons, including to: obtain medicine (often pursuant to a prescription) or other health and beauty products; make use of a pharmacy service such as a medicines use review (“**MUR**”) or smoking cessation service; or obtain advice from a pharmacist. A customer’s choice of pharmacy may therefore be influenced by a range of factors, including convenience of location, opening hours, ease of access, availability of particular services and the customer’s relationship with the pharmacist, as described further below.

The customer journey may also take a number of different forms, depending on: the type of condition that the customer is seeking to treat; the way in which a prescription is obtained by a pharmacy (whether direct from a customer, transmitted electronically or collected by the pharmacy from a GP); and the method of delivery (either collected by the customer or someone else on the customer’s behalf, or delivered).

Pharmacies located in outpatient departments in hospitals (often referred to as OPD pharmacies) are discussed separately in Part I below.

2 Pharmacy products and services

The Medicines and Healthcare products Regulatory Agency (“**MHRA**”) categorises medicines into three groups: prescription only; pharmacy only/P-meds; and general sales list. Typically, a customer will visit a pharmacy for the purposes of obtaining one or more of these products, and/or specific pharmacy services. Customers may also visit a pharmacy in order to obtain general advice from the pharmacist.

2.1 Prescription only medicines (POMs/ethicals)

Prescription only medicines, also referred to as ethicals, are pharmaceutical products which are only available to customers possessing a prescription from a GP or other prescribing healthcare professional (for example: a dentist, nurse, pharmacist or midwife). Prescription products account for the large majority of the products sold by both Lloyds and the Sainsbury’s pharmacy business.

Prescription medicines may be further segmented into branded prescription medicines on the one hand (where the product is branded according to the pharmaceutical company that initially developed and had the patent protection for it), and generic prescription medicines on the other (where the patent has expired and the product may be produced by a number of manufacturers under licence). In addition, some prescription-only medicines are classed as controlled medicines, such as morphine, pethidine and methadone, due to their potential for abuse. Stricter legal controls apply to these medicines.

Price regulation of prescription medicines

There is no price competition between pharmacies for NHS prescription medicines, as prices are set by the NHS Drug Tariff.⁸ Adjustments to prices by the NHS can be (and usually are) made every quarter. Pharmacies are not permitted to advertise or market any

⁸ Note that prices of prescription medicines for private (non-NHS) patients are not regulated. However, these only account for [X] of the parties’ total sales (private sales represented [X] of Sainsbury’s total sales from P11 2014/15 – P7 2015/16 and represented [X] of Lloyds’ total sales of all retail pharmacy prescriptions for calendar year 2015).

prescription drugs or pharmaceuticals, nor can they provide discounts or incentive schemes (such as loyalty card schemes) for such products.

The majority of a pharmacy's revenue will be based on reimbursement from the NHS to cover medicines dispensed and fees associated with the dispensing of prescriptions. The reimbursement price to NHS contract pharmacies for prescription medicines that they dispense is listed in the NHS Drug Tariff. This price is determined by various schemes and mechanisms, depending in part on whether the product is a branded or generic medicine. A deduction scale is also applied to the reimbursement price, which is determined by the size of a pharmacy's dispensing activity.

The prices paid by a pharmacy for the supply of medicines will be determined by that pharmacy's negotiations with the wholesaler or manufacturer supplying the product, and may take different forms.

While on average more than 100% of the price charged by wholesalers of pharmacies for prescription medicines is passed on by the pharmacies to the ultimate customer (i.e. the NHS or private patients), there is a term in the NHS pharmacy contract which limits the profits that pharmacies are able to make as a result of purchasing products at a lower price than the reimbursement price to a global cap of £2.8 billion for all community pharmacies (split into £0.8 billion for pharmacy contractors and £2 billion in fees to cover the cost of the service). This is monitored by the Department of Health and adjusted through the reimbursement prices of drugs on a quarterly basis following negotiations between the NHS and Pharmaceutical Services Negotiating Committee ("PSNC").

2.2 Pharmacy medicines (P-meds)

P-meds⁹ do not require a prescription but can only be supplied to a customer by, or under the supervision of, a pharmacist. Customers will be asked if they have any medical conditions or take any other medicines, to check that it is safe for them to take the medicine. The pricing of P-meds is not regulated. As set out in Part H section 2, P-meds account for [X] of the products sold by both Lloyds and the Sainsbury's pharmacy business. Examples of P-med products include antibiotic eye drops for eye infections, and "pharmacy-strength" treatments for excessive sweating and fungal infections.

2.3 General sales list products

General sales list ("GSL") products are medicines that can be sold with reasonable safety without the supervision of a pharmacist, and which are therefore stocked by a range of retailers, including supermarkets (e.g. in the health & beauty aisle), convenience stores, petrol stations and online. Examples of these products include some painkillers, such as paracetamol or aspirin (up to certain quantities), and cold remedies. [X].

2.4 Substitutability of P-meds and GSL products

Many P-meds are substitutable for GSL products (either the same product in the form of a smaller pack size, or a similar product to treat the same symptoms), and customers may therefore easily switch between certain P-med products and the equivalent GSL products to treat the same or very similar symptoms.

⁹ In some contexts, the term "over-the-counter" or "OTC" can include both P-meds and GSLs.

In practice, customers frequently prefer to “self-select” medicines where possible, and manufacturers have therefore supported moves towards the reclassification of a greater number of products as GSL products rather than P-meds (see below).

Pursuant to the transaction agreements, Sainsbury’s will continue to purchase and sell GSL products independently of the target business post-Transaction.¹⁰

2.5 Product licence changes

It is also the case that the MHRA will reclassify products within the prescription-only, P-med and GSL categories. New medicines tend to be licensed in the prescription-only category so that healthcare professionals can supervise their use during the first few years they are available.

If a medicine proves safe for large numbers of patients over several years, the MHRA may consider changing its status from prescription-only to P-med. Examples of such reclassifications include higher strength omeprazole (used for relief of reflux-like symptoms) and diclofenac diethyl ammonium (used for the relief of the pain of non-serious arthritic conditions).

If a product continues to be safe for another few years, a switch to GSL status may be considered, so it can be sold directly from retail outlets; such a reclassification favours non-specialist operators in the market, such as supermarkets, as these products account for a greater share of their sales.

By way of example, the following products have previously been reclassified as GSLs from P-meds in recent years:

- *Paracetamol*: The maximum strength of GSL liquid paracetamol preparations for adults and children aged 12 years and over has been increased from 2.5% to 5%.
- *Nicotine*: Nicotine patches releasing 25mg over 16 hours of continuous application may now be supplied on general sale as an aid to smoking cessation.
- *Sodium cromoglicate*: Sodium cromoglicate 2% eye drops may be supplied on general sale for the relief and treatment of the eye symptoms of hay fever in adults and children aged 6 years and over.
- *Clarityn 30’s*: An allergy/hay fever product whose active ingredient is loratadine. The change in licence opens the pathway to allow own brand development of a GSL equivalent.
- *Anusol Soothing Relief*: A haemorrhoid treatment whose active ingredient is hydrocortisone acetate.

2.6 Other products

Some pharmacies, including Lloyds pharmacies, may also stock a range of other (non-medicinal) products as part of their wider offering, such as toiletries and other health and beauty products.

¹⁰ The Cooperation Agreement dated 29 July 2015 between the parties provides for a limited number of exceptions, as a result of which Lloyds will also be entitled to sell: [X]. Under these arrangements, there will be no loss of competition between Sainsbury’s and Lloyds with regard to GSL products, as Sainsbury’s will continue to compete in the provision of such products, and Lloyds remains free to continue to sell such products in any of its pharmacies not located in a Sainsbury’s store.

2.7 Pharmacy services

Pharmacies are also commissioned to provide a variety of services, including NHS services which may be commissioned at a national or local level.

The NHS Community Pharmacy Contractual Framework (on which see section 6.2 below) consists of three levels of services: (i) essential services; (ii) advanced services; and (iii) enhanced services. While access to such services is normally via pharmacies, other providers are available for certain services which do not require the provider to be a registered pharmacy (e.g. smoking cessation).

2.7.1 Essential services

Essential services must be provided by all pharmacy contractors, and are commissioned by NHS England. These include dispensing prescriptions and repeat prescriptions, disposing of unwanted medicines and promoting a healthy lifestyle.

2.7.2 Advanced services (nationally commissioned)

Advanced services – which include the MUR and New Medicines Service (“**NMS**”) (which are, respectively, designed to help ensure patients are receiving optimal medicines, and that medicines are being used correctly) – are commissioned nationally by NHS England, pursuant to terms agreed between the PSNC and the NHS. All pharmacy contractors may provide such services once accreditation requirements are met.

2.7.3 “Enhanced” or locally-commissioned NHS services

In addition, local services (referred to as “enhanced services”) are commissioned and funded by NHS England, local authorities and Clinical Commissioning Groups (“**CCGs**”) in response to the health needs of the local population. Enhanced services include smoking cessation, substance misuse services, sexual health, NHS Healthchecks and medication used for palliative care. These services are funded by the State and provided for under contractual arrangements with the commissioner.

Such services can only commence once contracts (which are either NHS standard contracts or Public Health Services contracts) have been agreed between the pharmacy and the local commissioner. Access to contracts is normally competitive, through a robust public sector procurement process. Pricing is either fixed by the commissioner or, alternatively, sealed bids are requested as part of the tender process. The service provider is required to submit an invoice or activity document to claim payment from the commissioner for the service. In the event that the pharmacy changes ownership, the new owner is required to continue with the existing service provision to ensure that the customer offer does not change.¹¹

Contracts may either be concluded with a single preferred provider, restricted to a defined number based on need/access/location, or made available to any qualified provider. Pharmacies may also be directed by the NHS to provide a number of services as part of a 100 hour licence. Minimum service standards are defined and

¹¹ Grounds for appeal over change of ownership include any change to service provision; [X].

mandated, and providers must adhere to these standards in order to remain eligible.

2.7.4 Other services

Pharmacies may also perform a range of other private services, including certain vaccinations (including flu and travel vaccination services).

As described in further detail below, pharmacies may also offer collection and delivery services.

2.7.5 Payment for pharmacy services

Most NHS or locally commissioned services are provided free to customers, and are reimbursed by the NHS or local CCG. Certain other services (for example flu vaccinations and travel vaccinations) may be charged to patients by providers.

3 The customer journey for retail consumers

Customers may follow a number of different paths (and face a wide range of choices) when obtaining pharmacy products and services, resulting in a large degree of differentiation in terms of customer type and pharmacy offering, as set out below and discussed further in Part D below.

Set out below is a flow chart showing some of the most common permutations of a typical retail pharmacy customer journey from Sainsbury's perspective.¹²

[✕]

3.1 General practitioners and healthcare specialists

In the UK, GPs prescribe the majority of prescriptions in the community (as opposed to in a hospital environment). GP practice boundaries are currently agreed with local commissioners. Customers who live within the boundary of their chosen surgery are entitled to the full range of general medical services, including home visits. However, to encourage competition among GPs, all GPs are now (since 5 January 2015¹³) free to register new patients who live outside their practice boundary area.

It is common for GPs to operate from both their main surgery and branch surgeries in outlying areas. These branch surgeries will provide the same services as the main surgery, but typically operate for much shorter hours, and may only be open on certain days of the week and for restricted hours.¹⁴

When choosing a GP, customers will typically take a range of factors into account, including GP location, surgery hours, services, performance and personal preferences/relationship. It is generally straightforward for a customer to move from one GP and register with another should he or she wish to do so.

¹² Prepared by Sainsbury's in January 2016. This is similar to a typical retail pharmacy customer journey from Lloyds' perspective, except that in Lloyds stores, the dispensing happens before the patient arrives in almost all circumstances, except those where the patient is bringing a paper prescription with them.

¹³ See: <http://www.nhs.uk/NHSEngland/AboutNHSservices/doctors/Pages/patient-choice-GP-practices.aspx>.

¹⁴ See for example Rye Medical Centre, which runs several branch surgeries in the village halls of surrounding villages, each of which is open from one morning every two weeks up to three mornings a week: <http://www.ryemedicalcentre.com/seeadoctor.html>.

In addition to GPs, there are a number of other healthcare specialists that are qualified to prescribe prescriptions, including nurses.

3.2 The type of prescription/medicine and the medical condition to be treated

The condition which the customer is seeking to treat, and the resulting approach to care, may take different forms, as follows:

- *Acute prescription:* The condition may be an acute condition requiring a “one-off” prescription (for example, an infection, or short term pain management after an operation).
- *Repeat prescription:* The condition may be a chronic condition requiring medium to long term treatment using a repeat prescription (for example, diabetes, asthma, high blood pressure and high cholesterol). Approximately three-quarters of all prescriptions generated in primary care are for patients needing repeat supplies of regular medicines,¹⁵ and (as noted above), since 2005, repeat dispensing has been an essential service within the Community Pharmacy Contractual Framework.
- *P-med/GSL:* The customer may be seeking to treat a condition (very often a milder condition than those treated with prescription products) using P-meds or GSL products (and customers may acquire such products to be used immediately, or may keep a regular stock of certain products at home and top these up from time to time).

3.3 How the pharmacy obtains the prescription

Pharmacies may obtain prescriptions in a number of different ways, as follows:

- The customer may present the pharmacy with a paper prescription obtained from his or her GP (or may be obtaining a prescription on behalf of someone else) – often referred to as a “walk-in” customer. The customers often have an acute or “one-off” prescription.
- The customer may ask the pharmacy to collect a prescription (usually a repeat prescription) from his or her GP.
- The prescription may be delivered electronically to the pharmacy from the GP via the Electronic Prescription Service (“EPS”), which is currently being rolled-out by the NHS. This service enables a GP or other prescriber to send prescriptions electronically to a designated dispenser of the patient’s choice, enabling a more efficient and convenient process for both patients and healthcare/pharmacy staff, and has grown steadily since its introduction in 2009.
- The pharmacy may be presented with several prescriptions by a representative on behalf of a number of customers, for example a community nurse performing home visits, a care home, a prison or a mental health trust (see section 4 below).

3.4 The method of delivery to the customer

Similarly the method of delivery to the customer may vary:

¹⁵ See for example: <http://bmchealthservres.biomedcentral.com/articles/10.1186/1472-6963-14-76> and http://www.kingsfund.org.uk/sites/files/kf/field/field_publication_file/polypharmacy-and-medicines-optimisation-kingsfund-nov13.pdf (pages 20-21).

- the customer may wait for the prescription to be dispensed “on the spot” (again, more likely in the case of an acute prescription which the customer wishes to obtain as quickly as possible);
- the customer may return at a specific time or date to collect the prescription (for example in the case of a repeat prescription which has been collected by the pharmacy from the GP); and
- the prescription may be delivered direct to the customer at an address of his or her choice.

3.5 Shopping mission and choice of pharmacy

In the same way that a customer may rely on one or more different criteria when selecting a GP, a customer may base their choice of pharmacy on a number of different factors, including:

- shopping mission (whether solely to visit a pharmacy, or as part of a wider shopping mission);
- convenience of location (relative to GP surgery, home, work or other shops, for example);
- opening hours;
- ease of access/availability of parking;
- the relationship with the pharmacist;
- availability of collection/home delivery/click and collect services;
- provision of locally commissioned and/or private services; and/or
- online GP service.

While some customers may tend to use the same pharmacy for most or all of their needs, others may use a number of different pharmacies depending on their particular needs at a given time. Data available from the Health and Social Care Information Centre indicates that the number of EPS nominations for individual pharmacies may vary over time.

4 Other customer groups

4.1 Prisons and mental health trusts (no overlap)

Sainsbury's does not supply prisons and mental health trusts. [X].

In contrast, Lloyds and a number of its competitors supply prescription medicines and other products to prisons and mental health trusts, either pursuant to a contract with the institution, or on an ad hoc basis. Contracts may either be concluded on a wider basis (for example in the case of a national chain of care homes), or locally (for example as a result of marketing efforts by an individual pharmacy). Products are typically delivered by the pharmacy to the institution in question (or may be collected by a representative).

[X].

4.2 Care homes (negligible overlap)

Lloyds has an established presence in care home activities, [REDACTED].

In contrast, [REDACTED], and [REDACTED] further stores have non-negligible ad hoc care home supply volumes (of around [REDACTED] prescriptions per week). [REDACTED]. Accordingly, care home supply is not discussed further in this submission.

The parties' activities in relation to pharmacies within hospitals are described in more detail in Part I of this submission.

5 Supply chain

5.1 Prescription medicines

There are three main wholesalers in the UK competing for the distribution of the majority of prescription medicines, namely: Alliance Boots, AAH and Phoenix/Rowlands. There are also a number of other competitors for the wholesale supply of prescription medicines, including "short-liners" (see Part J section 2 of this submission for further details on the wholesale market for pharmaceuticals).

However, no single wholesaler is able to supply the entirety of an individual pharmacy's needs, as some pharmaceutical manufacturers have entered into restricted arrangements with wholesalers to control the distribution of branded prescription products. Some of these contracts are exclusive solus arrangements, whereby a sole wholesaler is appointed to distribute particular prescription medicines nationwide (for example, since 5 March 2007, Alliance has held the exclusive rights to distribute Pfizer's prescription only medicines). Typically, therefore, a pharmacy will obtain supplies from a number of wholesalers, and the concept of a "full-line wholesaler" in the traditional sense is no longer valid, and has instead been replaced by the concept of a "broad-line wholesaler".

For non-branded medicines, a large number of wholesalers compete.

Typically wholesalers are required by the manufacturer to provide a twice daily delivery service to all pharmacies nationwide (a "**universal service obligation**"). Pharmacies do not therefore necessarily need to retain significant stock levels, and in practice will adjust their individual stock requirements according to likely demand for individual medicines (based on dispensing history).

5.2 P-meds

P-meds are also available from wholesalers or may be procured direct from manufacturers, and are often delivered on a weekly basis (or more frequently, if required). As for prescription medicines, P-meds are often supplied by both "broad-line" and "short-line" wholesalers; however, a large section of the P-med market is supplied direct by manufacturers.

6 Regulatory landscape

6.1 Licensing regime

Pharmacies in the UK are subject to specific regulatory and licensing requirements. England, Scotland, Northern Ireland and Wales each have their own regulatory controls.

Pharmacies in England are controlled by The National Health Service (Pharmaceutical and Local Pharmaceutical Services) Regulations 2013 (the “**2013 Regulations**”) and their associated Terms of Service.¹⁶ The 2013 Regulations permit applications to be made for a pharmacy licence where a need is identified in the local Health and Wellbeing Board’s Pharmaceutical Needs Assessment (“**PNA**”), which is reviewed and updated by the local authority every three years. Outside the scope of the PNA, any application requires an evidenced case to be made to the NHS England Area Team (which must demonstrate that the proposal will secure improvements or better access for patients). Generally, pharmacy licences are valid indefinitely, so long as the pharmacy remains on the pharmaceutical list maintained by NHS England and is registered with the General Pharmaceutical Council.

The 2013 Regulations are more restrictive with regard to market entry than the Regulations in place between 2005 and 2013. PNAs on the whole do not identify many new pharmacy contracts and the “unforeseen benefits Regulation”¹⁷ has a high threshold that needs to be surpassed to see an application granted. The removal of 100 hours exemptions which allowed for new pharmacy licences to be granted without a PNA¹⁸ resulted in a reduced growth in pharmacy openings, with the exception of internet pharmacies (see “Distance selling”/internet pharmacies below).

Fixed contracts are usually entered into for local pharmaceutical services (which are directly commissioned contracts between the pharmacy and Trust), and tend to run for around five years.

Pharmacies in Scotland, Wales and Northern Ireland are licensed pursuant to similar regulatory regimes, whereby the grant of a new contract depends on demonstrating that a contract is necessary or desirable to secure adequate provision of pharmacy services. Minor relocations are also permitted.

6.1.1 “Distance selling”/internet pharmacies

The 2013 Regulations also introduced a new licensing regime for “distance selling pharmacies” (which includes internet based pharmacies and any mail order based pharmacy). Pharmacies may apply for a distance selling licence without having to demonstrate the need for an additional pharmacy pursuant to a PNA. However, pharmacies holding a “pure” distance selling licence are prohibited from dispensing prescriptions face-to-face via a physical store format.¹⁹ Within the UK, distance selling pharmacies are only authorised in England, and must ensure that their services are available in all parts of England (i.e., they cannot be limited to targeting certain parts of England).

Increasing numbers of distance selling pharmacies, including as a result of their ability to benefit from the growth of EPS, together with a move towards more online ordering and delivery of prescriptions more generally, will significantly change how the competitive market will work, with bricks and mortar pharmacies not always being required.

¹⁶ Set out in Schedule 4 of the 2013 Regulations.

¹⁷ The 2013 Regulations, Regulation 18.

¹⁸ Under 13(1)(b) of the National Health Service (Pharmaceutical Services) Regulations 2005 exemption from the “necessary or expedient” test was granted to new pharmacies undertaking to provide pharmaceutical services for at least 100 hours a week in certain types of location. This exemption was repealed in the 2013 Regulations, which reverted to the needs based approval regime.

¹⁹ Pharmacies may also supply products via mail order and online pursuant to a standard “bricks and mortar” licence.

More generally, the Department of Health published an open letter to the PSNC on 17 December 2015, in which it expressed a desire for more patients to be able to access their medicines online and have them delivered to their home or through “click and collect” services. The policy to increase the use of online prescription services has also been highlighted in the Treasury’s publication “A better deal: boosting competition to bring down bills for families and firms” (November 2015), in which it was stated that the government will examine the NHS community pharmacy market to ensure the regulatory framework and payments system facilitates online, delivery-to-door and click-and-collect pharmacy and prescription services.

6.1.2 Dispensing doctors

In addition to community and internet pharmacies, certain patients are also eligible to obtain prescriptions from dispensing doctors, who are licensed to dispense products to patients living further than one mile from a pharmacy or who would have serious difficulty obtaining medicines from a pharmacy. Dispensing doctors require a licence from the NHS to dispense pharmaceuticals in this way. There are approximately 1,233 dispensing doctors in the UK, who dispense approximately 6% of prescriptions based on volume of product purchased.²⁰

6.2 Common standards

Customers are in practice afforded a significant amount of protection as a result of stringent quality and service standards that apply to all pharmacies.²¹ These derive from two sources: the General Pharmaceutical Council (“GPhC”) and the Terms of Service contained in the 2013 Regulations.

The GPhC sets the Standards for Registered Pharmacies (the “Standards”), which are common across the profession. They are designed to strengthen the regulation of pharmacies and improve the quality of pharmacy practice. They focus on outcomes achieved for patients and people who use pharmacy services. Both pharmacy owners and Superintendents (on which see below) are accountable for achieving these Standards. The Standards recognise that owners and Superintendents are responsible for creating and maintaining a physical and organisational environment in which pharmacies practice safely and effectively. The Standards are set out under five principles which describe arrangements for safe and effective pharmacy care.²²

- Principle 1 – The governance arrangements safeguard the health, safety and wellbeing of patients and the public.
- Principle 2 – Staff are empowered and competent to safeguard the health, safety and wellbeing of patients and the public.

²⁰ Source: IMS.

²¹ In general, customers of any medical service offered by a pharmacy will be likely to benefit from the culture of stringent quality and standards which apply to NHS services, even where those standards do not expressly apply to that service, due to the fact the same staff and facilities are being used for those services. For example, customers of private non-commissioned services offered by some pharmacies, such as travel vaccinations, would benefit from the general culture resulting from pharmacies being heavily regulated in most areas.

²² <http://www.pharmacyregulation.org/sites/default/files/Standards%20for%20registered%20pharmacies%20September%202012.pdf>.

- Principle 3 – The environment and condition of the premises from which pharmacy services are provided, and any associated premises, safeguard the health, safety and wellbeing of patients and the public.
- Principle 4 – The way in which pharmacy services, including the management of medicines and medical devices, are delivered safeguards the health, safety and wellbeing of patients and the public.
- Principle 5 – The equipment and facilities used in the provision of pharmacy services safeguard the health, safety and wellbeing of patients and the public.

Monitoring of the Standards is carried out by the GPhC Inspectorate, who conducts a risk based inspection of all pharmacies in the country. The outcome of any inspection will produce a rating of “poor”, “satisfactory” or “good”. All pharmacies which are judged to be “poor”, and those which are judged as “satisfactory” but have not met all of the Standards, will be required to complete and implement an improvement action plan. Any actions from the inspections must then be implemented by the pharmacy within the timelines specified. Failure to comply with concerns raised by the GPhC could lead to removal from the register.

Every holder of a pharmacy licence must have a “Superintendent”.²³ As mentioned above, this person’s role is to ensure that the Standards set by the GPhC are met and that all pharmacies comply with the relevant legal requirements, including those covering medicines legislation, health and safety, employment data protection and equalities legislation. The Superintendent must also make sure that all members of the team, including non-pharmacists involved in the management of pharmacy services, are familiar with the Standards and understand the importance of compliance. For independent pharmacies which are owned by individual pharmacists, that pharmacist will also be the Superintendent for legal and regulatory purposes, and must therefore also comply with the outlined regulations.

[✕]

6.3 The Terms of Service

The 2013 Regulations provide a mechanism that allows the relevant Primary Care Organisation to take action against a pharmacy, should it make repeated breaches of the Terms of Service, and ultimately can give notice to remove that pharmacy from the pharmaceutical list.

The requirements contained in the Terms of Service are summarised below:

6.3.1 Opening hours

The Terms of Service refer to both “core” and “supplementary” opening hours. Core hours relate to the legal minimum number of hours a pharmacy must open; supplementary hours refer to the actual number of hours over which a pharmacy is trading. As a result of legislative changes in recent years, pharmacies fall into two basic groups with respect to opening hours:

²³ Section 71 of the Medicines Act 1968 provides that pharmacies which are part of a body corporate, and which keep, prepare and dispense medicinal products other than GSL products, are required to be under the management of a superintendent (a “**Superintendent**”). The Superintendent can only hold their position at one body corporate. Pharmacies are required to be under the direction of a “responsible pharmacist”, who must be either the Superintendent or a manager/assistant subject to the Superintendent’s directions, and who themselves is a pharmacist.

- pharmacies with core/minimum hours of 40 hours per week (and the ability to add supplementary hours above this minimum); and
- pharmacies which opened under the previous “100 hour exemption”, which have core hours of 100 hours per week (and the ability to add supplementary hours to this, although this is less common).

Pharmacies that operate under a 40-hour licence can apply to vary their supplementary hours, provided that they give the National Health Service Commissioning Board (the “**NHSCB**”) 90 days’ notice of the intention to alter their opening hours, and provided that the hours remain equal to or above the 40-hour minimum. One hundred-hour pharmacies cannot apply to reduce either their core or supplementary hours below the 100 hour per week threshold.

6.3.2 Access

A proposal to relocate a pharmacy within the area of the Health and Wellbeing Board (or to an adjacent area) will be considered favourably where it can be demonstrated that the relocation will not significantly change the provision of pharmaceutical services and will not be significantly less accessible for patient groups used to accessing the current premises.

6.3.3 Professional standards

The Terms of Service provide that:

- A pharmacist and a counter assistant must be present during every operating hour of a pharmacy.
- A pharmacist or NHS appliance contractor must provide pharmaceutical services and exercise any professional judgement in connection with the provision of said services in line with the “generally accepted” standards of the pharmaceutical profession.
- An NHS pharmacist must participate in “an acceptable system of clinical governance”. To be “acceptable”, a clinical governance system must contain the following components:
 - a patient and public involvement programme – this requires that a pharmacist produces, in an approved manner, a practice leaflet containing approved particulars in respect of its pharmacy surveys and that the pharmacist publishes the essential and any advanced services available from it. Where a pharmacist publishes information on essential services or any directed services that are available at or from its pharmacy, they must do so in a manner which makes clear that the services are funded by the NHS;
 - a clinical audit programme, including one clinical audit specified by the NHS pharmacist, and whichever of the following the NHSCB specifies: (a) a clinical audit; or (b) a policy-based audit to support the commission policies of the NHSCB. Both of these need to be carried out in a manner compatible with the NHSCB’s arrangements for receiving and processing data;

- a risk management programme, which includes, inter alia, arrangements for procurement and handling of stock, maintenance of equipment, an effective incident reporting system, record keeping and medical/confidential waste disposal system;
- a clinical effectiveness programme, including arrangements for ensuring appropriate advice is given by the pharmacist when providing drugs and appliances, including providing advice to carers of vulnerable people;
- a staffing and staff management programme, which requires that proper inductions/training are provided for staff, and that mechanisms are in place to identify poor performance. Provision is also made to protect whistle-blowers;
- an information governance programme providing for compliance with approved procedures for information management and security, and submission of an annual self-assessment of compliance; and
- a premises standards programme, which sets out a system for maintaining cleanliness at the pharmacy to minimise the risk of “health acquired infection” in a proportionate manner. Additionally, compliance arrangements are required in areas of the pharmacy where patients receive NHS services, to ensure, in a proportionate manner, that those areas are an appropriate environment in which to receive healthcare.

6.4 Assessing compliance

All community pharmacies providing NHS services operate under an NHS Contract, also known as the Community Pharmacy Contractual Framework, whose legal basis is the 2013 Regulations.

The Community Pharmacy Assurance Framework (“**CPAF**”) was developed by NHS Primary Care Commissioning as a toolkit to assist Primary Care Trusts in assessing compliance and quality under the Community Pharmacy Contractual Framework. Inspections are carried out against this CPAF by local area teams of their counterparts in Scotland and Wales. Similarly, the Community Pharmacy Patient Questionnaire is another audit required by the NHS to monitor compliance and quality. Actions from any professional audits are used to improve the quality of pharmacy services, resulting in a better patient experience. Poor performance on these audits can lead to breach and withdrawal of a pharmacy licence.

[✕]

PART D. COMPETITIVE LANDSCAPE

1 Introduction

The UK pharmacy industry is characterised by a large number of competitors which operate in a diverse range of formats. The following table²⁴ gives an overview of the competitive landscape, and set out below are the categories into which competitors broadly fall.

[REDACTED]

2 Independents

Independent pharmacies represent a vibrant and growing part of the pharmacy sector (by market share), accounting for more than [40-50]% of all pharmacy contracts in the UK.²⁵ Independents are typically found in community, high street or GP/health centre locations.

Previous OFT investigations into the retail pharmacy market confirmed that independents are strong competitors, and this remains true today. Indeed, market statistics confirm a growth in the volume of prescriptions dispensed by independent pharmacies relative to market share²⁶ and in the number of new applications made by independents. Independents have also generally taken an aggressive approach to EPS nominations, which has aided their growth. Additionally, independents compete strongly on location; for example, independents often have strong relationships with local GP surgeries which can trump other considerations (such as financial considerations) when GP practices choose which pharmacy to have on site.

Independent pharmacies are subject to the same price and service regulations as the parties, and are often perceived by customers to provide better, individualised pharmacy services than larger chains, given their owner-operator model and frequent close links to GPs. Independent pharmacies typically also benefit from lower labour costs and overheads (with limited need, for example, to rely on locum staff) and continuing capital growth as the value of licences and premises continues to rise.

The Chemist and Druggist (a pharmacy publication) holds annual awards for pharmacies, with awards in a number of different categories including “pharmacy team of the year”, “business initiative of the year” and “GP partnership of the year”.²⁷ The majority of these awards are generally won by independent pharmacies.

[REDACTED]

There are significant networks of independent pharmacies, through which independents are able to increase their buyer power, as well as receiving a wide range of other support services, including marketing support and various pharmacy management services. The

²⁴ Extracted from Celesio, Project Hippo – potential acquisition of Sainsbury’s pharmacy business, 10 June 2015, slide 21. In relation to the number of pharmacies operated by supermarket players, cf. the Verdict UK Pharmacy Report (2015), page 37, [REDACTED].

²⁵ [REDACTED] (source: the “Access Pharmacy Report”, Issue 1, Volume 13, dated January 2015 provided at Appendix 10(a)(xi) of the Merger Notice).

²⁶ Based on analysis of NHS Business Services Authority data (England).

²⁷ For further details, and the 2015 winners, see here: <http://www.chemistanddruggist.co.uk/awards/winners>.

majority of independent pharmacies in the UK are members of such networks, which include:

- *Numark* (which is owned by Phoenix, the pan-European wholesaler which also owns the Rowlands chain), a network of 3,000 independent pharmacies throughout the UK which was formed to help independent pharmacies with “every area of their business”.²⁸ Each pharmacy business within Numark is independently owned, but Numark membership enables individual retailers to take advantage of group purchasing deals to reduce their costs in a model known as a symbol group, or virtual chain. Numark also offers advice, guidance and support to its members across a breadth of areas, including: (i) pharmacy practice; (ii) marketing and promotion, such as through signage, advertising and demographic research for product targeting purposes as well as a “loyalty card” scheme; (iii) NHS and private services; and (iv) various training opportunities.²⁹
- *Alphega Pharmacy*, a network of independent pharmacists in Europe, supporting more than 1,000 independent pharmacies across the UK. Alphega Pharmacy provides wholesale and pre-wholesaling services to independent pharmacies, and training and support services in a number of other areas, including: (i) dispensing; (ii) professional services; (iii) retail; (iv) bespoke apps; (v) team and personal development; (vi) customer care (e.g. through a mystery shopper programme); (vii) digital marketing; and (viii) branding and signage (with over 650 pharmacies in the UK now carrying Alphega branding). Alphega Pharmacy was created and developed by Alliance Healthcare, which is now part of the Walgreens Boots Alliance group.³⁰
- *Cambrian Alliance Group*, made up of more than 1,300 independent pharmacy members from across the UK, making it one of the country’s largest pharmacy buying groups which “provide[s] members with complete provision of professional pharmacy services and support”.³¹ It provides rebates and bonuses, negotiates special deals with blue-chip suppliers, has a team of regional business managers covering the whole of the UK to provide advice and support to members and offers a price-comparison stock-ordering tool for its members. One in four independent pharmacies is a member of the Cambrian Alliance Group.³²
- *Avicenna*, a network of independent pharmacies with more than 1,000 members in the UK, established with the purpose of helping its members negotiate better terms with suppliers, but also offering a vast array of services designed to keep its members “ahead of the competition at all times”,³³ including day-to-day member support, regulatory and professional guidance, and member events and networking opportunities. Additionally, since 2012, Avicenna has been acquiring pharmacies in

²⁸ See: <https://www.numarknet.com/about-numark?ref=footer>.

²⁹ For further information on Numark, see: <https://www.numarknet.com/>.

³⁰ For further information on Alphega Pharmacy, see: <http://www.alphega-pharmacy.co.uk/web/b2b/home>, <http://www.alliance-healthcare.co.uk/products-services/alphega-pharmacy/> and <http://b2b.alphega-pharmacy.co.uk/in-the-press>.

³¹ See: <http://www.cambrianalliance.co.uk/why-join-us/>.

³² For further information on the Cambrian Alliance Group, see: <http://www.cambrianalliance.co.uk/>.

³³ See: <http://www.avicenna.org/about-us/what-we-do/>.

its own right and now owns 22 pharmacies (located mainly in the south of England), with the intention to expand this further.³⁴

These large buying groups of independent pharmacies further increase the strength and viability of independents as competitors to the regional and national pharmacy chains. Additionally, as noted above, Numark and Alphega Pharmacy are each linked to one of the major national pharmacy chains (namely Rowlands and Boots, respectively).

3 Boots

Boots (a subsidiary of Alliance Boots, acquired by U.S. drugstore operator Walgreens in 2014) is the largest single chain, with a national share in the UK of [20-30]%. Boots offers a number of different formats across over 2,300 pharmacy stores, from small community and high street pharmacies to town centre outlets with a wider retail offer to large out-of-town retail outlets. Over 1,400 Boots pharmacies are small, local locations which only provide prescriptions, P-meds and a smaller range of healthcare products. Some Boots pharmacies are also linked with GP practices. Boots also provides an online pharmacy service.

4 Other large national multiples

There are a number of national pharmacy chains, with a range of different formats.

- Well (formerly the Co-operative pharmacy chain, which was acquired by Bestway in 2014) is the third largest pharmacy chain in the UK, with 780 pharmacies and a national share of [5-10]%. Many Well pharmacies are located either in or near to GP practices as well as on high streets and in shopping centres.
- Rowlands is the UK's longest established chain of local community pharmacies, with over 500 community pharmacies throughout England, Scotland and Wales, as well as providing an online pharmacy service. Rowlands has a national share in the UK of [0-5]%.
- Day Lewis, which has over 250 pharmacies in England. Day Lewis pharmacies vary in format, with stores in town centres and some operating from GP practices, as well as offering an online prescription ordering service.
- Superdrug is also present nationally, with a [0-5]% national share in the UK. Superdrug has 200 stores offering both a pharmacy service and a wider retail offering and 15 stores also offering nurse clinics providing health checks. A number of Superdrug pharmacy stores also provide additional services such as travel and flu vaccinations. Superdrug also provides an online doctor service, and is a significant high street competitor in the beauty product category.
- Cohens, which has approximately 160 pharmacies located mainly in the community and increasingly within new community health centre developments.

All of the national pharmacy chains generally offer prescription services, P-meds and GSL products, as well as healthcare advice and a variety of other services which vary to some extent between stores.

³⁴ For further information on Avicenna, see: <http://www.avicenna.org/>.

5 Regional multiples

There are many smaller or regional multiples that nonetheless still operate a large number of pharmacies under a single brand.³⁵ Examples include:

- Weldricks, which is a pharmacy chain with over 60 stores across South Yorkshire and the North Lincolnshire area and with an online presence, offering prescription services as well as various retail items.
- Gordon's Chemists, which is the largest independent pharmacy chain in Northern Ireland, with more than 60 pharmacies on the high street and in shopping centres across Northern Ireland and Scotland. Gordon's Chemists also has an online presence, although this does not offer prescription services.
- Paydens Limited is a large independent pharmacy chain, with stores in the Kent, Essex, London, Surrey and Sussex areas. Its pharmacies vary in size from a small village pharmacy to large high street shops with additional departments such as perfumery, photographic and alternative therapies. The pharmacies around Kent, Sussex and Surrey take care of a number of residential and nursing homes. Paydens Limited also offers a service to those being cared for at home. Additionally, Paydens Limited owns an online pharmacy retailer, Express Chemist, which provides prescription services, as well as offering a wide range of P-meds and GSL medicines for delivery.
- There are several other independent regional pharmacy chains with significant numbers of stores, such as PCT Healthcare Limited, Dudley Taylor Pharmacies Ltd. and MediCare Pharmacy Group.³⁶

6 Supermarket pharmacies

Tesco, Asda and Morrisons operate a similar in-store model to Sainsbury's and have national shares in the UK of [0-5]%, [0-5]% and [0-5]%, respectively. At financial year end 2013, Tesco had [X] pharmacies, Asda had [X] pharmacies and Morrisons had [X] pharmacies.³⁷

7 Internet/mail order pharmacies

There are estimated to be over 200 distance-selling pharmacies operating out of England.

Many of the pharmacy chains, both national and regional, also offer online pharmacy services handling single and repeat NHS and private prescriptions. In addition, there are a number of online-only pharmacies, including:

- Pharmacy2U, a dedicated NHS approved online doctor and pharmacy which delivers prescriptions, P-meds and GSL products. It is the UK's largest dedicated internet and mail order pharmacy; and
- Chemist Direct, an online pharmacy retailer providing a wide range of P-meds and GSL products, as well as offering an online doctor and prescription service.

³⁵ [X] (source: the "Access Pharmacy Report", Issue 1, Volume 13, dated January 2015 provided at Appendix 10(a)(xi) of the Merger Notice).

³⁶ This can be seen from the table on page one of the "Access Pharmacy Report", Issue 1, Volume 13, dated January 2015 provided at Appendix 10(a)(xi) of the Merger Notice, [X].

³⁷ Verdict UK Pharmacy Report (2015), page 37.

While internet pharmacies must sell across the whole of England, some, in practice, have focused on operating more locally, for example, by advertising or creating links with GP surgeries (including marketing within the GP practice) and arranging for local collection and delivery services to target specific surgeries (this could include a local delivery service to meet local needs, and a postal service to fulfil orders from the rest of England). For example, Pharmacy2U advertises and delivers direct to homes locally in East Grinstead, and has gained a significant local presence.

8 Dispensing doctors

As noted above, certain patients are also eligible to obtain prescriptions from dispensing doctors who are licensed to dispense products to patients living further than one mile from a pharmacy, or who would have serious difficulty obtaining medicines from a pharmacy. As noted above, there are approximately 1,233 dispensing doctors in the UK who dispense approximately 6% of prescriptions based on volume of product purchased.³⁸

9 Market share data

Set out below is a table of market share data, extracted from the Verdict UK Pharmacy Report (2015).³⁹ Note that the pattern of shares again reflects the strong differentiation between the parties' offers, with [X]

Retailer	Retail pharmacy market share (%)⁴⁰	Market share of NHS revenue (%)⁴¹	OTC market shares (%)⁴²
Independent/ other	[40-50]	[40-50]	[40-50]
Boots	[20-30]	[20-30]	[20-30]
Lloyds Pharmacy	[10-20]	[10-20]	[5-10]
Co-operative Pharmacy (now Well)	[5-10]	[5-10]	[0-5]
Tesco	[0-5]	[0-5]	[5-10]
Rowlands	[0-5]	[0-5]	[0-5]
Sainsbury's	[0-5]	[0-5]	[5-10]
Asda	[0-5]	[0-5]	[5-10]
Superdrug	[0-5]	[0-5]	[0-5]
Morrisons	[0-5]	[0-5]	[0-5]
Combined Lloyds/ Sainsbury's	[10-20]	[10-20]	[10-20]⁴³

³⁸ Source: IMS.

³⁹ Market share data for 2014, Verdict UK Pharmacy Report (2015), tables 10, 11 and 12.

⁴⁰ Calculated on the basis of percentage of contracts.

⁴¹ Calculated on the basis of sales revenue.

⁴² Calculated on the basis of sales revenue, using a definition of OTC which includes both p-meds and GSL products.

⁴³ The combined Lloyds/Sainsbury's OTC market share is therefore likely to materially overstate the combined share of the OTC market which will be held by Lloyds post-Transaction, because the vast majority of Sainsbury's GSL business is not being acquired by Lloyds [X].

PART E. THE PARTIES

1 Lloyds Pharmacy Limited

1.1 Overview

Lloyds is a subsidiary of Celesio AG, an international pharmaceutical wholesale and retailer which also provides logistics and services to the pharmaceutical and healthcare sectors. In addition to Lloyds, Celesio has the following activities in the UK:

- wholesale distribution of pharmaceutical and healthcare products and services to pharmacies, hospitals and dispensing doctors via its subsidiary AAH; and
- the provision of clinical homecare services in the UK via its subsidiary Evolution Homecare.

Celesio is ultimately owned by McKesson Corporation, a U.S. corporate which is listed on the New York Stock Exchange. McKesson, which delivers pharmaceuticals, medical supplies and healthcare information technology around the world, currently owns approximately 75% of the outstanding shares of Celesio AG.

Lloyds operates more than 1,500 pharmacies across the UK, mainly in community and health centre locations. It also operates [X] OPD pharmacies (see Part I section 2 for further details).

1.2 History of Lloyds Pharmacy

Celesio AG purchased AAH in 1995 before acquiring Lloyds Chemist PLC, which at the time had 902 pharmacies, in 1997. Combined with AAH's 350 pharmacies, the combined group had 1,250 pharmacies, which has grown to over 1,500 pharmacies across the UK.

Lloyds itself owns a number of companies, including:

- John Bell & Croydon, a retail, online and wholesale business delivering a broad range of high quality healthcare products and solutions to the medical profession, businesses and the general public in the UK and globally. The company is the holder of the Royal Warrant as Pharmacists to Her Majesty Queen Elizabeth II.
- Betterlife Healthcare, an internet and mail order retailer of mobility and disability living aids and products.
- The Dr Thom online doctor healthcare service (now known as "Online Doctor"), which allows Lloyds to meet the needs of customers beyond the provision of traditional pharmacy services.

2 Sainsbury's pharmacy

2.1 Overview

Sainsbury's is a UK retailer with just over 1,300 grocery stores in the UK, of which approximately 597 are supermarkets and 707 are convenience stores. Its retail offer covers grocery products, general merchandise and clothing in addition to retail sales of petrol and pharmacy services. Sainsbury's also offers retail banking and insurance services provided by Sainsbury's bank. Sainsbury's is listed on the London Stock Exchange.

Sainsbury's operates 277 pharmacies located within or adjacent to a supermarket store.

Sainsbury's also provides pharmacy services within four hospitals under contract with [REDACTED] hospital trusts.

2.2 History of Sainsbury's pharmacy

Sainsbury's pharmacy has been in existence for over 20 years, but was a relatively late arrival to the UK pharmacy sector relative to other supermarkets. The first supermarket pharmacies were opened by Safeway (now Morrisons). These were followed by Tesco in the early 1990s and then Asda. The supermarket pharmacy offer underpinned the growth of health and beauty products in supermarkets, and was also driven by the fact that spending, and the demand for services, was moving away from the high street at that time to out-of-town retail parks. Boots subsequently also developed an out-of-town large format and began competing directly with the supermarkets.

Sainsbury's opened its first pharmacy in 1995 and by 2004 had grown its estate to 115 pharmacies, of which 112 resulted from the acquisition and relocation of a local pharmacy to a Sainsbury's store.

With the introduction of the 100 hours exemption in 2004, Sainsbury's was able to grow its estate further, leading to a total of 274 pharmacies by the time the exemption was withdrawn in 2013.

Sainsbury's opened its first GP in store operation in 2007, whereby patients were able to see a local GP from a converted pharmacy consultation room. Approximately [REDACTED]% of Sainsbury's pharmacies now have an on-site GP.

PART F. THE TRANSACTION

1 Transaction rationale

From Lloyds' perspective, the acquisition of Sainsbury's pharmacy business will complement Lloyds' existing business, enabling it to expand its format offering to include pharmacy store services within Sainsbury's grocery stores and realise a number of synergies across the businesses, as well as entering a number of new local markets where it does not currently compete.

From Sainsbury's perspective, the Transaction will provide its customers with an enhanced pharmacy service compared to the service that is currently available and ensure that the future service and services that are required can be delivered with expertise and confidence. Additionally, the Transaction will provide its colleagues with the benefit of enhanced training and specialist expertise, and the benefit of an ongoing partnership with a provider with significant industry expertise.

2 Transaction background

2.1 Circumstances leading up to the Transaction: Sainsbury's

[X].

2.2 Circumstances leading up to the Transaction: Celesio

[X].

2.3 Rationale and synergies from Celesio's perspective

[X] The Transaction would, among other things, enable Celesio/Lloyds to:

- [X].

2.4 History of the previous relationship between the companies

Celesio and Sainsbury's have a pre-existing relationship in the following areas:

- As noted above, [X].
- [X].

2.5 Transaction negotiations and timetable

[X]

After a period of negotiation, the parties entered into a Business Sale Agreement on 29 July 2015 (the “**BSA**”) pursuant to which Celesio has agreed to acquire certain assets and liabilities of the target business.

The parties also entered into a Cooperation Agreement on 29 July 2015, which will govern the on-going relationship between the parties after the Transaction has been implemented, given that the target pharmacies will continue to be located within or adjacent to a Sainsbury’s store.

3 Transaction agreements

Key terms of each agreement are summarised below.

3.1 Business Sale Agreement

The key terms of the BSA are as follows:

- [X].
- [X].
- [X].
- [X].

4 Cooperation Agreement

The Cooperation Agreement will govern the nature of the ongoing relationship between the parties. Its key terms are as follows:

- [X].
- [X].
- [X].
- [X].
- [X].
- [X].

PART G. MARKET DEFINITION

1 Product scope

While the Parties operate in different segments of the UK retail pharmacy market – the traditional high street/community segment in the case of Lloyds, and the supermarket segment, in the case of Sainsbury's – it is meaningful, for purposes of market definition and testing theories of harm, to treat the parties as competitors in an overall retail pharmacy market.

1.1 Retail supply of prescription and P-med products

The parties take no issue with the settled approach of the UK competition authorities to product market definition, including at the Phase I stage of this case. This approach defines separate product markets, or frames of reference, in respect of various product categories supplied by a typical UK retail pharmacy, and set out at Part C sections 2.1 – 2.3 above, including:

- prescription-only medicines; and
- pharmacy-only medicines (P-meds).

In particular, the CMA noted at Phase I (decision, para. 39) that:

The UK competition authorities 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.

The parties agree with this summary, and the CMA's conclusion that there was no evidence at Phase I justifying a different approach on these issues, and submit that it would be appropriate for the Phase II analysis to proceed on the same settled basis.

1.2 Retail supply of GSL and non-pharmaceutical products

The parties note that GSL products were not mentioned in the market definition or competitive effects sections of the Phase I decision in this case, consistent with the lack of any plausible competition concern in relation to the GSL segment, not least because (as noted at 2.3 above) Celesio will not assume any control or influence over Sainsbury's sales of GSL product, which remain outside the scope of the Transaction and collaboration.⁴⁴ Instead, the Phase I product analysis focused on prescription medicines and P-meds only.

In addition, for the sake of completeness, the parties note that their outlets also sell non-pharmaceutical products, such as toiletries, baby food and health food. At Phase I in this case, consistent with previous cases, these were not defined as a separate product market nor examined given, as the OFT has previously put it, "the vast array of alternative [non-pharmacy] suppliers of these products".⁴⁵

Accordingly, the parties submit that at Phase II it makes sense for the CMA to focus its product category analysis on prescription and P-med products, although in doing so the

⁴⁴ Subject to limited exceptions as set out in footnote 10 above.

⁴⁵ OFT, *Boots plc/Alliance UniChem plc*, decision of 6 February 2006, para. 12.

CMA should recognise that the prices of many P-meds are constrained by the sales of GSL products.

1.3 Retail pharmacy services

The parties also agree that it makes sense, as set out as a separate frame of reference in the CMA's Phase I decision, to consider retail pharmacy services to consumers (cf. paras. 41, 60) alongside prescription and P-med products.

OPD services are discussed in detail in section Part I below.

2 Geographic scope

It is settled decisional practice that:

- demand for retail pharmacies is "local" or "predominantly local"⁴⁶ but
- it is appropriate also to consider competitive effects at the national level, given that in this case the parties and many of their rivals represent national chains of stores, and that numerous parameters of competition are set nationally/centrally or have a national dimension.

2.1 Local retail overlap analysis

It has been standard decisional practice in prior retail pharmacy cases⁴⁷ to take as the starting point a one-mile radius around each party's store as the proxy catchment area or geographic market. This approach applies to the retail supply of prescriptions, P-meds and pharmacy services alike.

In this case, the CMA considered that Lloyds' 80% customer catchment areas were broadly consistent with it drawing customers from a [X] radius around its stores, and the parties submit that there is no good reason to discard this approach at Phase II.

However, prior UK pharmacy merger cases had never involved an in-store supermarket pharmacy operator. As is apparent, Sainsbury's pharmacies are highly differentiated from a typical stand-alone community or high street pharmacy, reflecting the different customer acquisition strategies of the parties. In the case of Sainsbury's and its supermarket pharmacy competitors, their collective pharmacy proposition is aimed at grocery customers who travel considerably further (and typically by car) primarily to conduct a large-store (which typically have adjacent parking) grocery shop. This crucial fact affects not only the competitive effects analysis, but also the starting point approach to geographic market definition.

The CMA recognised the peculiarity of this case at Phase I insofar as it adopted the parties' differentiated approach to determine the catchment areas of Sainsbury's pharmacies, using drive-times rather than the one-mile radius, and settling on the standard

⁴⁶ CMA Phase I decision, para. 45; OFT, Boots plc/Alliance UniChem plc, decision of 6 February 2006, para. 15.

⁴⁷ See, for example: Case No. ME/3004/07, the anticipated merger between Co-operative Group (CWS) Limited and United Co-operatives Limited, OFT decision of 23 July 2007; Case No. ME/3007/07, the anticipated acquisition by Lloyds Pharmacy Limited of Independent Pharmacy Care Centres Plc, OFT decision of 8 June 2007; Case No. COMP/M.4301: Alliance Boots/Cardinal Health, Commission decision of 22/09/2006, anticipated acquisition by Boots Plc of Alliance UniChem plc, OFT decision of 6 February 2006; Case No. ME/2035/05 anticipated acquisition by Lloyds Pharmacy Limited of part of the Cohens & Scholes pharmacy chains, OFT decision of 29 November 2005; and Case No. ME/3933/308, the completed merger between Co-operative Group Limited and Lothian Borders & Angus Co-operative Society Limited, decision of 6 March 2009.

UK grocery store overlap starting point of a 10- and 15-minute drive-time around relevant Sainsbury's stores, for urban and rural areas, respectively.

3 Interpretation of “local overlap” results

The parties endorse this differentiated approach to geographic market definition at Phase I, as it reflects the differentiated nature of their retail offering. There was therefore general agreement that it was appropriate on a cautious Phase I basis, and as a very first methodological step, to use this approach to generate an initial bare list of technical geographic catchment “overlaps”, however modest, between the parties' store catchments.

While this first step did reflect both the hybrid pharmacy/grocery nature of the Transaction, and the major asymmetry with substantially different-sized geographic markets, it ultimately proved difficult to move meaningfully beyond this first step: the CMA found in its Phase I decision that the combination of a one-mile radius around Lloyds stores and a 10/15 minute drive-time around Sainsbury's stores generated 546 Lloyds store overlaps and 217 Sainsbury's store overlaps, resulting in 763 overlap stores, for a transaction that only involves the acquisition of a total of 277 Sainsbury's in-store pharmacies – in other words, 2.75 overlaps for every Sainsbury's store being acquired.

This meant that the case in Phase I turned on the “filtering” question of which overlaps might fall within the subset of “possibly problematic” within the confines of the Phase I process. While overlap analysis is often conceived as a facilitating tool to frame and focus meaningful assessment of competitive effects, the parties argued that any mechanistic results of this sort of overall analysis need to be approached with careful judgement, informed by the weight of all available evidence.

In particular, the parties were of the view that the different-sized catchment areas, reflecting different customer journeys and shopping missions/types of store visits, should already indicate that the Transaction involves very different players, a fact reinforced by the share data at national level: a combination of a high street player with an [10-20]% share and a supermarket/edge of town player with only a further [0-5]%, ought to provide a good indication that, all else equal, one would not expect there to be many local overlaps that should raise initial concerns based on filtering criteria.

With this in mind, a simple technical *geographic* or *catchment* overlap analysis, yielding 763 overlaps for the Transaction, cannot be said to account for or engage with the evidence supporting the parties' contentions on a lack of close competition or any scope for unilateral effects. Rather, the parties continue to believe that there is a very limited prospect that a substantial proportion of Lloyds' customers in the 546 apparent “overlap” stores would consider a Sainsbury's supermarket – with its in-house pharmacy, often

located some distance away – as a close substitute retail pharmacy (and still fewer as the closest substitute).⁴⁸

For this reason, the parties supported a comprehensive approach to the Phase II survey of local areas, in the firm belief that it would evidence their lack of closeness of competition, even in those local areas perceived to be of most relative interest to the CMA.

4 Desktop concentration-based filters vs. economic effects analysis

Despite the fact that the picture of the Transaction painted by concentration screens was a radically different picture than that implied by either the national share data or all the evidence on the differentiation between the parties, very considerable efforts were made on the part of the parties to address the long-list of 763 technical overlaps and convert it into a shortlist of potential local areas that generated possible concerns, based on the Phase I “may be the case” threshold, with reference to one or both of (1) traditional fascia count analysis employed in all prior Enterprise Act pharmacy merger decisions⁴⁹ and/or (2) GP prescription data (newly-available for England but not in the time available in Phase I for Scotland, Wales or Northern Ireland).

Despite best efforts, this proved wholly unworkable, in part because these filters were not designed to engage with available evidence on the combination of the regulatory context and lack of close competition (set out in detail in Part H, below). As such, the parties do not intend to revisit the technicalities of all the relevant Phase I methodological issues in this initial submission. It stands to reason that concentration measures as initial proxies for competitive effects are the primary terrain of Phase I, given the limitations of time and resources.

For the purposes of Phase II, however, the parties submit that the evidence in the round unequivocally shows that the Transaction does not combine close competitors, in a retail pharmacy market with numerous vibrant competitors, and where the scope for adverse merger effects of material degree are – as recognised in past decisions – already limited. The parties’ view does not change in respect of any particular local area or subset of local areas based on simply on a desktop characterisation that a given local area may have a low fascia count and/or a high Lloyds’ share of supply at a particular sub-set of local GP surgeries.

Instead, the parties believe that the CMA is correct to focus on survey evidence and the development of other economic evidence that will assist, in a way the desktop filters have

⁴⁸ Conversely, in the case of the wide 10-15 minute drive-time catchments of the larger Sainsbury’s supermarkets that feature a pharmacy, and the additional 217 store overlaps generated by these catchments, the fact that there is at least one Lloyds store within such a wide catchment would at first glance suggest that no more than a small fraction of Sainsbury’s catchment area customers (i.e., those most geographically proximate to the Lloyds store) would consider the Lloyds store to be convenient to them. This view is supported by the fact that the Sainsbury’s 80% customer catchment area has on average roughly a [REDACTED]-mile radius (at least for those relatively higher concentration areas where data have been collected for Phase I – the average across Sainsbury’s total pharmacy portfolio may well be higher). This implies that the area needed to capture 80% of Sainsbury’s customers is around [REDACTED] square miles (compared with closer to [REDACTED] square miles for a Lloyds store that draws 80% of its customers from within typically around a [REDACTED]-mile radius). Even before taking account of the fact that a typical Sainsbury’s pharmacy issues substantially fewer prescriptions than a Lloyds pharmacy, this suggests that the typical competitive impact of a Sainsbury’s pharmacy is spread out over a relatively wide area, and therefore will tend to be relatively weak over the more concentrated footprint of any given Lloyds pharmacy in its catchment (particularly where that Lloyds pharmacy is not located very close to the Sainsbury’s).

⁴⁹ See for example OFT cases of *Boots/Alliance UniChem* (decision of 2 February 2006) and *Celesio AG v OFT* [2006] CAT 9 (judgment of 9 May 2006); *Lloyds/IPCC* (decision of 8 June 2007); *CGL/United Co-op* (decision of 23 July 2007); *CGL/Lothian Borders and Angus Co-op* (decision of 6 March 2009).

not, in assessing whether there is the prospect of local-level merger effects in any given overlap area.

PART H. COMPETITIVE EFFECTS: RETAIL SECTOR

1 Overview

In summary, the parties submit that:

- National level market share and concentration data strongly suggest no risk of competition concerns at this level (combined share of [10-20]%, increment [0-5]%).
- Local concentration data, while giving a very varied picture of concentration depending on the metric used, are not a good guide for the prospect of likely adverse merger effects at local level.
- Certain key adverse effects normally at issue in retail merger cases are not capable of resulting from the Transaction in any local market, regardless of local concentration. For instance, there is no risk of higher prescription prices or higher prices for pharmacy services, nor is there any risk of reduced service levels below the regulatory minimum standards.
- For residual variables which competition might in principle affect, the parties are not close competitors, and there is no realistic prospect that these factors would be varied to customers' detriment as a result of the Transaction. This includes pricing of P-meds (and pricing of GSL products, which is outside the Transaction scope).
- On the critical non-price variable of convenience (store location), there is no basis to conclude that the Transaction will change the existing market dynamic, due to the high degree of differentiation in the parties' store location preferences (Lloyds' stores are situated on high streets or within/adjacent to GP surgeries, whilst Sainsbury's pharmacies are located within large supermarkets, the location of which is driven by the interests of the wider groceries business).
- On other non-price variables capable of being affected by competition between pharmacy rivals, the parties are not close competitors, and there is no reason to think that the presence of the other party locally is driving an enhanced service or quality offer that the Transaction would adversely affect.
- In the absence of any plausible ability or incentive of Lloyds to worsen price or non-price variables to the detriment of customers, it cannot be appropriate for the CMA to form any provisional expectation of an SLC as a result of the Transaction.

2 Limited scope for merger effects in the retail pharmacy sector

In the parties' view, the scope for merger effects of any type in this case is limited given the regulatory framework that applies to the UK pharmacy industry, as set out further below. In particular, there is no scope for price effects for prescription products or commissioned services which together represent around [X]% of sales for Lloyds (and [X]% of sales in Sainsbury's).

Figure 1 and Figure 2 below chart how the parties' medicines and services revenues at pharmacy locations are split between key categories. [X]

Figure 1: Lloyds' pharmacy medicines and services revenue 2015⁵⁰

⁵⁰ [X]

[REDACTED]

Figure 2: Sainsbury's pharmacy medicines and services revenue January – October 2015⁵¹

[REDACTED]

2.1 Prescriptions

A large majority of the parties' pharmacy revenue is price regulated, due to the fact that NHS reimbursement prices to pharmacies for prescription products are fixed by the NHS Drug Tariff (see Part C section 2.1 above). The key quality parameters for prescription products are also tightly regulated. In particular, the quality of prescription medicines is fixed, and both parties are required to supply the same specific medicines to fulfil prescriptions. It is not possible for a pharmacist, for example, to substitute a prescription for a branded product with the equivalent generic product – he or she is legally required to dispense the product that is mentioned on the prescription.

Pharmacists are also under an obligation to stock a full range of prescription products, to fulfil prescriptions with “reasonable promptness” and to operate minimum levels of staffing. As noted above, pharmacy openings, relocations and opening hours require regulatory approval.

There is therefore very limited scope for adverse merger effects in relation to prescription products.

2.2 P-meds

Price

Retailers are in principle free to determine retail prices for P-meds, but in practice there is also limited scope for price competition on P-meds as a result of ethical standards and ASA regulations. In particular, MHRA guidance provides guidance on advertising and promotions (specifically, it explains the provisions and requirements laid down in the legislation on advertising medicines, and provides additional clarification, where necessary, on the interpretation of the law and its application to certain commonly found situations), and the Proprietary Association of Great Britain monitors all advertising of medicines.

Prices for P-meds are not widely published, and are excluded from price comparison publications. This lack of transparency limits the extent to which pharmacy operators can effectively flex their p-med pricing in response to the activities of their rivals. In practice, [REDACTED].

Moreover, both parties set their prices for P-meds [REDACTED]. The Transaction will not provide any new ability or incentive for Lloyds to change its [REDACTED] approach to P-med pricing, [REDACTED].

The pricing of many P-med products is also constrained by GSL products (as the same product may be available as both a P-med and a GSL in different pack sizes, or similar products may be available as both P-med and GSL to treat the same symptoms. As noted above, P-meds may also in time be reclassified as GSLs). As set out in Part C section 2.4 above, Sainsbury's will continue to sell GSL medicines independently from, and in competition with, Lloyds. P-meds typically sell at far lower volumes than their GSL equivalents, and tend to be promoted much less frequently than GSL medicines.

⁵¹ [REDACTED]

Range

Equally, ranging decisions are determined [REDACTED].

[REDACTED].

2.3 Pharmacy services

Again, the scope for merger effects is limited as reimbursement prices for services are generally fixed either nationally by the NHS (e.g. for the MUR and NMS) or locally by CCGs (e.g. for smoking cessation services). There are also, typically, service level agreements in place for the provision of pharmacy services which set out key standards with which providers must comply.

2.4 Residual variables

Taking the above factors into account, the residual variables over which competition may therefore take place are, in the parties' view⁵² broadly as follows:

- the location of the pharmacy;
- pharmacy format/environment including consultation space;
- opening times;
- the provision of services, including health services and other services such as prescription collection and home delivery services; and
- provision of staff over and above the regulatory minimum (and the quality and experience of those staff).

As demonstrated in the following section 3, the parties are not close competitors on any of these variables.

3 The parties are not close retail pharmacy competitors

It is evident from an assessment of each feature of the parties' customer proposition, summarised in the table below and supported by internal documents and customer research commissioned by each of them, that the parties are not close competitors.

⁵² This view is also consistent with the view of the OFT in *CGL/Lothian*.

PROPOSITION	SAINSBURY'S	LLOYDS
Location/format	Within/adjacent to supermarket Counter + consultation room	High street/community/health centre Range of formats
Access	More customers access by car Car parking at all stores (usually free of charge) Wider catchment area Minimal home delivery ⁵³	More customers access on foot or by public transport Limited parking available Narrower catchment area Home delivery
Opening hours (regulated)	Longer, but driven by supermarket hours (not in response to other pharmacies or GPs)	Not open as long, driven by local GP hours (no competition for "after-hours")
Customer demographic	Generally representative of population (consistent with profile of grocery shoppers)	Older demographic/lower socio-economic profile. Higher proportion of repeat prescriptions/free prescriptions.
Customer acquisition strategy	[REDACTED]	[REDACTED]
Prescription collection (GP)	Yes	Yes/more broadly
Enhanced facilities/services	[REDACTED]	[REDACTED]
Staff	[REDACTED]	[REDACTED]

3.1 Location and format

The parties operate out of differentiated locations and formats.

Lloyds pharmacies aim to be accessibly located within the community and a large proportion of Lloyds' stores are located either within or very close to GP practices. The Lloyds estate is split into three formats:

- *Health and Medical (approximately [REDACTED] stores): [REDACTED].*
- *Health and Community (approximately [REDACTED] stores): [REDACTED].*
- *Health and Skin Extra (approximately [REDACTED] stores): [REDACTED].*

In terms of format and location, therefore, Lloyds pharmacies are most similar to independent pharmacies, smaller multiples and smaller Boots units. As noted in Part B above, Lloyds benefits from some flexibility in location in that it may be able to acquire existing licences and locate itself in situ, and/or it may be able to relocate premises with relative ease ([REDACTED]), and without losing significant customer flow as premises are typically similar.

By contrast, Sainsbury's pharmacies are located within or adjacent to large Sainsbury's supermarkets, which are typically located outside town centres. Unlike a typical community pharmacy, supermarket pharmacies are not typically located with GPs in mind (although if in-store space permits, the store may explore the possibility of making space available to a GP to conduct consultations). Rather, the location of the supermarket itself is driven by the interests of the wider groceries business. Moreover, patients who access supermarket pharmacies tend to do so during their grocery shop (with the choice of store being driven by lifestyle factors such as where they work, where they live, or en route between the two).

⁵³ [REDACTED].

In order to grow its pharmacy business, Sainsbury's typically must acquire a licence from an existing operator (unless it is able to satisfy the local PNA) and seek consent to relocate the licence into one of its supermarket stores. [REDACTED].

Sainsbury's pharmacies typically consist of a counter and one consultation room, which is a similar format to those of other supermarkets, including Tesco, Asda and Morrisons and, to some extent, large out-of-town Boots stores which Lloyds identifies as "health supermarkets".

3.2 Access

While some Lloyds pharmacies are within GP practices and therefore have access to any car-parking facilities which may be available for customers at GP surgeries, many of its stores are also located in town centres and on high streets and do not provide their own parking facilities. Customers to these stores will often come on foot or by public transport. Lloyds also offers home delivery services throughout its network of pharmacies, which can be utilised by customers with access difficulties.

By contrast, all Sainsbury's stores with a pharmacy offer customer parking (which is generally free of charge). At the vast majority of its pharmacies, Sainsbury's does not offer a home delivery service ([REDACTED]).[REDACTED].

3.3 Catchment areas

The customer catchment area of a typical Sainsbury's pharmacy is much wider than that for a Lloyds pharmacy. Evidence presented during Phase I⁵⁴ demonstrated that the customer catchment area for a Lloyds pharmacy (based on the postcodes of patients for whom prescriptions are dispensed) is typically approximately [REDACTED] around the pharmacy, whereas catchment areas for Sainsbury's pharmacies are consistently and significantly wider, averaging between [REDACTED] (or between [REDACTED] and [REDACTED] minutes' drive-time). This corresponds to the general catchment area for supermarket stores based in urban or rural areas.

Although Sainsbury's draws its customers from a wider area, the degree to which a Sainsbury's pharmacy is likely to constrain other pharmacies (within the limited parameters described above) will tend to be weaker at longer distances. As the Phase I evidence shows, Sainsbury's pharmacies typically attract at least half of their demand from within a [REDACTED] radius.

3.4 Opening hours

Lloyds' opening hours will [REDACTED] to which they are closest. The vast majority of Lloyds pharmacies are closed in the evenings (i.e. they are closed after 6:30pm) and on Sunday; and about half of Lloyds pharmacies are either closed, or open for just half a day, on Saturday.

By contrast Sainsbury's pharmacy opening hours will [REDACTED] and are open for an average of around 90 hours each week, opening early in the morning and closing late in the evening, seven days a week (albeit with shorter opening hours on a Sunday – as for the supermarket store). Sainsbury's will often, therefore, dispense prescriptions at a time when many other local pharmacies are closed, and may dispense prescriptions from prescribers

⁵⁴ See Appendix 15(6) to the Merger Notice.

other than routine GPs (e.g. local accident and emergency departments or out-of-hours services).

[REDACTED].

3.5 Customer demographics

Lloyds' customers are [REDACTED]. By contrast, Sainsbury's typically captures a customer demographic that is more representative of the population as a whole (and who are visiting the pharmacy at the same time as shopping for groceries).

While Sainsbury's is unable to provide an accurate split between acute and repeat prescriptions (given that many medicines may be used to treat a range of conditions), Lloyds estimates that, [REDACTED],⁵⁵ whereas Sainsbury's estimates that it serves [REDACTED]. This is consistent with the fact that [REDACTED] of prescriptions dispensed by Sainsbury's are paid for by customers (c. [REDACTED]%, compared to c. [REDACTED]% for Lloyds) with the remainder benefitting from an NHS exemption.

3.6 Customer acquisition strategies

[REDACTED].

3.7 Collection and delivery services

Lloyds provides a repeat prescription service both online and in store, by which it sets up automatic ordering of repeat prescriptions at the customer's request, collects the prescription from the GP and then dispenses the prescription for collection by or delivery to the customer as and when required.

Lloyds also offers a click-and-collect service in all of its locations, whereby customers can order certain products online, and can collect in their nominated store when they are notified that the item is ready for collection.

All in-store items are also available on the Lloyds website to order for delivery. Additionally the Lloyds website provides an "Online Doctor" service, which allows customers to obtain prescriptions for next-day delivery or same-day collection.

Sainsbury's does not offer a formally structured collection or delivery service, but [REDACTED] of its pharmacies offer to collect prescriptions from local GP surgeries using existing pharmacy staff. [REDACTED].

[REDACTED].

3.8 Health services

Lloyds aims to be more than a dispenser of medicines, and provides additional services aimed at prevention, management and treatment. Lloyds looks proactively to work closely with local healthcare providers to develop and deliver commissioned services to address specific health needs within communities. In addition to essential services, Lloyds has historically provided a wide range of advanced and enhanced services (as described in Part C section 3.7 above) as part of its community pharmacy business model of offering a

⁵⁵ Research in this area confirms that the percentage of patients receiving at least one repeat prescription increases with age from 20% in 0-9 year olds to over 75% for the over 60s. See: <http://bmchealthservres.biomedcentral.com/articles/10.1186/1472-6963-14-76>.

wide range of healthcare services to its customers. Lloyds' approach is to look after the whole patient's healthcare needs as a "one stop shop".

Lloyds will tender for what it considers to be core pharmacy services, including:

- medicines management (MUR and NMS);
- NHS health checks;
- minor ailments;
- smoking cessation;
- sexual health;
- drug and alcohol misuse; and
- needles exchange.

Lloyds provides the necessary training to colleagues in order to deliver these services to the required or a higher standard and quality, and Lloyds pharmacies promote services to their local population in order to ensure an appropriate uptake and support the health promotion, disease prevention and disease management strategies of the commissioners.

Sainsbury's approach to health and pharmacy services [REDACTED]. It offers advanced services (i.e. the MUR and NMS) across its pharmacy network. [REDACTED] Similarly Sainsbury's offers some private services (such as Wellness checks, Healthy Living Plans, flu vaccination services (non NHS) and Stop Smoking services) [REDACTED].

[REDACTED].

3.9 Staff

Lloyds employs around 17,000 staff, [REDACTED] of whom are pharmacists. Lloyds currently has [REDACTED] locums on its books (although note that this does not equate to the number of locums in use at any one point), and thus its ratio of pharmacists to locums is [REDACTED].

[REDACTED] Sainsbury's currently employs [REDACTED] pharmacy managers and used [REDACTED] locums during 2015. [REDACTED].

3.10 Customer perceptions/market research

[REDACTED].

3.10.1 Management presentation

The management presentation prepared by Sainsbury's summarised the various research commissioned as follows, [REDACTED].

3.10.2 Celesio/Lloyds brand awareness research

[REDACTED].

3.10.3 Celesio/Lloyds acquisition appraisal

[REDACTED].

3.11 Identification of key competitors

[REDACTED].

3.11.1 Boots

As the largest national pharmacy chain, Boots is a key competitor to Lloyds. Boots is held in high regard generally due to the Advantage card⁵⁶ and its increasing beauty credentials, and [REDACTED].

3.11.2 Independent pharmacies

Lloyds sees independent pharmacies as key competitors to its service-focused offering. [REDACTED]. See Part D section 2 above for further information on independents as key competitors.

3.12 Reaction to proposed entry

Available evidence provides no indication that either party reacts to the proposed entry of the other to any greater extent than another competitor. For example:

- [REDACTED].
- [REDACTED].
- [REDACTED].
- [REDACTED].

3.13 Phase 1 entry/exit analysis

The CMA's own econometric analysis performed during Phase I was also consistent with the evidence presented above, as it suggested that [REDACTED].

⁵⁶ While loyalty cards cannot be used when purchasing prescription items, they are able to be used when purchasing P-meds.

PART I. OPD SERVICES

1 Background

The provision, in essence, of a pharmacy in a hospital is referred to as the supply of outpatient dispensing (“OPD”) services to hospitals. Within the UK, such outsourcing is limited at present to England.⁵⁷

OPD contracts are typically publicly tendered, usually under the terms of the public procurement rules.⁵⁸ These procurement rules are designed to open up markets to competition, and include requirements in relation to non-discrimination, transparency and the minimum number of bidders (generally either three or five). Most OPD contracts restrict the ability of the in-hospital pharmacy to dispense prescriptions other than those for ethical medicines to patients of that hospital, and consequently, in-hospital pharmacies typically cannot compete with community retail pharmacies.

A small number of OPD pharmacies may also, in addition to their OPD contract, have obtained a community pharmacy contract for the same site allowing them to fulfil other NHS prescriptions – but this will be rare.⁵⁹

2 Lloyds

Lloyds has an established presence in the OPD pharmacy sector: it holds [REDACTED] contracts with various NHS Trusts, pursuant to which it provides OPD services to [REDACTED] hospitals. Its largest competitor, by number of OPD contracts won, is Boots with [REDACTED] contracts.

[REDACTED].

3 Sainsbury’s

Sainsbury’s has been a limited player in terms of bidding for OPD contracts. [REDACTED].

Sainsbury’s has not been a close competitor to Lloyds, and would not become one absent the Transaction.

4 Product scope

The parties submit that it is not necessary to debate whether the OPD sector is or is not a separate market for CMA purposes, because nothing turns on the issue in this case. Even on the narrowest possible frame of reference (the supply of OPD services to hospitals in England), the competitive effects analysis indicates, as set out below, that no concerns arise.

5 Geographic scope

The parties submit, consistent with the view taken by the CMA in Phase I, that the relevant geographic frame of reference for OPD services is national. Third party evidence at Phase

⁵⁷ Why are OPD services outsourced? Because NHS Trusts are not classed as commercial organisations, they can not claim the VAT back on drug purchases. However, by outsourcing OPD operations, the external service provider can do so, and then pass on the savings to the NHS Trust. These OPD service providers will charge the NHS Trust a fee for providing the service, which will cover the elements of running costs and profit.

⁵⁸ Notably, *The Public Contracts Regulations 2015*.

⁵⁹ For example, Sainsbury’s pharmacies at the Guy’s and St Thomas’ hospital sites have community pharmacy licences (100 hour licences).

I indicated that competitors are generally able to compete for OPD contracts throughout England.

6 Competitive assessment

6.1 The supply of OPD services is based on competitive public tenders

The CMA concluded in its Phase I decision that the supply of OPD services to hospitals in England is based on *publicly tendered* OPD contracts of *fixed duration* (for instance, a standard OPD contract held by Lloyds will run for an average period of [REDACTED] years, before coming up for re-tender).⁶⁰

Only a relatively small number of participants are required to create sufficient competitive tension, because NHS trusts and hospitals award OPD contracts based on competitive tender processes that will typically involve multiple bidders (public procurement rules generally require at least three or five).

There are no material advantages of incumbency (i.e., holding an OPD contract with an individual hospital) or a relatively high share of supply (i.e., holding a relatively high proportion of all OPD contracts with hospitals in England), because hospitals will regularly put their OPD contracts back out to competitive public tender, which allows other firms the opportunity to displace incumbent providers.

6.2 Sainsbury's is not an important rival to Lloyds, having won [REDACTED] tenders in the last three years

Within this competitive context, Sainsbury's is in any event not an important competitor to Lloyds in bidding for OPD contracts absent the Transaction. In particular, [REDACTED]. There are two key reasons for Sainsbury's limited role in this respect.

[REDACTED].

6.3 Boots and an array of other candidate rival bidders will constrain Lloyds for future OPD contracts

All existing pharmacy operators (including retail pharmacy operators) are capable of tendering for, and have the ability to supply, OPD services to hospitals. Accordingly, there are many existing (and potential) competitors for the supply of OPD services in England who will continue to constrain Lloyds in the post-Transaction period.

Most notably, while Sainsbury's has won [REDACTED] OPD tenders in 2013, 2014 and 2015, and has [REDACTED]:

- *Boots* holds [REDACTED] OPD contracts with various NHS trusts, and based on the parties' data on successful OPD bids from 2007-2015, has won more tenders than any other firm during this period, and won the most contracts of any player ([REDACTED] out of [REDACTED]) in the last three years ([REDACTED]). *Boots*, with its unique brand mix of traditional high street pharmacy and convenience retail offering, can compete strongly in tenders where large footprint units are proposed by the NHS Trust, and brings additional benefits in respect to financial performance and NHS trust employee satisfaction. In particular, *Boots* has been expanding rapidly in recent years, and has won:

⁶⁰ Subject to the exercise of any options to extend or other special circumstances.

- [REDACTED] OPD contracts by way of competitive tenders in [REDACTED]; and
- [REDACTED] OPD contracts by way of competitive tenders in [REDACTED].

Boots is owned by Walgreens Boots Alliance, which also owns and operates the “Alcura Homecare” business in the UK. Alcura Homecare provides clinical homecare services to NHS trusts, enabling them to reduce demand on outpatient dispensaries by dispensing and delivering medicines direct to the patients’ homes. Alcura Homecare have around [REDACTED]% of the clinical homecare segment by value.

- There are a number of other established competitors for the supply of OPD services to hospitals in England. While they (individually) do not hold [REDACTED], the same can be said of Sainsbury’s. These bidders cannot be ranked behind Sainsbury’s based on past performance (wins), and nor is there any reason to doubt that they are well-placed to be credible bidders going forward. Moreover, [REDACTED], some of these firms have a well-developed capability to provide homecare services, which have strong potential to be integrated with OPD services. They include:
 - *Well* – holds [REDACTED] OPD contracts, and has won competitive tenders to secure these in [REDACTED].
 - *Pharmaxo* – A retail pharmacy operator, Pharmaxo currently provides OPD services to [REDACTED], and also homecare delivery services for the [REDACTED]. Pharmaxo holds [REDACTED] OPD contracts in total, and has won competitive tenders to secure these in [REDACTED]
 - *Rowlands* – holds [REDACTED] OPD contracts in total, having won competitive tenders to secure these in [REDACTED].
 - *Healthcare at Home (“HaH”)* – holds [REDACTED], which it won by way of competitive tender in [REDACTED]. HaH is the largest provider of clinical homecare services in the UK, with approximately [REDACTED]% of this segment by value. HaH also operates advanced “virtual ward” models, which allow NHS trusts to build capacity to treat patients in their own homes.

In addition, there is no good reason to limit the pool of potential bidders for any given NHS trust contract to a player that has already won a contract in another part of England, so the Transaction does not materially reduce the long list of credible candidate bidders for contracts.⁶¹

Further, NHS Trust subsidiaries (“**NHS Subs**”) will also continue to compete for OPD contracts, winning two contracts in the last three years. NHS Subs are subsidiaries which are specifically set up by an NHS Trust for the provision of OPD services to a hospital on the same basis as a private provider.⁶² NHS Subs effectively “set the competitive floor” in the supply of OPD services – if private providers such as Boots and Lloyds cannot supply these services at a lower cost and higher quality than an NHS Sub, they will not be awarded a contract by an NHS Trust: it will be awarded to the NHS Sub instead. In effect,

⁶¹ It should be noted that procurement synergies are irrelevant in bids for OPD contracts. The hospital or NHS trust concerned will negotiate the purchase price with the manufacturer for the majority of medicines required by the OPD pharmacy, and so all OPD providers receive the product at the same price. OPD pharmacies operators are typically remunerated by way of a dispensing fee and, in that regard, any interested pharmacy operator has an equal chance of successfully bidding for an OPD contract, regardless of their scale.

⁶² This structure delivers a cash flow/tax benefit to NHS trusts.

the use of NHS Subs allows NHS trusts to sponsor new entry in relation to the supply of OPD services to certain hospitals.

The above suggests that the loss of just one conceivable bidder for OPD contracts, Sainsbury's – [X] – cannot possibly be regarded as a material reduction in competition.

This conclusion is underlined by the ongoing presence of Lloyds' far and away most important competitor based on winning past track record and national retail share, Boots, but also in light of the extensive competitor set of actual and potential credible bidders, comfortably in excess of the number required to achieve a competitive outcome for any given NHS trust that may consider outsourcing its OPD services.

7 Conclusion

Accordingly, the Transaction does not give rise to a real risk, let alone an expectation, of substantial lessening of competition in relation to outsourced OPD services in England or any less narrowly-defined market.

PART J. VERTICAL EFFECTS

1 Sainsbury's wholesale supply arrangements

[X].

2 The wholesale market for pharmaceuticals

The wholesale market for pharmaceuticals is characterised by strong competition:

- between large nationally-active “broad-line” wholesalers that form part of vertically-integrated groups, notably:

Walgreens Boots Alliance – Alliance Healthcare (wholesaling) and *Boots* (retail);

Celesio – AAH (wholesaling) and *Lloyds* (retail);

Phoenix – Phoenix Healthcare Distribution (wholesaling) and *Rowlands* (retail); and

- from other regional and smaller and “short-line” wholesalers; and
- direct from pharmaceutical manufacturers via the introduction of “direct to pharmacy” schemes and reduced wholesaling models that bypass or substantially bypass the traditional wholesaling model; and/or
- more generally, there is an increased competitive role for manufacturers through “reduced wholesale agreements” (including solus agreements), which limit the distribution of products to a restricted list of wholesalers (such that “full-line” wholesalers are no longer “full-line”, in the same comprehensive sense as was traditionally the case, but are instead “broad-line”).

As a result, all pharmacies, including the retail chains of the parties, must out of necessity contract with a number of different wholesalers and manufacturers in order to ensure access to all relevant medicines. This relationship of mutual dependency disincentives attempts to refuse or degrade supply between wholesalers and the retail arms of competing wholesaling groups, and partly explains non-discrimination and other protective clauses in contractual arrangements (the other factor contributing to such protective clauses is the incentive faced by leading pharmaceutical manufacturers to maximise access to their product at the downstream retail level, which is discussed in further detail below).

At the same time, in respect of all products (save for those covered by an exclusivity arrangement), customers are readily able and willing to switch wholesaler suppliers – and, due to current arrangements, will already necessarily have commercial agreements with all the major wholesalers – reinforcing the ease of switching and the degree of competitive pressure at the wholesale level for these products.

3 No vertical foreclosure effects at national or local level

3.1 No ability or incentive to foreclose customers

[X] However, the Sainsbury's pharmacy business accounts for only [0-5]% of the downstream retail pharmacy market. Its acquisition by Lloyds cannot be said to pose any risk of customer foreclosure for other wholesalers such as Alliance (Walgreens Boots Alliance) or Phoenix, whose competitiveness (e.g., economies of scale and scope) cannot

remotely depend on supplying this small fraction of the downstream market. This is particularly the case given that, [X]. Accordingly, it is fanciful to suggest a risk of material customer foreclosure – Lloyds' ability and incentive to foreclose access to other customers in the wider retail pharmacy market will remain essentially unchanged.

3.2 No ability or incentive to foreclose inputs

It is equally fanciful that AAH would, as a result of the [0-5]% retail share increment caused by the Transaction, suddenly acquire both the ability and incentive to refuse or worsen supply to Lloyds' retail competitors.

For the reasons set out in section 2 above, AAH currently supplies its own (i.e., Lloyds') retail rivals on competitive terms, not least because rival retail pharmacies collectively account for most ([X]%) of the downstream market, and benefit from multiple-sourcing, ease of switching, and a competitive upstream wholesale market. This competitive dynamic – and the lack of any ability on Lloyds' behalf to foreclose access to inputs – is compounded by the role played by the powerful leading pharmaceutical manufacturers. These manufacturers are incentivised (by their desire to maximise sales volumes of their products at the retail level) to insist that wholesalers such as AAH do not discriminate against rivals (e.g., other pharmacy retailers) in the downstream retail market by limiting the supply of their products, and have the ability (due to their position as the sole suppliers of many unique, proprietary pharmaceutical products) to enforce this state of affairs when negotiating supply arrangements with wholesalers. Branded manufacturers supply UK wholesalers only on contractual conditions that they offer uniform national service (i.e., they prevent any discrimination risk against retail operations of rival wholesale groups).

The modest addition of a [0-5]% retail share to Lloyds' [10-20]% share can have no material impact on these competitive conditions.

PART K. GLOSSARY

TERM	MEANING
2013 Regulations	The National Health Service (Pharmaceutical and Local Pharmaceutical Services) Regulations 2013, which contain the provisions for pharmaceutical lists, pharmaceutical needs assessments, market entry, performance-related sanctions and the terms of service for pharmacy contractors.
AAH	AAH Pharmaceuticals Ltd, Celesio's pharmaceutical wholesaling business.
ASA	The Advertising Standards Authority.
BSA	The business sale agreement entered into between Lloyds and Sainsbury's on 29 July 2015 pursuant to which Sainsbury's has agreed to sell, and Lloyds has agreed to acquire, certain assets and liabilities of the target business.
CCGs	Clinical Commissioning Groups, which commission most of the hospital and community NHS services in the local areas for which they are responsible. This involves deciding what services are needed, and ensuring that they are provided. CCGs are overseen by NHS England, which retains responsibility for commissioning primary care services such as GP and dental services, as well as some specialised hospital services. All GP practices now belong to a CCG, and CCGs also include other health professionals, such as nurses.
Celesio	Celesio AG, an international pharmaceutical wholesaler and retailer which also provides logistics and services to the pharmaceutical and healthcare sectors.
CMA	The Competition and Markets Authority, an independent non-ministerial department that works to promote competition for the benefit of consumers, both within and outside the UK. Amongst other things, it is responsible for investigating mergers which could restrict competition. From 1 April 2014, the CMA took over many of the functions of the Competition Commission (CC) and the Office of Fair Trading (OFT).
Cooperation Agreement	A cooperation agreement entered into between Sainsbury's and Lloyds on 29 July 2015, which will govern the on-going relationship between the parties after the transaction has been implemented.
Community Pharmacy Contractual Framework	The Community Pharmacy Contractual Framework makes clear the nature of services to be provided by a pharmacy. All pharmacies must provide essential services, and additional services may be provided upon accreditation of pharmacy, or if services are commissioned at a local or national level.
CPAF	The Community Pharmacy Assurance Framework was developed by NHS Primary Care Commissioning as a toolkit to assist Primary Care Trusts in assessing compliance and quality under the Community Pharmacy Contractual Framework.

TERM	MEANING
EBITDA	A company's "earnings before interest, tax, depreciation and amortisation", which is an accounting measure used as a proxy for a company's current operating profitability.
Enterprise Act	The Enterprise Act 2002.
EPS	The Electronic Prescription Service enables prescriptions to be sent electronically from a GP's practice to the pharmacy of the patient's choice.
ethical or POMs	Prescription only medicines, which are pharmaceutical products only available to customers possessing a prescription from a GP or other prescribing healthcare professional.
GPs	General practitioners are doctors who deal with a range of health problems, and offer medical advice, run clinics, give vaccinations and carry out simple surgical operations. GPs often work in practices as part of a team.
GPhC	The General Pharmaceutical Council is the independent regulator for pharmacists, pharmacy technicians and pharmacy premises in Great Britain.
GSL	General Sales List products are medicines that can be sold with reasonable safety without the supervision of a pharmacist, and which are therefore stocked by a range of retailers, including supermarkets (e.g. in the health & beauty aisle), convenience stores, petrol stations and online.
HaH	Healthcare at Home.
Lloyds	Lloyds Pharmacy Limited.
McKesson	McKesson Corporation.
Merger Notice	The merger notice submitted (in final form) to the CMA under section 96 of the Enterprise Act 2002 on 25 September 2015.
MHRA	The Medicines and Healthcare products Regulatory Agency is an executive agency sponsored by the Department of Health that regulates medicines, medical devices and blood components for transfusion.
MUR	Medicines Use Review is a free NHS service offered by pharmacies in the UK. The review involves an appointment with a patient's local pharmacist where they discuss and learn how their medicines should be used.
NHS	The National Health Service is the collective name for the publicly funded healthcare system for the United Kingdom with different divisions in England, Northern Ireland, Scotland and Wales.

TERM	MEANING
NHS Business Services Authority	The NHS Business Services Authority provides a range of critical central services to NHS organisations, NHS contractors, patients and the public. This includes the provision of strategic procurement expertise, distributing the NHS Drug Tariff and paying pharmacists in England for prescriptions dispensed in primary care settings.
NHSCB	The National Health Service Commissioning Board was established as part of a comprehensive commissioning system for healthcare services; its role includes supporting, developing and holding to account an effective and comprehensive system of local clinical commissioning groups.
NHS Subs	NHS Trust subsidiaries are subsidiaries which are specifically set up by an NHS trust for the provision of OPD services to a hospital on the same basis as a private provider.
NMS	The New Medicine Service is the fourth Advanced Service to be added to the NHS community pharmacy contract, and provides support for people with long-term conditions newly prescribed a medicine to help improve medicines adherence.
OFT	The Office of Fair Trading was responsible for protecting consumer interests throughout the UK, and its responsibilities included scrutinising mergers. It closed on 1 April 2014, with its responsibilities passing to a number of different organisations.
OPD	Outpatient dispensing, which is the dispensing of medicines to outgoing patients from a hospital.
OTC	Over-the-counter medicines, which can (in some contexts) include both p-meds and GSLs.
PAGB	The Proprietary Association of Great Britain is the UK trade association representing manufacturers of branded over-the-counter medicines and food supplements, which aims to secure self-regulation and support its members by checking their advertising and encouraging product innovation.
parties	Celesio and Sainsbury's.
P-meds	Pharmacy-only medicines are medicines available without a prescription, but which can only be supplied to a customer by, or under the supervision of, a pharmacist.
PNA	The Pharmaceutical Needs Assessment is a commissioning tool under the 2013 Regulations for identifying what is required at local level to support the commissioning intentions for community pharmaceutical services.
[✂]	[✂]

TERM	MEANING
PSNC	Pharmaceutical Services Negotiating Committee promotes and supports the interests of all NHS community pharmacies in England and is recognised by the Secretary of State for Health as the body that represents NHS pharmacy contractors. It works closely with Local Pharmaceutical Committees to support their role as the local NHS representative organisations.
Sainsbury's	Sainsbury's Supermarkets Limited.
SLC	Substantial lessening of competition; a term that is used in the CMA's Merger Assessment Guidelines, which explain that "... a merger that gives rise to an SLC will be expected to lead to an adverse effect for customers. Evidence on likely adverse effects will therefore play a key role in assessing mergers." (OFT1254/CC2 rev, para. 4.1.3)
Standards	The Standards for Registered Pharmacies, which set out the requirements for the provision of pharmacy services at or from a registered pharmacy and are determined by the GPhC. They are designed to create and maintain the right environment for the safe and effective practice of pharmacy and to improve the quality and safety of services provided to patients and the public.
Superintendent	Section 71 of the Medicines Act 1968 provides that pharmacies which are part of a body corporate, and which keep, prepare and dispense medicinal products other than GSL products, are required to be under the management of a superintendent whose role, among other things, is to ensure that the Standards are met.
target business	Sainsbury's pharmacy business, comprising 277 in-store pharmacies at larger Sainsbury's supermarkets and four OPD pharmacies.
Terms of Service	The terms of service for NHS pharmacists, contained in Schedule 4 of the 2013 Regulations.
Transaction	The sale by Sainsbury's to Lloyds, pursuant to the BSA, of the target business for a purchase price of £125 million.
Universal service obligation	Manufacturers' requirement that wholesalers provide a twice daily delivery service to all pharmacies nationwide.