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CELESIO AG / SAINSBURY'S PHARMACY BUSINESS
Response to the CMA's Provisional Findings

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A. Introduction

This paper (the “**Response**”) constitutes the response of Celesio AG (“**Celesio**”) and Sainsbury’s Supermarkets Ltd (“**Sainsbury’s**”; together, “the **parties**”) to the CMA’s Provisional Findings (“**PFs**”). In particular, the parties wish to respond to the CMA’s provisional expectation under s 36 of the Enterprise Act 2002 (the “**Act**”) of a substantial lessening of competition (“**SLC**”) in 13 local overlap areas in the UK (the “**13 Provisional SLC Areas**”) resulting from Celesio’s acquisition of the Sainsbury’s pharmacy business (the “**Transaction**”).

The parties wish to make the following key points, which are addressed in more detail in the remainder of this submission:

The only adverse effect articulated is a reduction in Lloyds’ opening hours, and does not support an SLC finding

- The PFs specifically articulate concerns that the Transaction may adversely affect opening hours at Lloyds stores. The theory appears to be that certain Lloyds stores may reduce hours and pick up diverted business at the nearby Sainsbury’s, making this profitable for Lloyds.
- However, these concerns are:
 - based on no valid evidence at all that Lloyds stores stay open longer in local areas because of Sainsbury’s, either in general or – as should be the case – in any of the 13 Provisional SLC Areas;
 - based on the wrong (“store closure”, i.e., CMA survey) diversion ratio, rather than on the relevant (“opening hours”, i.e., CMA demand estimation) diversion ratio;
 - fail to take account that a reduction in hours generally requires local regulatory approval, and do not explain why that approval would likely be forthcoming; and
 - do not grapple with materiality of the alleged adverse effect – given that a modest reduction in hours would, by definition, occur where there would still be a Sainsbury’s pharmacy open close by – and do not explain how that would be a substantial effect (“S” in SLC) justifying divestiture.

More broadly, the evidence in this case points to no expectation of SLC

- Beyond opening hours aside, no other specific adverse effects are identified in the PFs. There seems to be a vague concern about “quality reductions”. This is not a sufficiently clear articulation of how customers will likely be harmed by the Transaction – particularly for a regulated market in a case where it is agreed that the parties are not close competitors – to underpin an SLC.
- The overwhelming weight of evidence in this case clearly confirms that the parties are *not* close competitors in the economic sense, and that Sainsbury’s in particular does *not* drive Lloyds tangibly to improve quality, so that the removal of their rivalry will not create incentives to worsen quality.
 - The **economic** evidence the CMA and parties have together compiled on the economic impact that one party has on the other (or not) – including: (i) the

CMA's entry/exit analysis; (ii) the CMA's demand estimation work; (iii) the CMA's margin/concentration study; (iv) the CMA's refurbishment analysis; (v) CRA's work on waiting times, refurbishments and locums; and (vi) CRA's testing of the CMA's analysis of opening hours – all suggests that Sainsbury's has no demonstrable impact on the local retail offer variables of Lloyds (or vice versa).

- The direct evidence from a large number of ordinary course **internal documents** submitted in this case shows no monitoring, benchmarking or “competitor matching” behaviour, and no evidence of economic impact. A small minority of this evidence (one historic Lloyds document from 2011, one licence application objection) has been read out of context and, in any event, does not support a rational positive belief, on the balance of probabilities, that the parties are close competitors, or that the loss of their rivalry, at local level, would harm Lloyds' customers. This evidence cannot, even when read in the most unfavourable possible light to the parties, trump the other documentary and economic evidence in this case.

Certain inferences from maps and surveys are reasonable in isolation, but these do not support an expectation of SLC

- Taken in isolation, it is appropriate to draw inferences from certain maps, and survey results, and geographic proximity of stores, to suggest that the parties *do* compete to a degree locally, and that if one store were to shut, many consumers would divert to the other.
- These inferences are not direct evidence of close pre-merger constraints on each other's behaviour: maps and surveys are not evidence in and of themselves that Lloyds is reacting to Sainsbury's pressure with a superior local retail offer (in the way that economic evidence of competitive impact, or internal documents, might otherwise demonstrate).
- Moreover, store closure (reducing opening hours to zero) is not a good proxy for customer substitution in light of changed opening hours, or other alleged noticeable worsening of quality sufficient to trigger customer switching away from a Lloyds store. Finally, the closure of a profitable Lloyds store(s) is unrealistic in any of the 13 Provisional SLC Areas.

Conclusion

Accordingly, the PFs do not appropriately apply the SLC test in s 36 of the Act, which requires the CMA to establish the likelihood of material adverse effects resulting from the Transaction in order to reach an SLC finding, and do not explain what adverse effects are likely to flow from the loss of rivalry between Lloyds and Sainsbury's in any local area (let alone provide sufficient evidence to establish the probability and materiality of such effects).

B. Executive Summary

The parties' concerns in summary

In summary, the parties remain strongly of the view that the Transaction cannot be expected to result in an SLC in any local area. In particular, the evidence cited in the PFs does not establish with sufficient likelihood that the pre-merger constraint each party places on the other drives a tangible consumer benefit in the retail offer of the other. Accordingly, the PFs do not meet the task of articulating and evidencing “close” pre-merger competition in the economic (rather than geographic) sense. Having failed to establish that Sainsbury’s in particular (as opposed to other supermarket or non-supermarket pharmacies) is “pressurising” any “fruits” of competition out of Lloyds, or vice versa, the PFs consequently fail to explain how (let alone establish the probability that) the loss of rivalry between Sainsbury’s and Lloyds would make customers materially worse off. And without establishing the likelihood that the Transaction will result in adverse effects on customers that are sufficiently material, the contemplated remedy of compulsory divestiture of private property appears to be based more on supposition than evidence. A supposition is short of an expectation (which is the standard required under s 36 of the Act), and the parties therefore respectfully urge the CMA to reconsider the position set out in the PFs.

The parties submit that they do “compete” to some extent, notwithstanding the generally limited scope for competition in the highly regulated pharmacy sector...

It is common ground, acknowledged in the PFs, that regulation precludes many dimensions of rivalry between pharmacies and circumscribes the theoretical scope for adverse effects from a retail pharmacy merger relative to normal retail markets. That said, the parties have always accepted that there is residual competition, and that they are to some extent “competitors” in the ordinary sense of the word, and that they “overlap” locally: there has never been a “straw man” contention that the parties do not compete at all.

In particular, where the parties’ stores are close together, rival pharmacies are few, and the CMA has survey evidence (rather than simply drawing inferences from geographic features such as road networks) that substitution would be high were one store to shut (i.e. reduce opening hours down to zero), the parties acknowledge that one can infer they compete locally. Given this, there were valid reasons for concern at Phase I and even the initial part of Phase II, based on a supposition that this local Sainsbury’s vs. Lloyds rivalry *must be* “close” (in the economic, rather than just the geographic, sense) and therefore be generating pressure on each party to deliver a better retail offer for customers – pressure that the Transaction would remove.

...But the evidence supports the parties’ contentions that they are not “close” economic rivals in any local areas, and that competitive “pressure” from Sainsbury’s is not making Lloyds stay open longer or otherwise tangibly enhance its competitive offer (or vice versa).

However, having read the PFs closely, the parties do not believe that the CMA has identified any evidence which establishes that the parties’ respective retail offers in any local area are materially influenced or shaped by their rivalry with each other. This lack of evidence of any tangible consumer benefits which can be said to flow from rivalry between Sainsbury’s and Lloyds is apparent from a systematic review of the CMA’s concerns in relation to each parameter which the parties might theoretically be able to flex at the local level. The critical

question for the purposes of this investigation (in accordance with s 36 of the Act) is whether, and if so to what degree, the parties currently compete with each other on such parameters, and the extent to which Lloyds would have an ability, and merger-specific incentive, to worsen its competitive offer (reduce QRS) as a result of the loss of competition from Sainsbury's.

In this respect, the evidence available to the CMA clearly fails to establish that the parties are, on the balance of probabilities, currently constraining each other in connection with any relevant QRS parameter. Nor does the evidence establish that Lloyds would have a greater incentive to reduce any aspect of its competitive offer as a result of the Transaction. In particular:

- **Inferences from relevant internal documents.** The CMA has not identified any internal document which suggests that:
 - Lloyds considers Sainsbury's to be a *close* competitor at a national level or in any local area (or vice versa);
 - Lloyds *benchmarks* and/or attempts to *match* any parameter of its competitive offer against Sainsbury's at a national level or in any local area (or vice versa);
 - Lloyds materially *enhances* any parameter of its competitive offer (e.g. strives for shorter waiting times, longer opening hours, etc) in response to the competitive pressure from Sainsbury's at a national level or in any local area (or vice versa).

Rather than give this extensive body of documentary evidence any material credit, which is inconvenient to an SLC case, the CMA has "cherry-picked" and misinterpreted a tiny subset of documents. The most acute example is Lloyds' *Competitive Edge* document, which has not been in active use since 2011, and in any event makes no reference to Sainsbury's. The one objection by Lloyds to a pharmacy licence application by Sainsbury's cited by the CMA (in Wolverhampton) is also no "smoking gun": it underlines that the parties do compete to an extent (which is not in dispute), but are not close competitors (or else Lloyds would have [X]). Moreover, this example goes to the general nature of the parties' rivalry – it does not relate to any specific parameter of their respective competitive offers that could be worsened.

The CMA appears to believe that this evidence (such as it is) regarding the general nature of competition between the parties is strong enough to sustain an assumption that their rivalry is enhancing some element of their respective competitive offers. In the parties' view, this assumption is clearly not sustainable, both in light of a contextual reading of the documents and based on the economic evidence in this case.

- **CMA's entry/exit study.** For instance, the CMA's own entry/exit analysis points to a lack of any statistically significant impact of Sainsbury's specifically (or indeed supermarkets more generally, if Sainsbury's is included in the category) on the prescription volumes achieved by local Lloyds stores. The CMA believes it *does* have evidence of a statistically significant impact in relation to other supermarket pharmacies (Tesco, Asda, Morrison's), excluding Sainsbury's. But given the CMA has clear evidence that Sainsbury's itself does not have impact, it cannot reasonably

favour the less relevant evidence regarding other non-supermarket pharmacies over the Sainsbury's-specific evidence: the Transaction does not involve Lloyds and Tesco (or any other party); it is between Lloyds and Sainsbury's.

- **CMA's economic evidence on competitive parameters at the local level.** The CMA presents economic evidence concerning only three of the parameters of the parties' competitive offers which might potentially be flexed at the local level: Lloyds' opening hours, the timing of Lloyds' refurbishments, and whether Sainsbury's offers a stop-smoking service. Of these, opening hours are the only parameter in respect of which the CMA describes any possible incentive for Lloyds to deteriorate its offering as a result of the merger. However, the results of the CMA's own demand estimation analysis show that: (a) customer demand is in fact not particularly sensitive to opening hours in this market; and (b) there are very low diversions between the parties in response to a variation in opening hours, even in areas where there are few or no other rivals present locally. The CMA also fails to acknowledge the relevance of regulations which preclude any unilateral reduction of core opening hours (by even 5 minutes) without approval from the local authority.¹ Similarly, the CMA found that the entry by Sainsbury's into a local area near a Lloyds "was not statistically significant" in terms of its impact on the timing of Lloyds' refurbishments.² More broadly, the CMA also "did not identify a clear relationship between margin and concentration" – the existence of such a relationship may have suggested that the merged firm could have the ability and incentive to flex QRS parameters (which has a cost) in response to local competitive conditions, and the absence of such a relationship suggests the inverse.

No established likelihood of material adverse effects

In any event, the CMA has not clearly articulated what specific adverse effects could be expected to eventuate as a result of the Transaction, beyond rather vague assertions that Lloyds may have the incentive "to deteriorate aspects of its offer in certain local areas". The only parameter considered in any detail is opening hours, but the CMA does not identify what sort of reduction in opening hours it would consider to be sufficiently material to constitute an adverse effect that is capable of justifying an SLC finding in a local area.

The illustrative example in the PFs – which the parties have shown is unreliable (see Section 2.2 below) – refers to a small reduction in total opening hours (the figure cited in the PFs is 1%, which equates to 30 minutes per week or 5-to-6 minutes per day, for a pharmacy that is currently open for 50 hours per week). Even if Lloyds did reduce its opening hours as contemplated, at the very least the nearby Sainsbury's pharmacy would still be open at that time (the CMA appears to accept that Lloyds is unlikely to reduce opening hours at Sainsbury's pharmacies). This means the only specifically contemplated adverse effect is

¹ A pharmacy's opening hours are made up of (40 or 100) "core hours" (where permission must be sought from the local authority to vary hours and can be withheld), and in many cases also "supplementary hours" (where 3 months' notice must be given to the local authority of any proposed variation). In general, Lloyds has placed its core hours at the beginning and end of the day (e.g. 08.30-12.30 and 15.30-18.30), [§] Therefore, in many cases, Lloyds is not able to reduce hours at all – i.e. by opening later in the morning or closing earlier in the evening – without regulatory approval. However, in some cases, opening hours may have been extended beyond these originally committed hours (as "supplementary hours"), such that hours could in theory be reduced to the earliest and latest points of the "core hours" without regulatory approval (so long as 3 months' notice of any such change was given to the local authority). If a behavioural remedy were to be accepted in relation to any stores where this is the case, these core hours could be moved to the "extremes" of the current working hours (i.e. to either end of the day), in order to ensure that those hours could not be shortened at all without regulatory approval.

² PFs, Footnote 100.

that those few customers who may want to use a Lloyds pharmacy at a time when it would have been open but for the Transaction would have to travel slightly further to reach a pharmacy. The parties find it difficult to comprehend how this can be considered sufficiently material to warrant an SLC finding in any area, particularly when, in the *Poundland/99p* case, a reduction of opening hours to zero (i.e., permanent store closure) was considered to be an insufficiently material adverse effect, because customers would only need to travel a short distance to find an equivalent offering.

Conclusion

Given the requirements of the Act and associated CMA guidance to establish that a transaction “may be expected to result in [an SLC]”, and to have regard to the likely adverse effects flowing from that SLC, the parties are of the view that the CMA must do more to articulate and evidence its concerns in this case. The local analysis relating to the 13 Provisional SLC Areas is primarily focused on the geographic proximity of the parties’ pharmacies to each other, relative to other rivals. However, this confuses geographic proximity with economic closeness of competition (and only the latter is directly relevant for a unilateral effects theory of harm). By itself, geographic proximity is not evidence that Sainsbury’s is driving superior customer outcomes at the Lloyds pharmacies which might be jeopardised by the Transaction (or vice versa).

Even if the CMA is convinced that the Transaction is likely to lead to an anti-competitive outcome of some kind, the evidence in this case clearly does not suggest that the adverse effects which are likely to flow from any lessening of competition are sufficiently material to require the compulsory divestiture of property rights as the price of merger clearance.

C. General reactions to the PFs


1 The CMA's assessment of the (modest) degree of actual pre-merger competition between the parties does not properly take account of the evidence before it

1.1 The extent of differentiation between the parties is understated and competition between the parties is overstated

The parties accept that, as they are each pharmacy businesses, they do compete with each other to some, albeit limited, extent. The parties maintain, however, that they are highly differentiated, and thus not *close* competitors. The parties do not therefore materially constrain each other, and the Transaction is unlikely to have any relevant effects on the behaviour of Lloyds in the post-merger period.

In the parties' view, the CMA's analysis in the PFs underplays the differentiation between the parties (describing it as "slight"), while overstating the competitive constraint the parties place on one another. To restate the headline points, which were explored and substantiated in detail in the Further Submission of the Parties:³

- the parties do not monitor or benchmark themselves against each other's prices or services, even in any 'exceptional' local area;
- the economic evidence suggests that the parties do not improve their local non-price retail offer due to the presence of the other party, even in an "exceptional" local area;
- the gist of the qualitative evidence all points to two players that are set up to, and do, compete for very different customer missions; and
- even in extreme cases of geographic proximity, the evidence (including the CMA's own survey evidence) still suggests different customer shopping missions.

The extent of this differentiation is borne out by the evidence before the CMA, including the parties' internal documents and the CMA survey. Indeed, the CMA's analysis of the parties' internal documents concludes that "the Celesio documents suggest that Celesio sees supermarkets as retail competitors, but not its closest ones",⁴ and also notes that "Sainsbury's considered the disadvantages it faced compared with specialist pharmacies and identified several ways in which its services were differentiated from businesses such as Lloyds, including [5 However, notwithstanding this evidence, the CMA appears to remain of the view that differentiation between the parties is modest at best, in large part due to the fact that the customers of both parties consider "convenience" to be the most important factor in selecting a pharmacy.

The parties fully accept that "convenience" is important to customers. However, the evidence before the CMA suggests that "convenience" means something substantially different to the customers of the two parties, therefore underlining their differentiation. The CMA notes that "different types of locations may be differently convenient for different customer", and that "for some customers of Sainsbury's, convenience will relate to being able to combine visiting the pharmacy with their grocery shop". The varying meanings of "convenience" are also

³ Further Submission of the Parties: Cover Note to the Assessment of 32 Local Areas, 23 March 2016.

⁴ PFs, Appendix H, Para 8.

⁵ PFs, Para 7.73.

explicitly highlighted in the DJS report, which notes that “convenience tends to mean the location of the pharmacy (particularly for Lloyds customers), although it also includes opening hours and car parking (particularly for Sainsbury’s).” While the CMA acknowledges this fact, however, the PFs do not make clear how, if at all, the differentiation between the parties has been taken into account in the CMA’s analysis.

In the parties’ view, the differentiation between the parties undermines any suggestion that the parties take each other into account when determining their local offer, and the CMA does not give sufficient weight to the fact that it has not identified any internal document which:

- suggests that Lloyds considers or characterises Sainsbury’s as a close competitor in any local area (or nationally), or vice versa;
- suggests that Lloyds benchmarks any competitive parameter of its retail offer against Sainsbury’s in any local area (or nationally), or vice versa; or
- suggests that Lloyds changed any competitive parameter materially in the direction of a better outcome for customers (less waiting time, longer opening hours, etc) of its retail offer in response to the entry, or ongoing threat, of Sainsbury’s in any local area (or nationally), or vice versa.

This is discussed further in Section 2 below.

1.2 Insufficient weight has been given to the “muted” nature of competition in the pharmacy industry

Although in principle competitive effects can relate to any aspect of price, quality, range or service (“PQRS”) (or all of them), most competition investigations focus on price (and quantity) offered – and for good reason. Price is both the item that has the most direct impact on customer wellbeing, and the item that feeds most directly into supplier’s “bottom line”. In this case, the CMA appears to accept that regulated prices result in “limited price competition”,⁶ and that regulated minimum quality levels (including as to opening hours) result in competition that is “likely to be more muted than would otherwise be the case”.⁷ However, it is not at all clear how this has been taken into account and reflected in the CMA’s methodology and assessment of the impact of the Transaction compared with a standard retail merger, where competition on price and quality is unconstrained by regulation.

For example, take opening hours, which are discussed extensively in the PFs, and appear to be the key parameter on which the CMA appears to believe that: (a) the parties may possibly compete today; and (b) there is potential scope for an adverse effect as a result of the Transaction. While the CMA recognises that regulation is relevant to the assessment of the Transaction, no direct account appears to have been taken in the PFs of the fact that there are significant regulatory barriers to reducing opening hours. These are not limited to the minimum opening hours set out in pharmacy licences (which require a minimum of either 40 or 100 opening hours per week, depending on the licence). Those regulatory minimums set a floor – hours cannot be reduced below the regulated level. But pharmacies must also

⁶ PFs, Para 25.

⁷ PFs, Para 30.

apply to their local authority for permission to vary their opening hours even though they will remain above the regulatory minimum.⁸

Requests to vary opening hours are not always granted – and when they are, they may be subject to other conditions. For example, when Lloyds relocated one of its Hoddesdon pharmacies to a new site where opening hours were restricted under the terms of the planning permission for that site (meaning that original opening hours could not be maintained at the new location), Lloyds still had to request permission from the local authority in order to reduce its opening hours at the new site, and approval was only granted on the condition that Lloyds increase opening hours at the other Lloyds pharmacy in Hoddesdon to compensate.

Moreover, given that the local provision of service is a key part of the Pharmaceutical Needs Assessments that determine whether a pharmacy operator should be given permission to open a new pharmacy in an area, any pharmacy chain that pursued a deliberate strategy of reducing opening hours would significantly increase the risk that their applications for new pharmacies would be rejected in favour of rivals with longer opening hours. Adopting such a strategy might also make it more likely that a rival is granted a new pharmacy licence in an area where Lloyds is already present but has limited its opening hours (because the local authority may consider the local area to be under-serviced) – in other words, it could stimulate new entry. For these reasons, regulation also means that there can be little possibility of a material adverse effect relating to opening hours (and, as discussed further in section 3 below, the parties do not consider that any such concerns could result in a “substantial” lessening of competition).

1.3 Current approach of the parties to setting PQRS parameters at the local level

Despite the regulatory context, the CMA appears to remain concerned that a lessening of this muted competition on non-price (QRS) parameters as a result of the Transaction may be sufficiently significant in particular local areas to justify an SLC finding. Consequently, the CMA has investigated the extent to which regulation fixes or sets a minimum standard for each relevant QRS parameter, and concluded that it is *theoretically* possible for pharmacies, in general, to compete on some of those parameters at the local level (namely location, information given to GP practices, range of P-meds or services, stocking practices, waiting times, opening hours, training, timing of refurbishments and the pharmacy environment)⁹.

However, what is or is not theoretically possible for pharmacies *in general* should not be conflated with what the parties actually do in the pre-merger environment, nor can such conclusions be used as an accurate predictor of what the merged firm is likely to do in the post-merger period.

The CMA describes the parties’ views on how they compete – and in particular, on the approach that they take to setting various PQRS parameters – in paragraphs 7.22 to 7.29 of the PFs. While the CMA acknowledges that “the ability to flex some parameters is more limited at supermarkets such as Sainsbury’s than at Lloyds”, it does not appear that the CMA has taken into account fully the approach that Lloyds and Sainsbury’s actually use to set these factors when considering the extent to which they compete with each other, and the

⁸ Or at the very least, provide three months’ notice to the local authority of the proposed change, if it involves a reduction of “supplementary hours” that have been extended above and beyond a pharmacy’s “core hours”. As explained in Footnote 1 above, Lloyds has generally placed its core hours at the beginning and end of the day, which means that it is typically not able to reduce opening hours at all (even by 5 minutes) without regulatory approval.

⁹ PFs, Para 7.33.

possible consequences that may flow from the loss of their rivalry as a result of the Transaction (in particular the approach that Lloyds currently takes to setting its own PQRS parameters, given that the CMA's concerns are focused on the possibility of a worsening in quality of the competitive offer at Lloyds' stores). That approach is summarised in Table 6 in the PFs, which is set out on the **next page** (as Table 1 to this Response) for ease of reference.

Table 1 – Lloyds' approach to setting PQRS parameters

PQRS	PQRS parameter	Lloyds' approach to strategy on this variable?	Does Lloyds flex local store offer due to local competition?	Does Lloyds flex local store offer due to Sainsbury's?	Potential harm to consumers
Price	Prescription prices	[✂]	[✂]	N/A	N/A
	P-med prices	[✂]	[✂]	N/A	Higher prices
	GSL prices	[✂]	[✂]	N/A	Higher prices
Quality	Staff training	[✂]	[✂]	No	Service quality/ patient health
	Quality of advice	[✂]	[✂]	No	Service quality/ patient health
	Permanent/locum mix	[✂]	[✂]	No	Service quality
Range	P-med range	[✂]	[✂]	No	Smaller range/GSL substitution
	Prescription stocking	[✂]	[✂]	No	Need to return/go elsewhere
Service	Staffing levels	[✂]	[✂]	No	Inconvenience: longer wait
	Waiting times	[✂]	[✂]	No	Inconvenience: longer wait
	Opening hours	[✂]	[✂]	No	Inconvenience: store closed
	Refurbishments	[✂]	[✂]	No	Store ambience
	Additional services	[✂]	[✂]	No	Inconvenience: service unavailable
	Prescription collection	[✂]	[✂]	No	Inconvenience: no collection
	Home delivery	[✂]	[✂]	No	Inconvenience: no home delivery
	Information to GPs	[✂]	[✂]	No	Unclear
Convenience	Site location (proximate to GP practice)***	Local	[✂]	No	Inconvenience: location
	Site format: large free car park	N/A (outside LP control)	N/A	N/A	N/A
	Site format: one stop/large grocery offer	N/A (outside LP control)	N/A	N/A	N/A

As shown in Table 1 on the **previous page**, Lloyds only currently flexes [REDACTED] aspects of its offering at the local level: [REDACTED] site location (in particular, location relative to a GP practice). Local competitive pressure does influence the flexing of these [REDACTED] QRS parameters by Lloyds – [REDACTED]. Lloyds does not vary its local offering in response to the entry or subsequent actions of any supermarket pharmacies, including Sainsbury's.

As will be discussed in Section 2 below, the PFs do not refer to any evidence which would tend to suggest that Lloyds has misrepresented or departed from its current approach to setting PQRS parameters, or that Lloyds would be likely to depart from its current approach as a result of the Transaction.

1.4 The CMA misinterprets certain key documents

In the parties' view, the CMA has placed too much reliance upon, or misinterprets, a number of internal documents provided by the parties, notwithstanding the previous submissions from the parties in relation to these documents, in particular in the parties' Further Submission.

Lloyds' "Competitive Edge" document

The CMA has placed significant weight on Celesio's "Competitive Edge" document in its PFs, which it relies on throughout the PFs as evidence that Lloyds competes with other pharmacies on a number of parameters which can be flexed in the short run. The way in which the document is referred to in the PFs gives the impression that it is a current document or statement of strategy. However, the PFs do not take any account of (or accurately acknowledge) the context in which that document was created, or the fact that [REDACTED].

As previously submitted in response to the Phase 1 Issues Letter, in the parties' initial submission of 19 January 2016, at the hearing in March 2016, and in the parties' further submission of 23 March 2016, the Competitive Edge document is historic (created in 2011), related to the significant change in regulation (the advent of 100-hour pharmacies), was used in connection with that event only, and does not constitute evidence of closeness of competition between the parties nor of how Lloyds' would react to new entry by a Sainsbury's pharmacy. [REDACTED].

Responses to pharmacy licence applications

In Celesio's view, the CMA continues to overstate Lloyds' approach to competitor pharmacy licence applications, and has not taken sufficient account of the additional information and explanation which Lloyds has provided. For instance, Lloyds has clearly explained that:

- [REDACTED].
- [REDACTED].

Conclusive evidence has been provided to support this position, including a great deal of contemporaneous documentary evidence.¹⁰ The CMA notes the parties' arguments in relation to this issue,¹¹ yet still seems to give more weight to the historic strategy set out in

¹⁰ See: Email (and attachments) from Linklaters to CMA at 13:14 on 26 April 2016 in response to the "Additional information table (1)" that was put-back to the Parties by way of email from the CMA to Linklaters at 15:58 on 22 April 2016. See also: Email (and attachments) from Linklaters to CMA at 16:42 on 23 March 2016 in response to request for information sent by email from the CMA to Linklaters at 17:57 on 21 March 2016.

¹¹ PFs, Para 7.28 and footnote 85.

the Competitive Edge document [REDACTED]. Specifically, while the CMA accepts that [REDACTED].¹² In particular, the CMA cites the example of Lloyds' objection to the entry of a Sainsbury's pharmacy in Wolverhampton.

In relation to the Wolverhampton example, the evidence submitted by Lloyds clearly showed that Lloyds' objection [REDACTED].

Competition on waiting times

In its analysis on waiting times, the CMA continues to refer to a single Sainsbury's customer satisfaction survey which monitored waiting times as evidence that waiting times is a variable in relation to which the parties do, or could, compete.¹³ However, as explained in the parties' Further Submission dated 23 March 2016, [REDACTED].

Furthermore, as previously explained (and acknowledged in the PFs), waiting times are much less important for supermarket pharmacies, whose customers are actively encouraged to drop off their prescriptions whilst they shop in store.¹⁴ While the PFs are correct to note that there is also significant variation in waiting times across Lloyds stores, these do not reflect variations in competitive conditions, but simply the natural variation that will occur in relation to any performance metric when observed across a wide range of stores.¹⁵ The parties therefore maintain that they do not currently compete on waiting times, and Sainsbury's would not have the incentive to do so in the future.

Competition on the range of services

The CMA's conclusion that Sainsbury's does consider competition between pharmacies [REDACTED].¹⁶[REDACTED]. The alternative conclusion reached in the PFs appears to be based on an internal Sainsbury's document that [REDACTED].¹⁷ The CMA initially appears to acknowledge the context of this document; namely, that it was a strategic document prepared for the purpose of [REDACTED]¹⁸ [REDACTED].¹⁹ This context is incredibly important: [REDACTED]. However, the CMA does not appear to take this important context into account in its provisional conclusions on this topic.

2 The economic evidence that the merger parties drive each other's competitive offer today, or that the merged firm would have the incentive to flex any QRS parameters at the local level post-merger, is extremely weak

2.1 Evidence relating to the constraint imposed by other supermarkets cannot be imputed to Sainsbury's

After reaching the conclusion in the PFs that it is theoretically possible for pharmacies, in general, to compete on some QRS parameters, the CMA then proceeds to consider the

¹² PFs, footnote 85.

¹³ PFs, Para 7.44 (e).

¹⁴ In addition, a number of customers are merely collecting prescriptions that have been previously prepared by the pharmacy (e.g. those that are sent to the pharmacy in advance via EPS), and such customers will not need to wait for their prescription to be fulfilled.

¹⁵ [REDACTED]

¹⁶ This conclusion is stated in the PFs, at Para 7.58, as follows: "We nevertheless found evidence to suggest that Sainsbury's did consider competition between pharmacies in setting its offering, for example [REDACTED]."

¹⁷ PFs, Para 7.44(d).

¹⁸ [REDACTED]

¹⁹ Specifically, the CMA initially acknowledges that: "...[REDACTED]." See PFs, Para 7.44(d).

extent of competition between Lloyds and Sainsbury's.²⁰ When considering this point, the PFs state that "we [the CMA] focus on the extent to which the Parties compete with each other and particularly the extent to which supermarket pharmacies compete with more traditional high street pharmacies and vice versa".²¹ [emphasis added] In the parties' view, the CMA's focus here is misguided.

Even if certain pharmacies do have some ability (albeit limited) and incentive to flex QRS parameters in response to competitive conditions at the local level, that does not necessarily mean that a material competitive rivalry exists between *Lloyds and Sainsbury's* in relation to the relevant QRS parameters. Importantly, specific evidence of a significant competitive rivalry on the relevant QRS parameters *between the parties themselves* is required to support a conclusion that the Transaction is likely to result in an SLC that will lead to adverse effects for consumers in connection with one or more of those QRS parameters.

The CMA has said that it has not seen any evidence to suggest that the competitive constraint on Lloyds from Sainsbury's differs significantly from the constraint from other supermarket pharmacies,²² but this is not true. As discussed further below, every piece of analysis carried out by the CMA itself (including its analysis of quality parameters and its entry/exit analysis) shows that the competitive constraint on Lloyds from Sainsbury's *does in fact differ* from the constraint from other supermarket pharmacies. For instance, the CMA's entry/exit analysis now concludes that, when all supermarket pharmacies are considered together, there is in fact no statistically significant supermarket effect: such an effect is only found when supermarkets *excluding* Sainsbury's are treated as a separate group (see Section 2.3 below for further details). Drawing inferences from evidence in relation to other supermarket pharmacies would clearly be justified if there were, for some reason, no evidence in relation to Sainsbury's (e.g. no data points), but that is not the case here.

There are many possible reasons which might explain these differing results – for instance, the answer might lie in customer demographics, or the way these third parties run their respective pharmacy businesses – none of which appear to have been explored by the CMA. And the evidentiary burden certainly does not shift to the parties to explain *why* in some cases one or more of Tesco, Asda and Morrison's have this effect on Lloyds, according to the CMA's evidence, on the one hand, and why Sainsbury's does not, according to the CMA's own evidence, on the other. In any event, evidence that relates to other supermarkets (excluding Sainsbury's) cannot support an SLC finding in this case.

2.2 The CMA only explicitly identifies three possible parameters that the merged firm might flex locally – but the economic evidence suggests that this will not happen

The CMA presents economic evidence concerning only three of the variables in relation to which it considers competition may take place – Lloyds' opening hours, the timing of Lloyds' refurbishments, and whether Sainsbury's offers a stop-smoking service.²³ However, as set out below, in all three cases, a careful examination of the evidence should dispel any concerns. This is consistent with the CMA's evidence in relation to entry and exit impacts,

²⁰ See the PFs, from paragraph 7.61 onwards.

²¹ PFs, Para 7.61.

²² PFs, Para 7.102.

²³ The parties note that in respect of Highcliffe, the CMA also appears to posit a store closure theory. See PFs, Para 7.170: "In the event of either the closure of one or both Lloyds branches or a deterioration of quality sufficient to cause customers to divert, we consider that they are most likely to visit Sainsbury's as there are no high street pharmacies within the Lloyds catchment area." [emphasis added] However, this theory is not explained (let alone evidenced), nor is it posited in any other local area.

as well as the relationship between margins and concentration, all of which points to a lack of any significant impact of Sainsbury's specifically (or indeed supermarkets more generally) on the QRS offer of local Lloyds stores.

Opening hours: no relationship to Sainsbury's presence

Opening hours are the only aspect of the QRS offering in respect of which the CMA describes any incentive for Lloyds to deteriorate its offering as a result of the merger. The CMA states that its illustrative calculation finds that, if a 1% reduction in opening hours reduces payroll costs by 0.5%, the reduction in opening hours would be profitable where more than 40% of Lloyds' customers divert to Sainsbury's.²⁴

However, the results of the CMA's own demand estimation analysis shows that customer demand is in fact not particularly sensitive to variations in opening hours in this market, and there are very low diversions between the parties in response to a variation in opening hours even in areas where there are few or no other rivals present locally (never higher than 20% in any of the 13 Provisional SLC Areas). Thus, the results of the CMA's own analysis show that Lloyds would have no incentive to reduce opening hours following the Transaction.

The parties note that the PFs continue to assert that these demand estimates may understate the true diversions between the parties. However, the parties do not believe that these arguments suggest these diversions would be unreliable as a measure of the diversion in response to changes in opening hours, since this is exactly what the CMA model examines, so the resulting diversions are directly comparable to the CMA's 40% diversion threshold (which is also based on opening hours alone and not other elements of quality). Moreover, the parties do also not agree with the CMA's argument that the diversions are underestimates of the diversion in response to quality of service more generally, for the reasons that are explained in **Appendix 1** to this Response.

As well as estimating how opening hours affect demand, the CMA has also presented evidence that suggests Lloyds' opening hours increase, and Lloyds is more likely to open late and on Sundays, when there is a local Sainsbury's present (although this is only found to be the case in urban areas, and only at a significance of 10%). However, neither of these findings is robust, for the reasons set out below.

The PFs present two models of opening hours versus concentration that attempt to take account of a wider range of local factors that might influence opening hours, as well as to test for a specific impact of Sainsbury's on Lloyds' opening hours – one based on total opening hours, and one based on extended opening hours, defined as stores that are “open on Sundays or late at night”.²⁵ The PFs interpret the results as showing that “opening hours may be correlated with the number of competing stores in the local area” and “controlling for the size of the local market, the greater the number of other small pharmacy chains and of Sainsbury's nearby an existing Lloyds, the longer the existing Lloyds stays open.” Similar results are reported for extended opening hours.

The full results of CRA's assessment of both this analysis and the analysis “extended opening hours” can be found in **Appendix 3** to this Response. The results show that the

²⁴ PFs, Para 7.111. Note that the parties believe this threshold may well be understated for the reasons submitted in “Economic and Factual Comments on CMA Analyses”.

²⁵ G7, paragraph 18. Unfortunately, the source information for this latter variable is not clearly identified in the PFs (or the code the CMA provided), but it does not appear to relate well to the actual opening hours of Lloyds stores provided to the CMA. For example, the Lloyds Concord pharmacy (LP6849) is open until 8.30pm every weekday night but is not treated as a store with extended opening hours.

CMA's findings are artefacts of the way the CMA has taken account of the number of rivals. The CMA states that it prefers using a "continuous variable" to measure the number of rival stores to CRA's use of dummy variables, because this "allows us to estimate a more general relationship between the quality parameters and the degree of competition".²⁶ This is not correct, as the CMA's continuous variable is just a restricted version of CRA's dummy variable approach. The CRA approach in fact allows better for a general relationship to be estimated, since it does not assume that each additional store that a rival has in a locality has the same additional effect on quality of service as the first store (an assumption that is unlikely to be true in practice). The results in **Appendix 3** to this Response show that when this assumption is dropped, and a more general model is estimated, there is no evidence that the number of local competing Sainsbury's has any statistically significant effect on Lloyds' opening hours in either the opening hours or the extended hours model.

There is therefore no valid empirical evidence to suggest that Lloyds in fact varies its opening hours (either total opening hours or "extended hours") in response to the presence of one or more local Sainsbury's. This is consistent with Lloyds commercial position, which is that [X].

Store refurbishments: no evidence Lloyds will slow store refurbishments

The only other aspects of quality for which the PFs contain empirical analysis are store refurbishments. Appendix G to the PFs concludes that "this analysis is indicative evidence of Lloyds accelerating its refurbishment schedule in response to local competition by supermarkets, and by extension to competition by Sainsbury's". [emphasis added]

The parties do not believe that this conclusion is reasonable.

The CMA itself found that the "difference [in terms of timing of refurbishments] was not statistically significant" when a Sainsbury's entered.²⁷ Given this finding, there is no basis to impute any significance to competition from Sainsbury's in this regard. As set out in the "Economic and factual comments on CMA analyses" submitted on 19 April 2016, the analysis does not show any "Sainsbury's effect", nor does it show any effect for any supermarket more than 0.2 miles away. Analysis conducted by CRA has confirmed that there is no relationship between the rate of refurbishment (or other quality metrics) and the number of local competitors faced by Lloyds.²⁸

Moreover, in the main body of the PFs, the CMA appears to accept that its analysis does not control for other factors that might influence refurbishments, and therefore it "cannot conclude that competition is causing stores to be refurbished more quickly".²⁹ It therefore does not appear to be the case that the CMA's theory of harm is supported by these empirical findings, despite the conclusions presented in Appendix G to the PFs.

In addition, the fact that refurbishment cycles in this market are quite long suggests that refurbishment cannot be a major driver of customer decision-making. As indicated in the parties' Further Submission dated 23 March 2016, Lloyds will typically refurbish pharmacies on a [X] cycle.³⁰

Finally, the CMA's survey does not suggest that store ambience is a particularly important factor driving decision making. Figure 13 of the DJS report shows that "Environment" was

²⁶ PFs, Footnotes 97 and 98.

²⁷ PFs, Para 7.50.

²⁸ See the Further Submission of the parties dated 23 March 2016, Part B, Section 4.4.

²⁹ PFs, Para 7.50.

³⁰ See the Further Submission of the parties dated 23 March 2016, Par B, Section 4.4.

not the first mentioned reason to choose a pharmacy for any respondents to the survey, and was only mentioned at all by 1% at Sainsbury's, and 2% at Lloyds.³¹

Stop-smoking services: no evidence that the merged firm will reduce services

The PFs also cite evidence that whether Sainsbury's offers a stop-smoking service is influenced by the number of local Lloyds stores present within 1.5 miles in urban areas (no effect is found in rural areas).³² As an initial point, the CMA appears to have disregarded the parties' Further Submission on this topic, where it was explained that it is the local authority who decides which (and how many) pharmacies can provide such locally-commissioned services, and specifically noted that local authorities typically only select a limited number of pharmacies to provide stop-smoking services.³³

The parties note that this result again reflects the CMA's use of a continuous variable to measure the number of local Lloyds stores, rather than a set of dummy variables. If a set of dummy variables is instead used to measure the number of local Lloyds stores, then the results show that it is only if there are *three* local Lloyds in an area that the number of Lloyds has a significant positive effect on whether Sainsbury's offers this service (if there are just one or two local Lloyds stores, then this has no significant effect on whether Sainsbury's offers this service). Moreover, this finding that is based on just 13 observations out of a total of 76, which raises further questions about the robustness of the result (and in any event the impact, if any, could hardly be said to be substantial).

By contrast, the analysis for Lloyds (which is based on *hundreds* of observations) shows there is no relationship between the number of Sainsbury's or other supermarket pharmacies on the one hand, and the number of Lloyds stores on the other, in either urban or rural areas (and Figure 6 in Appendix G to the PFs suggests that Lloyds' stop-smoking services are less likely to be offered the more local competitors are present). Therefore, even if these results were taken at face value, the overall net impact of the Transaction on the offer of stop-smoking services would be highly ambiguous.

Moreover, the CMA provides no evidence to suggest that Lloyds would have any *incentive* to remove these services from Sainsbury's stores. Given that Lloyds offers stop-smoking services at a far higher proportion of its stores than Sainsbury's, and that one of the rationales of the Transaction is for Lloyds to be able to roll out its wider range of services into Sainsbury's stores, it is far more likely that the merger *increases* rather than *decreases* the proportion of Sainsbury's stores offering stop-smoking services. Indeed, the parties note that the main body of the PFs does not appear to place any weight on these findings.

³¹ "Environment" covers a range of responses, namely "attractive store", "privacy" and "seating". Accordingly, the features of a store that would actually be enhanced by a refurbishment are most likely only relevant to a smaller subset of these responses.

³² We note that Table 3 on page G10 appears to be mislabelled, with all columns indicated as relating to urban areas. It is unclear why this analysis has only been carried out for stop-smoking services, and not for the many other services for which the parties have provided data.

³³ Further Submission of the parties dated 23 March 2016, Part B, Section 4.12.3.

2.3 Other economic evidence confirms the lack of a material rivalry between Lloyds and Sainsbury's

The CMA's margin-concentration study

The CMA also “did not identify a clear relationship between margin and concentration”.³⁴ This is exactly the type of relationship we would expect to find if there were significant ability and incentive to flex any aspect of quality (which has a cost) in response to local conditions of competition: the fact that the CMA has not been able to find such a relationship strongly suggests that flexing quality in response to local competitive conditions is not a major characteristic of the market. Simply finding that there is “substantial variation in quality parameters between local Lloyds stores” is not evidence that these parameters vary in response to local competitive conditions, still less that they vary specifically in response to the presence of a local Sainsbury's. And, as will be discussed in further detail below, where the CMA has examined the relationship between these parameters and local competition it has not found robust or reliable evidence that Lloyds systematically flexes any of these parameters in response to the presence or number of local Sainsbury's.

The CMA's entry-exit study

The CMA continues to rely on evidence that *other supermarket pharmacies*' (excluding Sainsbury's) entry and exit affects Lloyds' prescription volumes as evidence that *Sainsbury's* competes with Lloyds – even though their direct estimation in relation to Sainsbury's shows no such effect.³⁵ Of most concern is that the CMA concludes on the basis of this evidence (or lack thereof) that: “we might expect to see high diversion from Lloyds to Sainsbury's in some areas”.³⁶

As discussed above, this approach is inappropriate, in that it simultaneously fails to take relevant considerations into account (i.e., evidence of the absence of constraint from Sainsbury's) and takes into account irrelevant considerations (i.e., evidence of the constraint from other supermarket pharmacies).

Moreover, the CMA's own analysis now concludes that, when all supermarket pharmacies are considered together, there is in fact no significant supermarket effect (such an effect is *only* found when supermarkets *excluding* Sainsbury's are treated as a separate group).³⁷ It is clearly not valid to treat this as evidence either that *supermarkets in general* or *Sainsbury's in particular* have an effect on Lloyds – and the parties find it surprising that result of this “robustness check” is not mentioned in the main body of the PFs, and does not appear to have been taken into account in the CMA's conclusions.

Evidence on quality/concentration

The parties previously submitted analysis conducted by CRA that showed that even in areas where Lloyds currently has a local monopoly position, there is no evidence that it has reduced quality of service in relation to waiting times, years since last refurbishment, locum

³⁴ PFs, Para 7.51.

³⁵ There is also no evidence that the entry/exit of Lloyds or other community pharmacies had any impact on *Sainsbury's* prescription volumes. By contrast, the analysis did show an effect of *supermarket* entry/exit on Sainsbury's in urban areas, and of independents and pharmacy chains on Lloyds – consistent with the parties' internal documents showing a strong degree differentiation between their offerings.

³⁶ PFs, paragraph 7.99.

³⁷ PFs, 18, paragraph 26 states “As a robustness check, we also estimated the effect on Lloyds' volumes pooling Sainsbury's entry events together with those of other supermarket chains. The estimated coefficients were not statistically significant.”

hours or mystery shopper ratings.³⁸ While the parties accept that these analyses were simple regressions, if there were a strong competitive effect on any of these factors we would expect to see the relationship in the data. Moreover, the parties do not agree that it is better to assume a linear relationship between concentration and quality than to look at the impact of discrete levels of concentration:³⁹ as noted above, not only is this in principle unlikely to be true (as common sense suggests that the introduction of one competitor is likely to have a bigger impact than the entry of a sixth competitor into a market), but again in these specific analyses such an assumption was clearly rejected by the data as incorrect.

The evidence submitted to the CMA therefore shows that Lloyds is not likely to have the incentive to act on any ability it may have to negatively flex certain QRS parameters following the merger. Most notably, Lloyds has not done so to date in any of the local areas where it faces little or no competition pre-merger (where the same ability to flex and lack of local rivalry presumably already exists). The CMA has not explained why Lloyds would depart from this approach – which reflects its current business strategy of delivering a consistently high-quality level of service in all its stores – in the 13 Provisional SLC Areas.

2.4 Lack of evidence on incentive to worsen QRS

The fact that neither Sainsbury's nor Lloyds appears to have significantly flexed QRS in response to competition from the other in the past is consistent with the (lack of) evidence on incentives to worsen QRS. The CMA has not provided any reasoning why opening hours or refurbishments should be particularly important to either supplier costs or consumer decision making in this market relative to other retail markets, and therefore why it should be a matter for first order competition concerns in this market but not in others.

Moreover, there is in most cases no evidence that the merged firm would be able to save significant cost by worsening those aspects of QRS that can be to some extent varied. The only QRS metric for which the CMA has provided even an illustrative calculation of cost savings is opening hours: but while it is intuitive that reducing opening hours could in theory save significant staff costs, it is far less obvious that providing fewer stop smoking sessions would do so, or what level of cost would be avoided by postponing refurbishments.

Nor is any evidence provided on what consequences the merged firm might suffer if it worsened these other elements of QRS. Again, the CMA provides an indicative estimate of the proportion of business that might be lost by closing early;⁴⁰ but does not provide any equivalent estimate for the level of sales that might be lost by worsening other elements of QRS. Nor does the CMA take into account the higher risk of a new entry, given a reduction in opening hours could result in the approval of a new entrant pursuant to the local PNA (as discussed in Section 1.2 above). This risk of entry is in fact precisely the reason why Lloyds typically sets its "core hours" at either end of the day – to demonstrate that it is committed to its full opening hours.

While there may be other factors that are relevant to customer decision making (e.g. how recently the store has been refurbished, additional services offered), the survey suggests that by far the most important factor for customer choice is convenience (primarily where the

³⁸ Further Submission of the Parties: Cover Note to the Assessment of 32 Local Areas – submitted 23 March 2016 and CRA presentation, "Analysis of Lloyds service quality and local competition", dated 16 March 2016.

³⁹ As suggested in the PFs at Footnote 97.

⁴⁰ Note that the parties believe that this estimate may be understated, and therefore understate the diversion to Sainsbury's that would be required to create an incentive to close early: see "Parties' economic and factual comments on CMA analyses".

store is and whether it is open) at 86% over service at 5 to 6%, and there is no evidence that there would be a strong diversion between the parties in relation to these service aspects of the parties' offer, or that the parties' profits would benefit from worsening these aspects of their service post-merger.

Without such evidence any theory of harm relating to these other QRS factors simply cannot be tested.

3 Conclusion: no material competitive rivalry on relevant QRS parameters, and no expectation of an SLC that will lead to adverse effects for consumers

In the parties' view, it is clear from the evidence in this case there is no material competitive rivalry *between the merger parties* on the relevant QRS parameters. In the absence of such a rivalry, the parties submit that an expectation cannot reasonably be formed that the Transaction is likely to result in an SLC.

3.1 An appropriate application of the SLC test requires the likelihood of material adverse effects to be established – and this has not been done

In particular, in order to conclude that the Transaction may be expected to result in an SLC in any local area, it must be established that the Transaction is likely to give rise to material adverse effects for customers. This is a widely accepted principle that is evident on the face of s 36 of the Act, which requires the CMA, when considering remedial action, to “have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it” [emphasis added]. This means that the reasonableness of any solution must be weighed against any adverse effects that are expected to flow from the SLC (as well as against the SLC itself).

This principle is also enshrined in the CMA's own guidance documents. In particular the CMA's Merger Assessment Guidelines (CC2) state “[a] merger gives rise to an SLC when it has a significant effect on rivalry over time, and therefore on the competitive pressure on firms to improve their offer to customers or become more efficient or innovative. 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” [emphasis added].⁴¹ This guidance reflects an understanding that an SLC finding should not be predicated on loss of rivalry that does not involve any likely adverse effects, given that adverse effects on customers – in this case, end consumers – represent the public policy justification for finding a loss of rivalry between merger parties to be so significant as to constitute a *substantial* lessening of competition.

The CMA's Merger Remedies Guidelines (CC8) provide further support for this view. stating that “the [CMA] will seek remedies that are effective in addressing the SLC and its resulting adverse effects and will then select the least costly and intrusive remedy that it considers to

⁴¹ CC2 Paragraph 4.1.3.

be effective. The [CMA] will seek to ensure...that no remedy is disproportionate in relation to the SLC and its adverse effects.⁴²

3.2 No clear explanation (or evidence) of why material adverse effects are likely in this case

As discussed above, it is clear that the CMA should be convinced that the Transaction is likely to give rise to material adverse effects for customers before finding an SLC in any local area.

While adverse effects – in the form of higher prices and reduced quality – are often relatively easy to posit for a merger, this is not true of this case, due to the combination of (i) highly regulated parameters; (ii) nationally-set competitive parameters that are not varied locally, and (iii) the lack of a specific competitive rivalry between Lloyds and Sainsbury's at the local level.

This last point (iii) is particularly relevant; as demonstrated in Section 2 above, the CMA has not established that:

- the parties' pre-Transaction rivalry (to the extent it exists) is driving higher QRS standards at either party's pharmacies – and most relevantly, it has not been shown that direct competitive pressure from Sainsbury's is driving Lloyds to materially improve its offer to customers in any local area (over and above regulatory norms and the pressure that Lloyds places on itself by virtue of its need to maintain a specialist brand proposition and reputation); or
- post-Transaction, the merged firm would have the incentive to flex any QRS parameters at the local level.

The parties therefore consider that it is not possible for the CMA to make a final SLC finding in any local area based on a mere supposition that consumer harm may occur at Lloyds stores simply because the Sainsbury's pharmacy is close by, particularly where the parties have presented consistent evidence in this case on every non-price parameter under discussion, and where the only potential harm is expressed in vague terms such as “an incentive for Lloyds to deteriorate aspects of its offer in certain local areas”.⁴³ The CMA has not therefore established that any possible adverse effects that might flow from the Transaction are more likely than not (on the balance of probabilities) to eventuate.

3.3 Those possible adverse effects that have been identified do not justify an SLC finding

Even if the CMA had established the likelihood of any adverse effects, it has not identified any such effects which are sufficiently material to warrant an SLC finding in any local area.

⁴² Merger Remedies Guidelines (CC8), paragraph 1.7. See also paragraphs 1.8, 1.9, 2.13 and 2.16. For instance, Paragraph 2.16 indicates that it may be more appropriate to select a behavioural remedy as the primary source of remedial action in a merger inquiry where the relevant costs of any feasible structural remedy (such as divestitures) “far exceed the scale of the adverse effects of the SLC”. The primacy of adverse effects in the context of Section 36 of the Act is also well-established by the jurisprudence of the Competition Appeals Tribunal and the Court of Appeal.⁴² In particular, the parties refer to *Global Radio Holdings Limited v Competition Commission [2013] CAT 26 (“Global Radio”)*. In that case, the Tribunal quoted the same passage from the Merger Assessment Guidelines (4.1.3) that is addressed in 3.1 above,⁴² and emphasised the importance of the passage from the Merger Remedies Guidelines (1.7) that is also addressed in Section 3.1 above.⁴² Notably, the Tribunal stated that the Merger Remedies Guidelines imported an obligation (on the Competition Commission, which now applies equally to the CMA) to ensure that “any remedial action is proportionate to the substantial lessening of competition and its adverse effects.” [emphasis added]

⁴³ PFs, Para 31.

The CMA has accepted that it “will be more difficult for Lloyds to change its offer materially or close the pharmacy counter at Sainsbury’s than at its wholly owned pharmacy stores”,⁴⁴ and so focuses on whether there is any scope for a material reduction in the competitive offer at Lloyds’ stores.

In particular, the CMA appears to suggest that there may be a possible incentive for Lloyds to reduce its opening hours at some of its stores in the post-merger period.⁴⁵ The CMA does not, however, identify what sort of reduction in opening hours it would consider to be sufficiently material to constitute an adverse effect that is capable of justifying an SLC finding in a local area.

The illustrative example discussed in the PFs – which the parties have shown is unreliable (see Section 2.2 above) – refers to a 1% reduction in opening hours.⁴⁶ If a Lloyds pharmacy were open for 50 hours a week (the regulatory minimum is at least 40 hours), a 1% reduction in opening hours equates to 30 minutes per week (which is five to six minutes per day, depending on whether the pharmacy is open on a Saturday). Even if the CMA’s illustrative example were sound, it is hard to conceive how the CMA could reasonably conclude that the prospect of a pharmacy closing 6 minutes earlier is sufficiently material to warrant an SLC finding in any area. It is equally hard to conceive how such an outcome could justify the imposition of any remedies, let alone the divestment of an entire pharmacy. Even if the CMA had evidence that a greater reduction in daily opening hours was likely (e.g. 1-2 hours), it would still need to explain why this should constitute a material adverse effect, given that: (a) it would only impact those few customers who may want to use a Lloyds pharmacy at a time when it would have been open but for the Transaction; and (b) those customers would only have to travel slightly further to reach another pharmacy (at the very least the nearby Sainsbury’s pharmacy would still be open at that time, and the CMA appears to accept that Lloyds is unlikely to reduce opening hours at Sainsbury’s pharmacies).

There is no finding in relation to any other specific aspect of Lloyds’ local offering – the CMA merely notes that “other aspects of the offer could be worsened to achieve cost savings”,⁴⁷ but neither the relevant cost savings nor the commensurate loss of business that would result from such a worsening of quality are estimated or even considered in the PFs. Given this approach, it is difficult for the parties to comment on the materiality of any other possible adverse effects in this case – it is simply not clear what harm the CMA believes might befall customers.

A finding of immateriality in relation to the possible adverse effects identified in the PFs would be consistent with the approach taken by the CMA in its most recent Phase II retail merger case, *Poundland/99p*.⁴⁸ In that case, the relevant concern was that customers would be inconvenienced by the permanent closures of stores, because they would have to travel further afield to find an equivalent offering. This concern was dismissed by the CMA, on grounds that the inconvenience to customers was not sufficiently material, because the average distance between the parties’ stores in overlap areas was very small (approx. 0.1 miles). Indeed, the CMA held that this possible adverse effect was not sufficiently material

⁴⁴ PFs, Para 7.110.

⁴⁵ PFs, Para 7.111.

⁴⁶ PFs, Para 7.111: “The illustrative calculation finds that, if a 1% reduction in opening hours reduces payroll costs by 0.5%, the reduction in opening hours would be profitable where more than 40% of Lloyds customers divert to Sainsbury’s.”

⁴⁷ PFs, Para 7.112.

⁴⁸ *Poundland/99p* Report, paragraphs 6.128-6.129.

to warrant a local-level inquiry, let alone an SLC finding that might require a divestiture-based remedy.

It is not clear to the parties why the possible detriment of customers having to walk slightly further to find a pound shop because their first choice of store has been permanently closed was so immaterial as to preclude a local-level inquiry, but the (unsubstantiated) prospect of a Lloyds pharmacy remaining open for business but reducing its opening hours by a very short period each day (in circumstances where, by definition, the nearby Sainsbury's pharmacy will still be open) can be used as the primary – if not the sole – justification for an SLC finding that leads to divestitures.

D. The 13 Provisional SLC Areas

1 Introduction

For the purposes of this part of the Response, the parties have focused on eight of the 13 Provisional SLC Areas in relation to which they believe there is further relevant evidence that demonstrates that there can be no expectation of an SLC arising as a result of the Transaction. These specific submissions are made in the alternative and without prejudice to the Parties' general submissions made in Parts A, B and C of this Response.

Before turning to these areas individually, the parties would also note the following general points:

- First, the PFs do not appear directly to acknowledge the Parties' submissions dated 23 March in relation to the key characteristics of the 32 local areas that were of interest to the CMA at that time (of which the 13 Provisional SLC Areas are a subset) ("**Previous Local Area Submissions**"). It is therefore not clear that the CMA has taken into account the arguments or evidence set out in the Previous Local Area Submissions, at least insofar as they apply to the 13 Provisional SLC Areas. For completeness, some of the key points from those submissions are repeated where relevant in the following sections.
- Second, the PFs do not cite any direct evidence that the parties respond to each other locally in any of the 13 Provisional SLC Areas (i.e., competitively flex their local offering). Nor do the PFs cite any evidence to suggest that the presence of a nearby Sainsbury's pharmacy has ever impacted Lloyds' opening hours, waiting times or service quality in any of the 13 Provisional SLC Areas (or vice versa).
- Third, when considering the CMA-surveyed areas within the 13 Provisional SLC Areas, the parties submit that the more appropriate survey diversion ratio to use (if a customer's response to store *closure* is in fact a relevant question) is the diversion in response to a single store closure, given that the CMA has not identified any likelihood of multiple Lloyds store closures (nor, for that matter, are single store closures identified as a likely outcome either), but focuses instead on possible variations in opening hours at the individual pharmacy level (and potentially other reductions in quality parameters, although this is not clear). This distinction is particularly important in Beaconsfield; Cardiff; and Warlingham. In these local areas, the diversion from Lloyds to Sainsbury's in response to the closure of the single Lloyds store alone is less than the 40% that the CMA states would be necessary for a reduction in opening hours to be profitable, despite being in response to a question that would be expected to drive substantially higher diversion than the theory of harm in question (a reduction in opening hours) – in response to which many customers might simply visit the same pharmacy at a different time or on a different day (meaning lower diversion to rivals).

2 Leeds (Alwoodley)

2.1 Overview of local area

The Lloyds pharmacy of interest is located at 2 the Avenue, Leeds, Alwoodley (5618, FQ490) ("**Lloyds Alwoodley**"). Lloyds Alwoodley overlaps with the Sainsbury's pharmacy located at 9-11 Moor Allerton Centre, Leeds (3631, FRD71) ("**Sainsbury's Moortown**"). The

Sainsbury's supermarket store is located on a dual carriageway (A6120) in Moortown, to the north of central Leeds, and the Lloyds Alwoodley pharmacy is located further north-west of the Sainsbury's supermarket. There are three other pharmacies in the area: two Living Care pharmacies and an Adel pharmacy.

For convenience, a map of the local area is set out in Appendix 4.

2.2 Factual errors in the CMA's provisional findings

The CMA has said that there are four pharmacies within a 1.4-mile radius of Lloyds Alwoodley, as follows:

- (a) *Sainsbury's, 1.1 miles away by road;*
- (b) *Living Care, 1 mile away by road;*
- (c) *Adel, 1.4 miles away by road; and*
- (d) *Living Care (south), 1.4 miles away by road.*" (Provisional Findings, paragraph 7.183).

However, according to Google Maps, Sainsbury's Moortown is actually 1.6 miles from Lloyds Alwoodley by car (from Sainsbury's to Lloyds, and by foot, it is 1.3 miles).⁴⁹

2.3 Further arguments and/or evidence which suggests that this local area should not raise any concerns

The CMA considers that "[d]ue to the location of customers and GP practices in this area, we do not consider that Adel pharmacy will compete closely with Lloyds. This is because it is located on the edge of the village of Adel, where very few Lloyds customers are located."

It adds "We consider that diversion from the Lloyds would primarily be split between Sainsbury's and the two Living Care pharmacies, although there may be some customers that go outside the Lloyds catchment area."

Of the two Living Care pharmacies, the CMA considers that the Lloyds competes most closely with the northern pharmacy, but notes that it is located in "a small self enclosed residential area, with only a single entry and exit point" whereas the Sainsbury's is more accessible and more likely to be convenient for customers.

However, there has been a recent material change of circumstances in this area, whereby the northern Living Care pharmacy relocated into the new Alwoodley Medical Centre (located at Saxon Mount, on King Lane, Leeds) in March 2016. Two GP surgeries (Moorcroft Surgery and Nursery Lane Surgery), which together serve a large number of patients (over 14,500 between them, compared with a national average of fewer than 4,000 patients per GP practice), and provide over 60% of prescription items dispensed in the Lloyds pharmacy, have also relocated into this development, which benefits from ample parking.⁵⁰

As a result, the relocated Living Care pharmacy is more easily accessible from King Lane (and visible from the main road), and therefore likely to exercise a much stronger constraint on both Lloyds Alwoodley pharmacy and the Sainsbury's Moortown pharmacy than it may have done in its former location. The relocated Living Care pharmacy is also – by a

⁴⁹ Source: Google Maps – using exact street address of each store (rather than a postcode or other less specific details).

⁵⁰ The Lloyds Harrogate Road store has also relocated from 396 Harrogate Road to 355 Harrogate Road, which is essentially a relocation to a new site across the road, and which results in an immaterial change in distance between this Lloyds store and the Sainsbury's store of under 100 yards, based on Google Maps (by car or by foot) using exact addresses.

significant margin – the closest competitor to Lloyds Alwoodley in terms of distance (being 0.6 miles from Lloyds Alwoodley both by car and on foot).⁵¹ The Parties therefore disagree that Sainsbury's would be likely to receive more diversion from Lloyds than Living Care, or that such diversion would necessarily be high.

Photo of the northern Living Care pharmacy prior to its relocation



Photo of the new Alwoodley Medical Centre, in which the northern Living Care pharmacy is now located



For completeness, the Parties also note that:

- The bus route noted by the CMA as connecting the Lloyds and Sainsbury's pharmacies also connects to the Well pharmacy at 139 Shadwell Lane, LS17 8AE, the southern Living Care pharmacy as well as the relocated northern Living Care pharmacy.
- Collection services (from the Alwoodley Medical Centre) are offered by at least six other pharmacies (including the Adel pharmacy), with all of these also offering free home deliveries for patients.
- Diversion ratios in response to variations in opening hours are estimated to be very low: only 2% from Lloyds to Sainsbury's (and only 6% from Sainsbury's to Lloyds) – well below the 40% threshold that the CMA believes would be necessary to make shortening opening hours profitable.

⁵¹ Source: Google Maps – using exact street address of each store (rather than a postcode or other less specific details).

2.4 Key points from Previous Local Area Submissions

- The Sainsbury's Moortown Pharmacy supplies a mere 321 prescriptions per square mile in its catchment area, whilst the Lloyds Alwoodley pharmacy supplies 1,498 prescriptions per square mile in its own catchment area (a ratio of 467%). These figures effectively show that Sainsbury's (at most) exerts only a very low level of competitive pressure on other pharmacies located in its quite large catchment. In other words, although the catchment of the Sainsbury's pharmacy overlaps with the Lloyds pharmacy's catchment, the customers of the Sainsbury's pharmacy are widely dispersed over Sainsbury's large catchment, and Sainsbury's is not likely to be competing strongly for customers in any particular subsection of its catchment – including those in that subsection of its catchment which overlaps with Lloyds' catchment.
- Lloyds Alwoodley Road is open for a total of 52 hours per week. By comparison, the Sainsbury's Moortown pharmacy is open for a total of 84 hours per week. The Lloyds pharmacy's weekday opening hours are very similar to the opening hours of its most important GP surgery (the Moorcroft Surgery). By contrast, Sainsbury's opening hours are 60% longer, and significantly longer than the opening hours of either GP surgery. The disparate opening hours of the Sainsbury's Moortown pharmacy and the Lloyds Alwoodley pharmacy in Leeds are inconsistent with the existence of a competitive rivalry on this parameter.
- Within Lloyds' catchment area, the fascia count is 4 to 3. Within Sainsbury's catchment area, on the other hand, the fascia count is 20 to 19, which reflects an extremely low level of concentration.⁵²

For more details, see Section 18 (Leeds) of the Previous Local Area Submissions.

3 Liverpool

3.1 Overview of local area

According to the PFs, the pharmacy of particular interest to the CMA is the Lloyds pharmacy at 1–3 Rice Lane (co-located with the Breeze Hill Health Centre). While there are a number of other pharmacies within the Lloyds catchment, the CMA considers the most relevant to be the Sainsbury's pharmacy, just under half a mile from the Lloyds at Rice Lane, a second Lloyds branch on County Road, and a pharmacy in Walton just over half a mile to the east.

For convenience, a map of the local area is set out in Appendix 4.

3.2 Factual errors in the CMA's provisional findings

The CMA states in its PFs that "Walton pharmacy" is located 0.6 to 0.8 miles to the east by road. We assume that the CMA is referring to the Coleman & Leighs pharmacy, which is located at 241 Walton Village. According to Google Maps, this pharmacy is located 0.6 miles away by road, and 0.5 miles away by foot (which is approximately an 11 minute walk).⁵³

⁵² According to the CMA, Sainsbury's Moortown has a much larger catchment area (radius of 2.4 miles) than the Lloyds pharmacy (radius of 1.4 miles). Sainsbury's pharmacy customers will be travelling from all over its large catchment area to do a grocery shop. Many of them will be located closer to the other pharmacy fascia that will remain following the merger.

⁵³ Source: Google Maps – using exact street address of each store (rather than a postcode or other less specific details).

3.3 Further arguments and/or evidence which suggests that this local area should not raise any concerns

According to the PFs, the CMA does not consider that any of the other pharmacies in the catchment area are relevant competitors to the four mentioned above “*as the area seems to be fairly self-contained in between a set of two railway lines. Furthermore, the cluster of GP practices and pharmacies located to the west of Lloyds would seem to form a natural micro-market, as there are number of pharmacies and GP practices all located close to one another. We would not expect many customers to travel either to or from this area to have a prescription fulfilled*” (emphasis added).⁵⁴ The CMA therefore assumes that most of the diversion from Lloyds would be to Sainsbury’s and the Walton pharmacy, and that, as Sainsbury’s is closer (although, the parties note, not much closer), it would benefit from higher diversion than the Walton pharmacy.

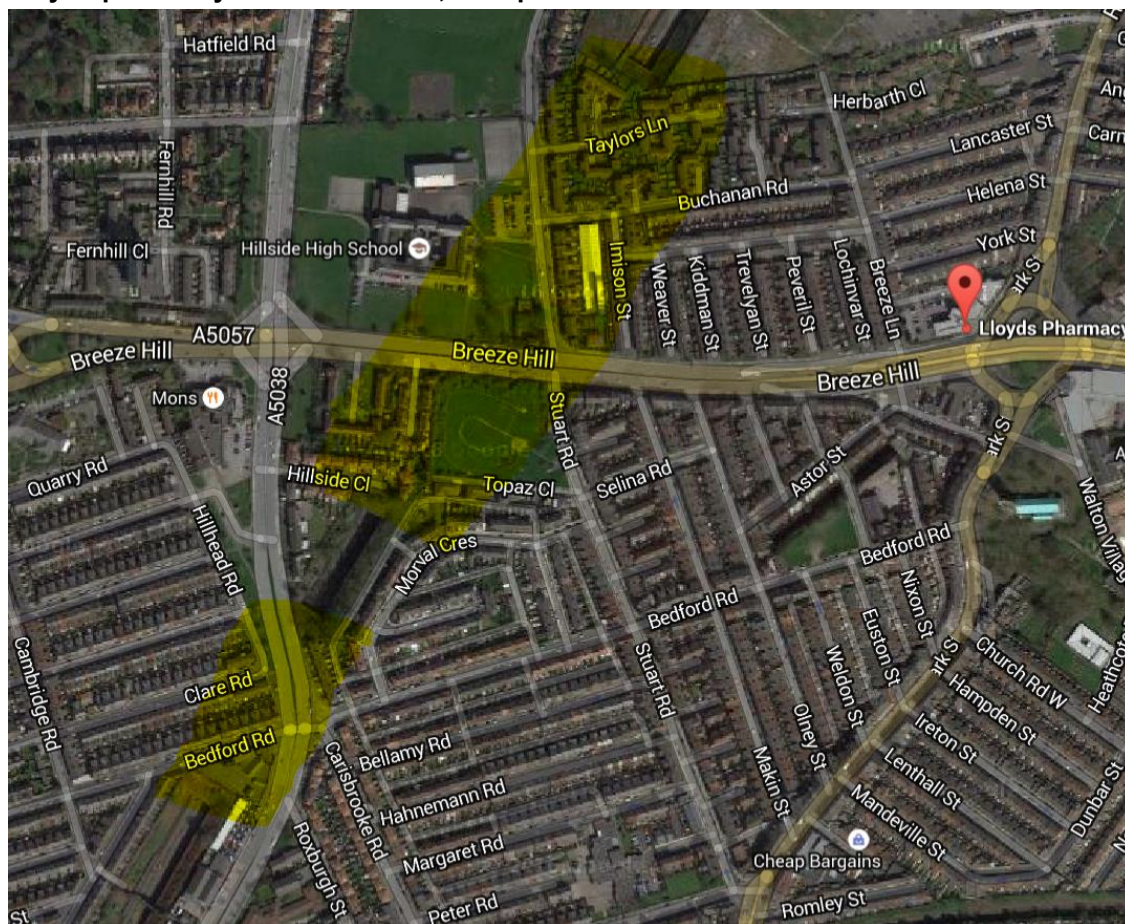
In the Parties’ view, the CMA’s local analysis is not sufficiently supported by evidence, and it cannot be assumed that Sainsbury’s would represent the most likely alternative choice to Lloyds’ customers such that diversion ratios between the Lloyds pharmacy and the Sainsbury’s pharmacy would be sufficiently high to justify an SLC finding.

In particular:

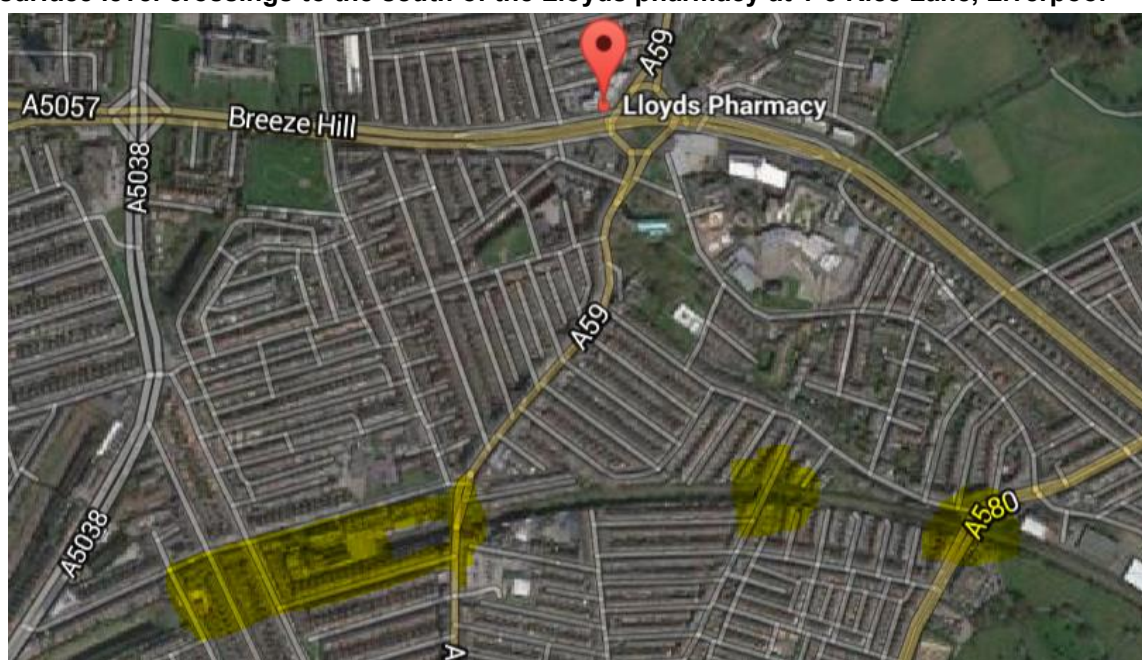
- The railway lines referred to by the CMA do not represent a barrier to customer movement in this area: as the satellite images on the **next page** show, these lines are metro lines, and in large parts run underground, with many roads and crossings at surface level that would allow customers to travel easily either to or from this area to have a prescription fulfilled (either by car, or by crossing those roads on foot).

⁵⁴ PFs, Para 7.193.

Satellite image that highlights underground sections of the railway line to the west of the Lloyds pharmacy at 1-3 Rice Lane, Liverpool



Satellite image that highlights an underground section of the railway line and multiple surface level crossings to the south of the Lloyds pharmacy at 1-3 Rice Lane, Liverpool



- The fascia count around the Lloyds pharmacy at 1-3 Rice Lane is 17 to 16, based on the CMA's standardised catchment distance of 1.4 miles.⁵⁵
- The GP surgery in which the Lloyds pharmacy is located brought together a number of GPs from different locations when it opened in 2008. Patients will therefore travel in and out of this area to see their GP, and may make use of a wide range of pharmacies. The GP practice list includes 10 pharmacies within its geography, with these 10 pharmacies all being well placed to serve patients living near them who travel to see their GP at Breeze Hill.
- The volume of prescriptions dispensed by the Lloyds and Sainsbury's pharmacies is at odds with the suggestion of a small self-contained market, but rather indicate a much wider catchment area. The three GP practices located at the Breeze Hill Health Centre (Walton Medical Centre, SSP Breeze Hill Practice, and Grey Road Surgery) between them serve over 14,500 patients.
- It is not appropriate to dismiss the pharmacies to the west of Lloyds as forming a "micro-market" which is irrelevant to the Lloyds pharmacy at Rice Lane, simply on the basis that there are also GPs located in this area. All of the pharmacies in this area collect prescriptions from the Breeze Hill Health Centre in which Lloyds is located, and also offer home delivery to their customers.
- The Asda pharmacy at Utting Avenue can also be expected to exercise a constraint, being only 1.1 miles away (i.e. a shorter distance than that between Lloyds and Sainsbury's in e.g. Highcliffe or Biggleswade, where the CMA considers that Sainsbury's is likely to be a relevant constraint on the local Lloyds pharmacies).
- The Walton pharmacy referred to by the CMA has recently been refurbished and is readily accessible on foot or by car from Breeze Close Health Centre (being 0.6 miles away by road and 0.5 miles by foot, or 11 minutes walking). It also offers prescription collection and delivery services.
- Collection services from the Breeze Hill Health Centre are offered by 15 other pharmacies, all of which also offer free home deliveries for patients.
- The only reason this area was captured by the CMA's filters was on the basis of a diversion ratio of 8% from Sainsbury's to Lloyds in the CMA's demand estimation analysis – the Lloyds store did not fail any of the CMA's filters, and the Sainsbury's stores did not fail filters of proximity or share.
- Although the estimated diversion ratio in response to a variation in opening hours is the reason that the Sainsbury's store failed the CMA's filter, (a) this diversion was still only 8% — well below the 40% diversion in response to early closing that the CMA's own calculations suggest would be necessary to make such early closing profitable, and (b) the Lloyds store did not fail the 5% diversion ratio filter or any other of the CMA's (in our view very conservative) filters. Given that the CMA appears to accept that there is very limited if any scope to change competitive conditions at Sainsbury's stores under the terms of the cooperation agreement, this strongly suggests that this area should not be of concern.

⁵⁵ This was not mentioned in our previous submission on the 32 local areas that were of interest to the CMA, because the CMA had indicated that it was primarily interested in Sainsbury's pharmacy.

3.4 Key points from Previous Local Area Submissions

- Sainsbury's Rice Lane's average monthly number of prescription items supplied is 6,612. Similarly, the numerous independent pharmacies within 1 mile of Sainsbury's Rice Lane dispense approximately 6,000 items on average each month.
- Sainsbury's Rice Lane supplies a mere 365 prescriptions per square mile in its catchment area, whilst the Lloyds Breeze Close Health Centre pharmacy supplies 2,466 prescriptions per square mile in its own catchment area (a ratio of 675%). These figures effectively show that Sainsbury's (at most) exerts only a very low level of competitive pressure on other pharmacies located in its quite large catchment. In other words, although the catchment of the Sainsbury's pharmacy overlaps with the Lloyds pharmacies' catchments, the customers of the Sainsbury's pharmacy are widely dispersed over Sainsbury's large catchment, and Sainsbury's is not likely to be competing strongly for customers in any particular subsection of its catchment – including those in that subsection of its catchment which overlaps with Lloyds' catchments.
- The Sainsbury's Rice Lane pharmacy is open for a total of 83 hours per week, considerably longer than the Lloyds pharmacy, which is open for just 50 hours a week. The Lloyds pharmacy's weekday opening hours are very similar to its most important GP surgery (the Walton Medical Centre), but the Sainsbury's opening hours are 65% longer. The disparate opening hours of the Sainsbury's Rice Lane pharmacy and the relevant Lloyds pharmacy are inconsistent with the existence of a competitive rivalry on this parameter.
- The fascia count around the Sainsbury's pharmacy is 27 to 26, based on the CMA's standardised catchment distance on 3.8 miles, which reflects an extremely low level of concentration.
- Even on a narrower basis, there are 11 rival pharmacies within a 1 mile radius of the Sainsbury's pharmacy.

For more details, see Section 20 (Liverpool) of the Previous Local Area Submissions.

4 Sutton Coldfield

4.1 Overview of local area

As the CMA notes, there are two Lloyds pharmacies located in Sutton Coldfield (Lloyds Mere Green: 4648, FML77; Lloyds Ley Hill: 6032, FGD12), along with a Boots and a Sainsbury's, with a further Boots store to the north west. The central Boots pharmacy is currently located in temporary accommodation, pending completion of the rebuilding of the retail parade (close to the GP surgery, Lloyds and Sainsbury's) on which it was located. The CMA's concerns focus on Lloyds Mere Green.

Only slightly further afield, there are two more Boots pharmacies and an independent Tri-Pharma pharmacy directly to the south of the Four Oaks rail station, which are easily accessible via the A5127.

For convenience, a map of the local area is set out in Appendix 4.

4.2 Factual errors in the CMA's provisional findings

The PFs suggest that the only relevant pharmacies within this area are the two Lloyds pharmacies, two Boots pharmacies and the Sainsbury's pharmacy. However, this overlooks the independent pharmacy, Manichem, which is also within the catchment area of both Lloyds pharmacies (and which is the *strongest* pharmacy in the wider area by a significant margin based on the average number of prescription items (12,723) it supplies each month). The Manichem pharmacy is 1.1 miles as the crow flies and 2.0 miles by road from Lloyds Mere Green (a 6 minute drive time).⁵⁶

4.3 Further arguments and/or evidence against an SLC finding

According to the PFs, "*customers travelling from the north west are likely to either divert to the Boots branch on their route or to visit Sainsbury's, although there is also a Waitrose supermarket in the local area, which may affect the number of customers visiting Sainsbury's for their grocery purchases. Customers living to the north-east are likely to divert either to Sainsbury's or Boots. Therefore we consider that diversion from Lloyds to Sainsbury's in this area is likely to be high.*"

In the Parties' view, the CMA's local analysis is not sufficiently supported by evidence, and it cannot be assumed that Sainsbury's would represent the most likely alternative choice to Lloyds' customers such that diversion ratios between the Lloyds pharmacy and the Sainsbury's pharmacy would be sufficiently high to justify an SLC finding.

In particular:

- As the CMA notes, the main competitor in this area is Boots, which the CMA acknowledges has a "particularly strong brand ... [which] means that it tends, for equivalent distances, to attract a higher customer diversion than other brands."⁵⁷ There is therefore no evidence to suggest that diversion ratios to Sainsbury's would be high; rather the logical assumption is that diversion ratios to Boots are likely to be high.
- Furthermore, the Boots refurbishment (due to open in September 2016) is likely to result in an improved Boots offering, increasing its brand strength in this area (see the photo and image on the **next page**). Both its temporary and future permanent locations lie *between* Lloyds and Sainsbury's, with strong visibility from both GP practices in the area.

⁵⁶ Distances by road from Google Maps using exact addresses.

⁵⁷ PFs, Para 7.147(b).

Photo of the *old* Boots site in Sutton Coldfield (near Lloyds Mere Green)



Image of the *new* Boots site in Sutton Coldfield (also near Lloyds Mere Green)



CGI of Mulberry Walk retail development in Mere Green

- Diversions in response to opening hours variations are extremely low between the parties (1% from Lloyds to Sainsbury's and 4% from Sainsbury's to Lloyds) – suggesting that even on the CMA's basis for assessment a reduction in opening hours would not be profitable in this area.

4.4 Key points from Previous Local Area Submissions

- Sainsbury's Mere Green supplies only 220 prescriptions per square mile in its catchment area, whilst the Lloyds Mere Green pharmacy supplies 1,540 prescriptions per square mile in its own catchment area (a ratio of 700%). These figures effectively show that Sainsbury's (at most) exerts only a very low level of competitive pressure on other pharmacies located in its quite large catchment. In other words, although the catchment of the Sainsbury's pharmacy overlaps with the Lloyds pharmacies' catchment, the customers of the Sainsbury's pharmacy are widely dispersed over Sainsbury's large catchment, and Sainsbury's is not likely to be competing strongly for customers in any particular subsection of its catchment – including those in that subsection of its catchment which overlaps with Lloyds' catchments.

For more details, see Section 28 (Sutton Coldfield) of the Previous Local Area Submissions.

5 Christchurch (Highcliffe)

5.1 Overview of local area

There are two Lloyds pharmacies located close to one another in Christchurch (Lloyds Highcliffe Medical Centre (5610, FPE99) (which is situated within the medical centre) and Lloyds Highcliffe (5839, FR859)) with no other pharmacies within their catchment. Sainsbury's is located 1.8 to 1.9 miles to the west (on the outskirts of Christchurch). There are a number of alternative pharmacies to the west, including two Wessex pharmacies, and a Day Lewis and a Tesco in New Milton to the east of Highcliffe.

For convenience, a map of the local area is set out in Appendix 4.

5.2 Factual errors in the CMA's provisional findings

The CMA suggests that there is only one Wessex pharmacy which is a "principal alternative pharmacy" in this area. However there are in fact *two* Wessex pharmacies located a very similar distance away from Lloyds Highcliffe and Lloyds Highcliffe Medical Centre:

- Wessex pharmacy (186 Somerford Road) is 1.9 miles by road from Lloyds Highcliffe Medical Centre and 2.1 miles from Lloyds Highcliffe; and
- Wessex pharmacy (94 Mundeford Road) is 2 miles by road from Lloyds Highcliffe Medical Centre and 2.5 miles from Lloyds Highcliffe.

Therefore, both of these Wessex pharmacies should be considered as "principal alternative pharmacies".

There is also a Tesco with a pharmacy around 3 miles from both Lloyds stores; this should also not be overlooked, as once a customer is travelling by car, it is not much further to travel 3 miles to the Tesco rather than just under 2 miles to the Sainsbury's.

5.3 Further arguments and/or evidence which suggests that this local area should not raise any concerns

According to the PFs, the CMA considers that, in the event of the closure of one or both Lloyds branches in Highcliffe, or a deterioration of quality sufficient to cause customers to divert, customers would be “*most likely to visit Sainsbury’s as there are no high street pharmacies within the Lloyds catchment area.*” The CMA adds “*Since Sainsbury’s is also the nearest supermarket for individuals living in Highcliffe, it is likely that a reasonable proportion of Lloyds’ customers are already visiting Sainsbury’s.*”

In the Parties’ view, the CMA’s local analysis is not sufficiently supported by evidence, and it cannot be assumed that Sainsbury’s would represent the most likely alternative choice to Lloyds’ customers such that diversion ratios between the Lloyds pharmacies and the Sainsbury’s pharmacy would be sufficiently high to justify an SLC finding.

In particular, the Parties note that:

- As the CMA notes, the Sainsbury’s is situated outside of the Lloyds catchment area. Ordinarily, therefore, the Sainsbury’s would not be expected to constrain the Lloyds pharmacies.
- As the CMA itself notes, the Day Lewis (to the east of Highcliffe, in New Milton) and Wessex pharmacies (to the west of Highcliffe) are approximately the same distance away as the Sainsbury’s pharmacy, with the Day Lewis being marginally closer. There is no reason to believe that these alternative pharmacies do not constrain the Lloyds pharmacies simply by virtue of the fact that they are not supermarket pharmacies. Indeed, the fact that they are more similar in format to the two Lloyds pharmacies may be attractive to customers.
- The journey to Day Lewis is at least as agreeable as the journey to Sainsbury’s, involving a direct route along a single carriageway road with readily available parking. By contrast, the journey to Sainsbury’s from Highcliffe involves crossing a major dual carriageway and roundabout.
- The CMA cites no evidence in support of the assumption that customers in Highcliffe are more likely to be using Sainsbury’s than another supermarket to do their grocery shopping (and thus may be more inclined to divert their pharmacy needs from Lloyds to Sainsbury’s rather than another alternative in the area). As noted, there is also a Tesco store in New Milton, which the parties believe to be approximately 2.4 to 2.6 miles as the crow flies from the Lloyds pharmacies and a 3 mile (9 minute) drive, and in a very similar position relative to the Lloyds pharmacies as the Sainsbury’s pharmacy. In addition, there is a Waitrose supermarket in Christchurch (close to a Boots pharmacy, among others in Christchurch) which customers may frequently use to access a range of services (being the nearest large town which is readily accessible from Highcliffe).
- The Sainsbury’s pharmacy’s average monthly number of prescription items supplied is 4,958. Both of Lloyds’ pharmacies have substantially higher prescription volumes: 9,227 at Lloyds Highcliffe Medical Centre and 8,672 at Lloyds Highcliffe.
- An assessment of the impact of the opening of the Sainsbury’s on the two Lloyds pharmacies finds no evidence of any negative impact on Lloyds’ sales at either pharmacy – at the Highcliffe Lloyds, sales were on average essentially the same in the two years before and after the opening of the Sainsbury’s, and the Highcliffe

Medical Centre Lloyds sales increased following the opening of the Sainsbury's in December 2005.

- The CMA's own demand estimate diversion ratio from the Lloyds Highcliffe Medical Centre pharmacy to the Sainsbury's Christchurch pharmacy is 0%. Similarly the demand estimate diversion ratio from the Lloyds Highcliffe pharmacy to the Sainsbury's Christchurch pharmacy is 0%. Therefore for the CMA's primary theory of harm regarding opening hours to be upheld, these diversion ratios would have to be understated by a factor of more than 80 (despite the CMA relying on these diversion ratios for its filtering exercise). The Sainsbury's in Christchurch operates on a 100 hours licence and is currently open 101 hours per week, and therefore could not reduce its hours (and in fact did not fail any of the CMA's filters, and therefore did not appear on the list of 154 stores of concern, suggesting that a reduction in Sainsbury's quality or opening hours is in any case not a focus of the CMA).
- Collection services are offered by 10 pharmacies in the area, with 9 of these also offering free home deliveries. Sainsbury's does not offer home deliveries.

5.4 Key points from Previous Local Area Submissions

- There are no other pharmacies in the catchment area of either Lloyds pharmacy. In this sense, there will be no fascia count reduction as a result of the merger (it is a 1 to 1 situation in each case).⁵⁸ Outside of the catchment areas for the Lloyds pharmacies in Highcliffe, however, there is a wealth of other pharmacy choices. Those living on the eastern side of Highcliffe may well find it convenient to visit the Day Lewis in Old Milton (just off Christchurch Road), or the Boots, Superdrug and Tesco in New Milton, whilst those living on the western side of Highcliffe can currently choose between two independent pharmacies (both trading under the Wessex brand) and the Sainsbury's supermarket pharmacy. Just to the west of the Sainsbury's supermarket pharmacy and the nearby Wessex pharmacy, there are two Rowlands pharmacies located near a GP practice.
- Sainsbury's Christchurch supplies a mere 109 prescriptions per square mile in its catchment area, whilst the Lloyds Highcliffe Medical Centre pharmacy (which is located within the GP premises) supplies 2,096 per square mile in its own catchment area (a ratio of 1,918%), and the Lloyds Highcliffe pharmacy supplies 1,408 prescriptions per square mile in its own catchment area (a ratio of 1,289%). These figures are significant; they effectively show that Sainsbury's (at most) exerts only a very low level of competitive pressure on other pharmacies located in its quite large catchment. In other words, although the catchment of the Sainsbury's pharmacy overlaps with the Lloyds pharmacies' catchments, the customers of the Sainsbury's pharmacy are widely dispersed over Sainsbury's large catchment, and Sainsbury's is not likely to be competing strongly for customers in any particular subsection of its catchment – including those in that subsection of its catchment which overlaps with Lloyds' catchments.
- Lloyds Highcliffe Medical Centre is open for a total of 50 hours per week, and Lloyds Highcliffe is open for 56 hours. These Lloyds pharmacies' opening hours are aligned

⁵⁸ The fascia count around the Sainsbury's pharmacy, however, is 11 to 10, based on the CMA's standardised catchment distance of 3.8 miles. This represents a very healthy degree of competition.

to the main GP surgery's core surgery hours, which finish at 18:30. By comparison, the Sainsbury's Christchurch pharmacy is open for a total of 101 hours per week. The disparate opening hours of the Sainsbury's Christchurch pharmacy and the two Lloyds pharmacies are inconsistent with the existence of a competitive rivalry on this parameter.

For more details, see Section 9 (Christchurch) of the Previous Local Area Submissions.

6 Sandy / Potton / Biggleswade area

6.1 Overview of local area

As the CMA notes, there are two Lloyds branches (Lloyds Biggleswade and Lloyds High Street Biggleswade) and a Boots branch located close together in the centre of Biggleswade, with an independent located to the east of the town. Sainsbury's is located on the northern edge of the town (close to the A1). Lloyds also has pharmacies in the town of Sandy and the village of Potton, located to the north of Biggleswade.

For convenience, a map of the local area is set out in Appendix 4.

6.2 Further arguments and/or evidence against an SLC finding

According to the PFs, the CMA is concerned that Sainsbury's is likely to be the main alternative other than Boots for customers in Biggleswade. The CMA is also concerned that Sainsbury's is the closest alternative to the two Lloyds pharmacies in Sandy, and is likely to represent the second alternative to customers located in Potton. The CMA therefore concludes that, notwithstanding the reduced scope to reduce the offering at Sainsbury's, "there is likely to be close competition between the Parties in the area as a whole".

In the Parties' view, the CMA's local analysis is not sufficiently supported by evidence, and it cannot be assumed that Sainsbury's would represent the most likely alternative choice to Lloyds' customers such that diversion ratios between the Lloyds pharmacy and the Sainsbury's pharmacy would be sufficiently high to justify an SLC finding.

In particular:

- The CMA's own demand estimation diversion ratio in response to variations in opening hours from the Lloyds High Street Biggleswade and Lloyds Biggleswade pharmacies to the Sainsbury's Biggleswade pharmacy is only 2%. This is well below the 40% that the CMA calculates would be necessary for a reduction in opening hours to be profitable.
- Collection services from both Biggleswade GP surgeries are offered by three other pharmacies, with two of these also offering free home deliveries for patients.
- The Jardines pharmacy to the east of Biggleswade should not be dismissed. The CMA's statement that Lloyds' customers are not located near the Jardines, and that it therefore will not receive significant diversion, overstates the situation. The absolute distances involved are very small, and thus the customers of both Lloyds and Sainsbury's are nearby. Furthermore, the Jardines is located only slightly further from either of Lloyds' stores in Biggleswade than the Sainsbury's, and the CMA's maps do not show the Jardines to be notably further away from Lloyds' customers than Sainsbury's.

- The Biggleswade GPs are also dispensing GPs, and can dispense to any patient living more than 1 mile from a pharmacy. 10.3% and 8.3% of patients of these two surgeries are registered for dispensing services from the GP (i.e., those patients have a choice of using a pharmacy or using their GP, and have chosen to use a GP). GP dispensing therefore clearly provides a notable competitive constraint on pharmacies in this local area.⁵⁹
- Similarly both of the GP practices in Sandy are dispensing GPs, representing 17.3% and 12.2% of patients for these GP practices respectively who will thus have a choice between Lloyds, the GP dispensary or another pharmacy.
- The fascia count reductions around each of Lloyds High Street and Lloyds Biggleswade are 4 to 3, with Boots and Jardines remaining as local competitors in central Biggleswade. By contrast, the fascia count around the Sainsbury's falls from only 6 to 5, while for the Lloyds stores in Sandy and Pottton there is no reduction in fascia within their catchment area.

6.3 Key points from Previous Local Area Submissions

- Boots is very close geographically to both parties' stores in Biggleswade, and will continue to exert strong competitive pressure following the merger. As the CMA itself has acknowledge, Boots has a "particularly strong brand ... [which] means that it tends, for equivalent distances, to attract a higher customer diversion than other brands."⁶⁰
- The Sainsbury's supplies a mere 70 prescriptions per square mile in its catchment area, whilst the Lloyds Biggleswade pharmacy supplies 1,812 prescriptions per square mile in its own catchment area (a ratio of 2,591%). These figures are significant; they effectively show that Sainsbury's (at most) exerts only a very low level of competitive pressure on other pharmacies located in its quite large catchment. In other words, although the catchment of the Sainsbury's pharmacy overlaps with the Lloyds pharmacies' catchments, the customers of the Sainsbury's pharmacy are widely dispersed over Sainsbury's large catchment, and Sainsbury's is not likely to be competing strongly for customers in any particular subsection of its catchment – including those in that subsection of its catchment which overlaps with Lloyds' catchments.

For more details, see Section 4 (Biggleswade) of the Previous Local Area Submissions.

7 Cardiff

7.1 Overview of local area

The stores in which the CMA is interested are located in a residential area north of Cardiff which includes a large number of other pharmacies. In particular, as noted by the CMA, the medical centre in front of the Sainsbury's store contains an InSync pharmacy. The Lloyds and Sainsbury's stores were included in the CMA survey, which found diversion ratios of

⁵⁹ This same point applies in Reading, with even greater force. The Theale GP surgery served by LP is a dispensing practice, and can therefore service any patient living more than one mile from the Lloyds Theale pharmacy. This provides a constraint on the parties' pharmacies in this local area which has not previously been considered by the CMA. 16.5% of the patients at the Theale GP surgery currently make use of the GP's dispensary function. Given the structure of the CMA's survey questions, this may well not have been picked up in the survey responses.

⁶⁰ PFs, Para 7.147(b).

44% from both Lloyds to Sainsbury's and from Sainsbury's to Lloyds, but *only if all stores of the first party were to close* in each case. That is, these figures provide an insight into what might happen if all the Lloyds stores in Cardiff were to close.

Sainsbury's supermarket pharmacy is located in Thornhill, Cardiff. It occupies a site behind a medical centre, in which there is a medical practice served with a collection and delivery service by an independent rival pharmacy (InSync).

The nearest Lloyds pharmacy is Lloyds Station Road Llanishen (6095, 602838K), located to the south of the Sainsbury's Thornhill store, in Llanishen, Cardiff. It is very close to a Boots pharmacy, and a different GP practice.

The Sainsbury's Thornhill supermarket pharmacy and the Lloyds Station Road Llanishen pharmacy are not linked by a direct main road. The parties' stores are separated by the B4562 road.

For convenience, a map of the local area is set out in Appendix 4.

7.2 Further arguments and/or evidence against an SLC finding

In the Parties' view, there is insufficient evidence to justify an SLC finding in this area.

In particular:

- The diversion ratio in response to a single Lloyds store closure is more relevant in this case, given that the CMA has not identified any likelihood of multiple Lloyds store closures (nor, for that matter, are single store closures identified as a likely outcome either). Instead, the CMA's focus is on local variations in opening hours at the individual pharmacy level (and potentially other reductions in quality parameters, although this is not clear). With that in mind, the single store closure diversion ratio is the more relevant figure. In this case, looking at the single store closure diversion ratio from Lloyds to Sainsbury's, the figure falls to 37% (i.e. below the 40% threshold used by the CMA (which the parties argue is in any case overly conservative when comparing a theory of harm based on opening hours with a diversion based on the much more extreme scenario of store closure)).
- The likely constraint imposed by the InSync pharmacy should not be dismissed. As the CMA notes, InSync (operated, owned and directed by a number of GPs and former employees of the North Cardiff Medical Centre, plus two pharmacists) has a "branch pharmacy" that operates out of the North Cardiff Medical Centre in front of the Sainsbury's store. This branch pharmacy provides a prescription collection/order point operating on behalf of InSync, which faxes prescriptions to the main pharmacy (located in the North Cardiff Medical Centre branch located on Thornhill Road in Llanishen), and offers patients a collection or delivery service. Overall, InSync currently dispenses a higher volume of prescriptions than either the Sainsbury's or the Lloyds pharmacies.
- It is also clear that InSync is seeking to expand in the area, with an application for a further licence at a third set of premises. Even if this licence application is unsuccessful, InSync intends to operate a further prescription collection service from this site (beginning as early as June 2016), increasing its presence in this area (which is likely to impact the Lloyds at Llanishen). InSync has also announced plans to collect from other GP surgeries in the area and to start opening on Saturdays.

- In addition, there are clearly a number of other competitor pharmacies within the catchment area that the CMA has not considered in any detail in its PFs. According to the parties' data, the following pharmacies are also within the CMA's 1.4 mile catchment area and are feasible alternatives for customers:
 - the InSync Pharmacy at the North Cardiff Medical Centre branch at Thornhill Road (i.e., not the “branch pharmacy” at the main North Cardiff Medical centre, but the main pharmacy at the Medical Centre branch which is located in Llanishen);
 - two Well pharmacies; and
 - four independents, namely: Brookes Pharmacy, Andrew J Hales, Thornes Pharmacy and W Griffiths Pharmacy.
- Additionally, looking at the results of the CMA's own survey in this area:
 - An area of clear differentiation between the parties is in relation to how customers reach the pharmacy. According to the CMA survey, 30% of Lloyds' customers walked to the pharmacy, compared to only 9% of Sainsbury's customers. 87% of Sainsbury's customers travelled by car to the pharmacy, versus only 64% of Lloyds' customers.
 - According to the survey evidence, Boots and InSync will remain viable alternatives for customers of both Lloyds and Sainsbury's pharmacies, as will Brookes Pharmacy in the case of Lloyds:
 - 14% of Sainsbury's customers said they would divert to Boots in the case of both a single store closure and an all-brand closure. 21% and 24% of Lloyds' customers said they would divert to Boots in the case of a single store closure and all-brand closure, respectively.
 - 13% of Sainsbury's customers said they would divert to InSync in the case of both a single store closure and an all-brand closure. 8% and 9% of Lloyds' customers said they would divert to InSync in the case of a single store closure and all-brand closure, respectively.
 - 8% and 9% of Lloyds' customers said they would divert to the independent Brookes Pharmacy in the case of a single store closure and all-brand closure, respectively.

7.3 Key points from Previous Local Area Submissions

- Within the catchment area of the Lloyds Llanishen pharmacy (1.4 miles), the fascia count is 9 to 8 (including multiple independent pharmacies, and two Well pharmacies), which reflects a very low level of concentration.⁶¹
- The Sainsbury's Thornhill supplies a mere 267 prescriptions per square mile in its catchment area, whilst the Lloyds Station Road Llanishen supplies 1,625 prescriptions per square mile in its own catchment area (a ratio of 609%). These figures effectively show that Sainsbury's (at most) exerts only a very low level of competitive pressure on other pharmacies located in its quite large catchment. In

⁶¹ Within Sainsbury's catchment area (the distance of which is 3.8 miles), the fascia count reduction is 33 to 32, which reflects an extremely low level of concentration.

other words, although the catchment of the Sainsbury's pharmacy overlaps with the Lloyds pharmacy's catchment, the customers of the Sainsbury's pharmacy are widely dispersed over Sainsbury's large catchment, and Sainsbury's is not likely to be competing strongly for customers in any particular subsection of its catchment – including those in that subsection of its catchment which overlaps with Lloyds' catchment.

For more details, see Section 7 (Cardiff) of the Previous Local Area Submissions.

8 Beaconsfield

8.1 Overview of local area

As the CMA notes, three pharmacies in Beaconsfield are situated in the new town centre: Sainsbury's, Boots and Lloyds The Highway (5404, FV161), in addition to a second Lloyds pharmacy in the old town centre approximately one mile away: Lloyds Beaconsfield (5067, FLY55), which is co-located with a GP practice. There is also a Tesco in the area, approximately 2.1 miles by road to the west of the old town (and 2.2 miles from Sainsbury's).⁶²

For convenience, a map of the local area is set out in Appendix 4.

The photo below shows the position of the Boots store relative to the Lloyds pharmacy in the new town centre (Lloyds The Highway).



8.2 Further arguments and/or evidence against an SLC finding

According to the PFs, the CMA considers that given the location of customers, GP practices and competitors in the area, Sainsbury's and Lloyds would be close competitors, with Boots the only other significant competitor. While the CMA concedes that Boots may be the closest competitor to Lloyds, it considers Sainsbury's to be a significant competitor and that the merger may therefore be expected to result in an SLC in the area.

In the parties' view, the CMA's local analysis is not sufficiently supported by evidence, and an SLC finding cannot therefore be maintained.

⁶² It is unclear what the source of the 2.7 miles figure cited by the CMA is, or what point is used to define the old town.

In particular:

- It appears from the PFs that the CMA's concerns in this area are focused on the Lloyds Beaconsfield pharmacy in the old town (located on London Road), which was included in the CMA's survey. According to the survey results, 37% of customers would choose to divert to Sainsbury's on the assumption that all rival Lloyds stores were closed, and only 30% if there was only a single Lloyds store closure (which is more relevant in this case, given the focus on local variations in opening hours at the individual pharmacy level). The parties note that either figure is below the 40% diversion threshold that the CMA states would be necessary for a reduction in opening hours to be profitable, despite being in response to a question that would be expected to drive substantially higher diversion than the theory of harm in question (a reduction in opening hours) – in response to which many customers might simply visit the same pharmacy at a different time or on a different day (meaning lower diversion to rivals).⁶³
- According to the CMA survey:
 - 34% of Lloyds' customers walked to the surveyed pharmacy, as compared to just 9% of Sainsbury's customers. 88% of Sainsbury's customers travelled by car to the Sainsbury's store (compared with only 61% of Lloyds customers).
 - Customers at Sainsbury's spent an average of £25.20 on non-pharmacy items, whereas customers at Lloyds spent only £1.20 on such items – illustrating the very different shopping mission of these customers.
 - Boots and Tesco will remain viable alternatives for both Lloyds and Sainsbury's customers (with Boots a particularly strong constraint on Lloyds, and Tesco on Sainsbury's, reflecting their differentiated offers and those of the parties):
 - 27% of Sainsbury's customers said they would divert to Boots in the case of both a single store closure and an all-brand closure. 27% and 47% of Lloyds' customers said they would divert to Boots in the case of a single store closure and all-brand closure, respectively.
 - 15% of Sainsbury's customers said they would divert to Tesco in the case of both a single store closure and an all-brand closure. 9% and 10% of Lloyds' customers said they would divert to Tesco in the case of a single store closure and all-brand closure, respectively.
- The CMA's own demand estimation diversion ratio from the Lloyds The Highway pharmacy to the Sainsbury's Beaconsfield pharmacy is 0%. Similarly, the demand estimation diversion ratio from the Lloyds Beaconsfield pharmacy to the Sainsbury's Beaconsfield pharmacy is 1%. Given that the only theory of harm based on empirical evidence is one of earlier closing, and that the CMA calculates that early closing would only be profitable in the face of a diversion ratio of 40%, in order to find these stores problematic the CMA would have to believe that its own demand elasticity estimates (on which its initial filtering exercise also relies) are understated by a factor

⁶³ The CMA did not survey customers at the Lloyds pharmacy in the new town centre (located at 5 The Highway, Beaconsfield), which has lower combined share and increment according to the CMA's linear weighted market share methodology.

of 40. It is not consistent to base the filtering exercise on these estimates while at the same time postulating such a large error in the results. The Sainsbury's store could not reduce its hours as it is a 100 hours pharmacy, currently operating at 101 hours.

8.3 Key points from Previous Local Area Submissions

- Sainsbury's Beaconsfield pharmacy's average monthly number of items is 2,358. This is a relatively low number, and suggests it does not currently exert a strong constraint on Lloyds' pharmacies in Beaconsfield.
- By comparison, the nearby Boots' average monthly number of items is much higher, at 4,071, whilst the Lloyds The Highway (new town) pharmacy supplies an average of 4,493 items a month, and the Lloyds Beaconsfield (old town) pharmacy supplies an average of 4,568 items a month. Interestingly, the Tesco pharmacy to the west of Sainsbury's Beaconsfield store supplies more items than any of these competitors: it averages 5,597 items a month.
- Lloyds The Highway is open for a total of 62 hours per week, and Lloyds Beaconsfield is only open for 54 hours. By comparison, the Sainsbury's Beaconsfield pharmacy is open for a total of 101 hours per week. The Lloyds pharmacies' weekday opening hours appear to be matched to those of their most important GP practices (Millbarn Medical Centre – surgery times finish at 18:00; and The Simpson Centre – surgery times finish at 18:30). By contrast, Sainsbury's Beaconsfield's opening hours are not at all closely aligned with its most important GP surgery. The disparate opening hours of the Sainsbury's Beaconsfield pharmacy and the two Lloyds pharmacies are inconsistent with the existence of substantive competitive rivalry on this parameter.
- The Sainsbury's pharmacy supplies a mere 52 prescriptions per square mile in its catchment area, whilst the Lloyds The Highway pharmacy supplies 730 prescriptions per square mile in its own catchment area (a ratio of 1,404%) and Lloyds Beaconsfield supplies 742 prescriptions per hour (a ratio of 1,428%). These figures are significant; they effectively show that Sainsbury's (at most) exerts only a very low level of competitive pressure on other pharmacies located in its quite large catchment. In other words, although the catchment of the Sainsbury's pharmacy overlaps with the Lloyds pharmacies' catchments, the customers of the Sainsbury's pharmacy are widely dispersed over Sainsbury's large catchment, and Sainsbury's is not likely to be competing strongly for customers in any particular subsection of its catchment – including those in that subsection of its catchment which overlaps with Lloyds' catchments.
- Within Sainsbury's catchment area, the fascia count is 9 to 8, which reflects a very low level of concentration.

For more details, see Section 2 (Beaconsfield) of the Previous Local Area Submissions.

9 Luton

9.1 Overview of local area

The area of interest to the CMA is to the north of Luton, and centred on the Lloyds pharmacy at Bramingham Park Centre, located next to the Barton Hills Medical Centre. As the CMA

notes, this pharmacy is around 0.1 miles from Sainsbury's Bramingham Park, with a number of other pharmacies in the area.

For convenience, a map of the local area is set out in Appendix 4.

9.2 Further arguments and/or evidence which suggests that this local area should not raise any concerns

According to the PFs, while the two nearest independent pharmacies to the Lloyds and Sainsbury's pharmacies fulfil a similar number of prescriptions to Sainsbury's, the fact that "they are located further away" together with the view that "the walking routes are not straightforward and the independent ... is across a major road" suggests that "Sainsbury's would capture a high proportion of customers diverting from the nearby Lloyds in the event of a quality drop".

In the parties' view, the CMA's local analysis is not sufficiently supported by evidence, and it cannot be assumed that Sainsbury's would represent the most likely alternative choice to Lloyds' customers such that diversion ratios between the Lloyds pharmacy and the Sainsbury's pharmacy would be sufficiently high to justify an SLC finding.

In particular:

- The CMA's own demand estimation diversion ratio from the Lloyds Luton pharmacy to the Sainsbury's Bramingham Park pharmacy is 0%. As above, this is not consistent with it being profitable to reduce opening hours at the Lloyds pharmacy. Although the Sainsbury's diversion is higher (at 5%), and indeed is given as the reason the Sainsbury's store failed the original filtering exercise, we note that this Sainsbury's is a 100 hours pharmacy, and is only open for 101 hours, and therefore could not reduce its opening hours further.
- The "major road" which separates Lloyds from the independent Warden Hill pharmacy is a single carriageway and a signal-controlled pedestrian crossing is located within 150 metres of the Warden Hill pharmacy (with a pedestrian island crossing also available 200 metres in the other direction). This is not likely to present a significant impediment to pedestrians. The route between the Barton Hills Medical Centre and Warden Hill Pharmacy is straightforward and is 0.7 miles by foot (approximately 13 minutes) or 0.9 miles by car (approximately 4 minutes without traffic).⁶⁴ It is certainly not likely to present more of an impediment to pedestrians than the footbridge over the M4 motorway in Reading, which:
 - it is necessary to cross if walking between the Lloyds in Theale and Sainsbury's store in Calcot; and
 - the CMA clearly does not believe poses a significant impediment to pedestrians, given its analysis in that area.
- The CMA makes no mention of the bus routes 24, 24H, 25 and 26 which serve both of the independent pharmacies from the Sainsbury's and the GP surgery / Lloyds pharmacy location, running on 20-30 minute intervals. There is a bus stop outside the Featherfield pharmacy on Birdsfoot Lane and a stop close to the Warden Hill pharmacy.

⁶⁴ Source: Google Maps – using exact street address of each store (rather than a postcode or other less specific details).

- Both independent pharmacies benefit from ample parking and are co-located with other retailers.
- Collection services from Barton Hill are offered by seven other pharmacies, all of which also offer free home deliveries.
- The practice area list for the GP surgery next to which Lloyds is located includes six pharmacies other than the Lloyds and Sainsbury's pharmacies, which indicates that the patients using the GP surgery benefit from a range of choice within the practice area.

9.3 Key points from Previous Local Area Submissions

- Looking at Lloyds Luton, there are *four* rival pharmacy stores within a 1 mile radius (not including Sainsbury's). Beyond this, there are an additional three rival pharmacy stores in its catchment area, including two Rowlands pharmacies. This means the fascia count reduction due to the merger would only be 7 to 6, based on the CMA's standardised catchment distance of 1.4 miles (suggesting that a very healthy level of competition would remain in the post-merger period).⁶⁵
- The Sainsbury's pharmacy's average monthly number of prescription items supplied is 3,975. Lloyds Luton's average monthly number of prescription items supplied is significantly higher, at 7,869. Of the four rival pharmacy stores within a 1 mile radius of Lloyds Luton, the first does an average of 4,257 (Warden Hill Pharmacy, Barton Road), the second does an average of 3,544 (LPC, Birdsfoot Lane), the third does an average of 5,927 (Calverton Pharmacy, Calverton Road), and the fourth does an average of 11,470 (Henlow Health, Birdsfoot Lane). These are all quite healthy figures, and show that these close geographic rivals to Lloyds Luton are attracting a significant number of customers in this local area.
- The Sainsbury's Bramingham Park pharmacy supplies only 84 prescriptions per square mile in its catchment area, whilst the Lloyds Luton pharmacy supplies 1,278 prescriptions per square mile in its own catchment area (a ratio of 1,528%) and the Lloyds Purley Centre pharmacy supplies 1,071 prescriptions per square mile in its own catchment area (a ratio of 1,280%). These figures effectively show that Sainsbury's (at most) exerts only a very low level of competitive pressure on other pharmacies located in its quite large catchment. In other words, although the catchment of the Sainsbury's pharmacy overlaps with the Lloyds pharmacies' catchments, the customers of the Sainsbury's pharmacy are widely dispersed over Sainsbury's large catchment, and Sainsbury's is not likely to be competing strongly for customers in any particular subsection of its catchment – including those in that subsection of its catchment which overlaps with Lloyds' catchments.
- Lloyds Luton is open for a total of 55 hours per week. By comparison, the Sainsbury's Bramingham Park pharmacy is open for a total of 101 hours per week. The Lloyds pharmacy's weekday opening hours are similar to those of its most important GP surgery (the Barton Hills Medical Group), but the Sainsbury's opening hours are 80% longer. The disparity in the opening hours of the Sainsbury's Bramingham Park

⁶⁵ Within Sainsbury's catchment area, the level of concentration is extremely low, with a fascia count of 34 to 33, based on the CMA's standardised catchment distance of 3.8 miles.

pharmacy and the Lloyds pharmacy is inconsistent with the existence of a competitive rivalry on this parameter.

For more details, see Section 21 (Luton) of the Previous Local Area Submissions.

Appendix 1 – Are the CMA’s demand model diversions understated?

We note that the PFs continue to assert that its demand model estimates of diversion in response to variations in opening hours may understate the diversions between the parties.

Rather than responding directly to the parties’ comment that this lack of variation in opening hours could not be a valid reason for low diversions (in particular as opening hours vary a great deal – as can be seen from Figure 1 on page E6 of the PFs), the PFs instead present a new argument why these diversions may be understated: namely that:

- Only opening hours are controlled for and not other aspects of quality competition, and
- The model assumes that consumers substitute to other pharmacies in proportion to GP practice share of prescriptions of each pharmacy, and that these shares are generally very small.

The parties note, however, that since the CMA’s demand model controls for opening hours, then regardless of whether the model controls for other aspects of quality competition, the resulting diversion ratios are estimates of the diversion arising from a change in opening hours. This is the only aspect of Lloyds’ QRS offering where the CMA has illustrated that Lloyds has an incentive to deteriorate its offering post-merger. Therefore, in assessing whether Lloyds actually has an incentive to deteriorate its opening hours, the estimated diversion ratios from the CMA’s demand model should be used (i.e. the demand model diversion ratios should be directly compared with the CMA’s critical diversion ratio of 40%), and not a diversion ratio based on a change in all quality parameters (much less a diversion ratio based on the pharmacy being closed for an extended period). Moreover, in comparing the estimated diversion ratio with the CMA’s critical diversion ratio there is no reason to adjust the demand model diversion ratios, as in the PFs the CMA provides no reason why these diversions underestimate the diversion in respect to opening hours.

Moreover, regarding the CMA’s first new reason why the demand model diversions might underestimate the diversion with respect to quality in general, although the lack of inclusion of information on other quality parameters could in principle result in understated diversion ratios:

- This is not necessarily the case if quality measures are correlated (so that stores that offer longer opening times also do better on other quality metrics);
- The size of any such effect is in any case likely to be small given that the survey evidence shows that convenience (including opening hours, whether the store is in a supermarket, and the location of the store – all of which are taken into account in the CMA’s analysis) is much more important than service to customer decision making (with service aspects only named as most important factor by 5-6% of respondents net).⁶⁶ It is therefore not valid to assume that the true diversions may be a factor of 6 higher than estimated (as was done for the filtering exercise), let alone a factor of 40+ higher (as is often the case in local areas, where an SLC is found to arise despite diversions from Lloyds to Sainsbury’s of 0-1%).

In relation to the CMA’s second reason why the demand model diversions might be understated (because pharmacy shares of GPs are small): although it is correct that the inherent structure of the model means that diversions are essentially determined by pharmacies’ shares of GP prescriptions (so lower shares will tend to result in low diversion ratios) the PFs do not explain why this should mean that the resulting diversion ratios are understated. Given the GP shares are on average low,

⁶⁶ DJS survey report, Figure 13 page 22.

it is not unreasonable to expect that the diversion ratios will also be low, but instead the CMA appears to have a prior view that despite the GP shares being low the diversion ratios should be higher. There is no explanation for this view in the PFs.

It is true of course that the contrast between the CMA's findings on diversion in response to variations in opening hours and the survey diversions in response to store closure in areas like Kidlington and Theale are particularly striking. However, this is consistent with many customers responding to a variation in opening hours by visiting the same store at a different time (rather than diverting to a different store). In this case the marginal impact of a merger in relation to an "early opening" theory of harm would be less than in relation to a "closing stores" or "raising price" theory of harm, as a given store would already recapture most of the lost demand from closing earlier at a different time/on a different day. It is clearly this marginal diversion to rivals that is relevant to a theory of harm around shortened opening hours, however, and not the survey diversion in response to a complete store closure.

Appendix 2 – Detailed criticism of the CMA’s filtering methodology

1 The filtering approach applied by the CMA was inappropriate

As set out in the main body of this Response, the parties maintain that there is no case for concluding that the merger may be expected to result in an SLC in any local area. Notwithstanding this position, the parties also note for the record that they continue to have a number of concerns regarding the CMA’s approach to local analysis in this case.

2 The approach used to narrow down problematic areas relies on extrapolation from a handful of case studies

Having identified 154 stores as potentially problematic, the CMA then “examined the survey case study areas in more detail to identify local market features that were associated with high diversion ratios and used these features to assess the characteristics of the areas around the 154 stores that failed... [its initial] filters”⁶⁷, and through this process ultimately identified 32 areas that were potentially problematic, which was later reduced to 13.

The PFs are now drawing conclusions on which “features” of local markets are likely to result in high diversions based on this very limited sample. It is not reasonable to try to extrapolate general conclusions in this way from such a small and unrepresentative sample.

Moreover, of the 16 local areas which were surveyed, only three areas showed diversion ratios for individual store closures that were clearly above the 40% threshold that the CMA claims is of concern (Lloyds and Sainsbury’s in Kidlington, Lloyds in Theale (Reading) and Sainsbury’s in Warlingham), with a further two areas showing diversions at or around the 40% level (Sainsbury’s in Beaconsfield, as well as Lloyds and Sainsbury’s in Cardiff). Even if the CMA was looking at five areas, that is far too small a sample from which to extrapolate a list of meaningful rules (referred to by the CMA as “characteristics”). As a result, the CMA’s list of 32 potentially problematic areas was not a reasonable subset of areas to investigate in further detail – it included many areas that were clearly not problematic.

Therefore, not only was the original identification of 154 stores of potential concern inappropriately conservative (resulting in stores being identified of potential concern when no such concern should have existed), but the method by which these stores were then narrowed down to the 13 Provisional SLC Areas is also flawed. The combination of these weaknesses results in areas appearing in the 13 Provisional SLC Areas, despite the fact that there is only very weak evidence (if any) to suggest that there would actually be any realistic prospect of an SLC.

3 Principles underlying the filtering approach

As noted above, the CMA’s theory of harm focuses on potential variations in *QRS* rather than price. Specifically, the CMA refers to a number of aspects of quality of service that *might* be varied, but offers a calculation of the incentives to do so in relation to only one: opening hours. As set out in the main body of this Response, the parties believe this is flawed both on the basis of forecast (as the 40% diversion threshold calculated may well understate the true diversion that would be required to make a reduction in opening hours profitable) and on the basis of past behaviour (as there is no robust evidence of significant historical constraints placed on one another by the parties). However, even if there were evidence that

⁶⁷ PFs, Para 34

Lloyds' opening hours were likely to be varied in response to the merger, in the parties' view, the relevant thresholds for identifying areas where this might take place would be much higher – in terms of:

- The **demand estimation diversion threshold** (which is the most direct evidence on diversion in response to variations in opening hours); and
- The **market share threshold** used, which can be considered as a proxy for such diversions.

These concerns are set out in greater detail below.

4 The 5% demand estimation diversion threshold is too low

The CMA calculates a “critical” diversion ratio of 40% in relation to varying opening hours. Strikingly, as set out in the main body of this Response, it does not carry out a similar calculation of the profitability threshold for any other element of QRS that might be varied, and therefore it is only a potential SLC through varying opening hours that can be quantified based on the evidence and arguments set out in the PFs.

The equivalent evidence for Sainsbury's pharmacies does not suggest that opening hours are sensitive to local concentration generally, or the presence of a local Lloyds store specifically, and neither has the CMA presented any calculation of the cost-saving benefits that a Sainsbury's store might expect to gain by closing early. Moreover, many Sainsbury's stores are constrained by the terms of 100 hours licences, so *could not* reduce their hours below this level, and all the acquired pharmacies will be covered by the Cooperation Agreement, which will make it very difficult for Lloyds to reduce hours at these stores in order to benefit its other stores. This would have a negative impact on Sainsbury's in order to benefit Lloyds, and there is no reason to believe that Sainsbury's would accept such a reduction. Therefore, no credible theory of harm has been put forward that the merged firm might have the ability and incentive to reduce its opening hours in these Sainsbury's located pharmacies.

The CMA's calculations suggest that reducing Lloyds' opening hours would be profitable if Lloyds were to recapture 40% of the lost demand. However, it then applies a 5% demand estimation diversion threshold for identifying problematic areas, on the basis that there is a loose correlation between survey diversions and demand estimation diversions in the surveyed areas, and that this relationship suggests that a demand estimation diversion of 5% would be “equivalent to” a survey diversion of 30%.

4.1 Concerns with the PFs methodology

There are several problems with this approach:

- First, the relationship between demand estimation diversion ratios and survey diversion ratios is extremely loose (with a low R^2),⁶⁸ and cannot be used as the basis for simply assuming that a 5% opening hours diversion (from the demand estimation) is “equivalent to” a 30% closure diversion (from the survey).

⁶⁸ This is the proportion of the variation in the demand estimation diversion ratio that is explained by the variation in the survey diversion ratios.

- Second, there is no evidence to support a 30% threshold as the relevant one. The CMA's own calculations suggest a threshold of 40% (and, as set out above, this may well understate the true threshold).
- Third, the CMA appears to have focused its comparison on survey diversions that would arise *if all Lloyds stores or all Sainsbury's stores were to close*, and not only the surveyed store. This is not the relevant test for an assessment of incentives to close *a single Lloyds (or Sainsbury's) store* early. Diversion to other Lloyds stores would already be taken into account by the focal store, and would not be directly affected by the merger. Therefore the incremental change due to the merger is generally given by the single-store closure diversion (DV6), and not the full fascia closure diversion (DV7). The latter would generally be relevant to nation-wide rather than local theory of harm.
- Fourth, and **most critically**, these diversion ratios ask customers where they would go if the store they use is closed. However, the theory of harm depends on how customers would respond to *early closing*, and therefore would result in a strictly *lower* diversion than in response to store closure (as customers would have the option of visiting the same pharmacy at a different time, rather than a different pharmacy).

The CMA has in fact estimated precisely the relevant diversion ratios to compare with this threshold: diversion in response to a small change in opening hours (using a demand estimation technique). As noted above, although the CMA suggests these could be understated as a measure of diversion in response to more general quality variations, there is no reason to suppose it is understated as a measure of diversion in response to small variations in opening hours.⁶⁹ Therefore, there is no reason to suppose that these are understated as a measure of diversion for the theory of harm in question.

If, on the contrary, the *unadjusted* demand estimation diversion ratios are used (which show directly the response to opening hours variations), no stores would fail this threshold. Even if these estimated diversions understate the actual position by a factor of 2 (which would be a very extreme assumption, given that the CMA's model accounts for the factors that the survey suggests are most important to customers: convenience/location), still no stores in the 13 Provisional SLC Areas would have an incentive to reduce opening hours in this way based on the CMA's own calculations.

4.2 Impact on results

This makes a difference to the results: notably, the only reason that Liverpool failed the CMA's filter is because of a Sainsbury's diversion in response to variation in opening hours of 8%. Even if a headline case had been made that Lloyds pharmacies located in Sainsbury's stores might have the ability and incentive to reduce opening hours post-merger, it cannot be the case that a diversion of 8% is problematic. Diversion ratios from Lloyds to Sainsbury's in Beaconsfield, Cardiff, Christchurch, Kempston, Kidlington, Leeds, Liverpool, Luton, Sandy/Biggleswade/Potton and Sutton Coldfield are all 5% or lower, and the only Lloyds diversion to Sainsbury's over 10% is seen in Warrington (14%). Even in this area, the

⁶⁹ As noted above, even if they were understated as a measure of diversion in response to quality variations more generally, there is no reason to assume that this understatement would be large: and certainly not of the scale of the factor of 6 that has been applied to these diversions for the purpose of the filter.

estimated diversion would have to be understated by a factor of 3 to breach even the CMA's 40% threshold.

Therefore, clearly none of these areas would trigger a 40% threshold under any reasonable adjustment, and therefore in none of them should a significant reduction in opening hours at Lloyds be seen as a realistic prospect post-merger.

5 The market share thresholds are too conservative

The CMA's use of a 40% threshold for the parties' combined share (using their linear weighted share methodology) seems to be based on a correlation between combined share of stores and the survey diversion ratio (with an R2 of 69% in the UK).

5.1 Concerns with the PFs methodology

First, we note that it would be far more logical to compare the implied *diversion* based on market shares with the implied diversion from the survey. Otherwise the analysis is comparing two fundamentally non-comparable metrics. However, even taking the analysis at "face value", the correlation (reading off Figure 8 on page K11) suggests that a survey diversion of 40% would be equivalent to a combined share of stores of around 53%. The CMA decided to filter stores based on much lower combined shares (at 40%), apparently on the basis that this was roughly equivalent to a 30% diversion: but as noted above, the CMA's own calculations suggest that the critical threshold is higher than that.

Moreover, the market share thresholds actually used by the CMA imply diversion ratios from Lloyds to Sainsbury's that are well below the threshold identified by the theory of harm (as noted above, there is no evidence provided to support any theory of harm in relation to varying opening hours or any other aspect of quality at Sainsbury's locations, and therefore it is diversion from Lloyds to Sainsbury's that are relevant to the theory of harm).

For example, consider an area that just triggers the CMA's filter, where Lloyds has 25% share and Sainsbury's has just over 15% (combined share just over 40%). In this area a simple calculation of diversions based on market share would give a diversion of 20%, i.e. only half the CMA's calculated threshold. More generally the table below shows that there are many sets of share combinations that would trigger the CMA's 40% combined/15% increment filter (shaded in pink), without generating a diversion ratio that is of concern even on the CMA's own methodology (shown in bold red text).

Table 1: Implied diversion ratios from Lloyds to Sainsbury's at different market share combinations

		Sainsbury's share:		
		15%	20%	25%
Lloyds share:	15%	18%	24%	29%
	20%	19%	25%	31%
	25%	20%	27%	33%
	30%	21%	29%	36%
	35%	23%	31%	38%
	40%	25%	33%	42%
	45%	27%	36%	45%
50%	30%	40%	50%	

Moreover, this would be to assume that all pharmacies are equally close competitors to one another: if in fact Lloyds and Sainsbury's are recognised as being relatively less close competitors, the equivalent diversion would be even lower.

Indeed, the shares on which these calculations are based do more than assume the different fascia are all equally close competitors: they actually *overweight* the competition from supermarket rivals (including Sainsbury's), relative to a community pharmacy at the same distance from Lloyds. This is explicitly recognised in Appendix K to the PFs (on page 9), but no adjustment has been made to take account of it.

5.2 Impact on results

Adjusting to take account of these problems would result in fewer areas failing the CMA's market share filter, including areas that continue to be found to be problematic. In particular, even using the CMA's own linear weighted market share calculations (complete with overweighting of Sainsbury's) and ignoring the evidence that the parties are not particularly close competitors, market-share based diversions from Lloyds to Sainsbury's would be below 40% in Leeds, Liverpool, Luton, Biggleswade (both stores) and Sutton Coldfield.

APPENDIX 3 – CRA ASSESSMENT OF THE CMA QUALITY OF SERVICE AND LOCAL COMPETITION REGRESSIONS

Overview and summary

CRA have reviewed and assessed the CMA's regression analysis of the relationship between the quality of service in Lloyds and Sainsbury's pharmacies and local competition that is set out in Appendix G of the PFs. Overall, the results of the CMA's analysis in this appendix show there is little evidence that local competition, and in particular local competition between the parties, is an important determinant of the quality of service at either Lloyds pharmacies or at Sainsbury's pharmacies. The only evidence the CMA presents in this appendix that local competition from the other party might affect quality of service concerns Lloyds' weekly opening hours and whether Sainsbury's offers a stop-smoking service. However, as CRA explain below, if a more general model is used, then there is no evidence that the number of local competing Sainsbury's pharmacies has any statistically significant effect on Lloyds opening hours in either the opening hours or the extended hours model, and it is only if there are *three* local Lloyds in an area that the number of Lloyds has a significant positive statistical effect on whether Sainsbury's offers this service.

The CMA's analysis

The only evidence in Appendix G that local competition from one of the parties affects quality of service at the other party, are the findings that:

- The number of local Sainsbury's has a positive and significant effect on the total weekly opening hours of Lloyds pharmacies in urban areas – see Table 1 in Appendix G;
- The number of local Sainsbury's has a positive and significant effect on the likelihood that a Lloyds pharmacy is open late or on Sunday – See Table 2 in Appendix G; and
- The number of local Lloyds has a positive and significant effect on the likelihood that a Sainsbury's pharmacy offers a Stop Smoking service – See Table 3 in Appendix G.

CRA have reviewed these regressions to see how robust and reliable these results are. In these regressions, the CMA measures local competition by including a continuous variable for the number of stores each rival (or group of rivals) has within a defined distance of the focal store. The CMA claims that using a continuous variable to measure the number of stores of each rival, "allows us to estimate a more general relationship between the quality parameters and the degree of competition", and is preferable to the approach CRA used in its assessment of quality of service and local competition, which involved including a set of dummy (or categorical) variables to capture the number of local rivals within a defined area around each focal store.

However, the use of a continuous variable to capture the number of stores of each rival means the CMA is assuming each additional store of a rival has the same incremental effect on quality of service at the focal store as the first store. For example, if there were three Sainsbury's in the local area, then in total, the presence of these three Sainsbury's is assumed to have three times the effect on Lloyds quality of service, compared with if there was just one Sainsbury's in the local area. However, in reality it is likely that if the presence of a local rival does affect quality of service, each additional store does not have the same incremental effect as the first store, but if anything has a smaller incremental effect (i.e. there are diminishing returns from further competitors). So in our example, we would expect the combined effect of the three Sainsbury's to be less than three times the effect of one Sainsbury's.

A more general way of capturing the effect the number of stores a rival has on quality of service of the focal store, is to replace the CMA's continuous variable with a set of dummy variables for the number of stores each rival has in the local area. Using a set of dummies for the number of stores of each rival allows the effect of each additional store on quality of service to differ, and is a more general approach of capturing these possible effects than the approach used by the CMA. Therefore, we have re-estimated the two regressions where the CMA found that the number of local Sainsbury's had a positive and significant effect on the total weekly opening hours at Lloyds and on whether Lloyds was open late or at the weekend, and the regression that found the number of local Lloyds had a significant effect on whether Sainsbury's offered the stop-smoking service, but including a set of dummy variables for each rival to capture the effect the number of stores that rival has in the locality, rather than the CMA's continuous variables.

Results of the robustness check

Table 1 below contains the results for the three re-estimated regressions – column (A) contains the results for Lloyds total weekly opening hours, column (B) contains the results for whether Lloyds is open late or on Sunday, and column (C) contains the results for whether Sainsbury's offers the stop-smoking service.

The results in the table show that none of the CMA's results are robust or reliable.

Columns (A) and (B) show that once the number of stores of each rival is modelled in a more general way, the number of Sainsbury's in the locality has no significant effect on either total weekly opening hours at Lloyds, or on whether Lloyds is open late or at weekends. In both regressions, the coefficients on the dummy variables for the number of local Sainsbury's are both individually insignificant and jointly insignificant.

In column (C), the results show that it is only if there are *three* local Lloyds in an area that the number of Lloyds has a significant positive effect on whether Sainsbury's offers this service: if there are just one or two local Lloyds, then this has no significant effect on whether Sainsbury's offers this service. Moreover, this finding that if there are three local Lloyds then Sainsbury's is more likely to offer the stop-smoking service is based on just 13 observations out of a total of 76, which raises further questions about the robustness of this result.

Furthermore, in each regression, the restrictions that need to be imposed to get the CMA's model specification are rejected.

More generally, these regressions show that competition from rival pharmacies is not an important determinant of either Lloyds opening hours or whether Sainsbury's offers the stop-smoking service. Most of the dummy variables for the number of stores a rival has in the locality are statistically insignificant (both individually and jointly for each rival) in each of these regressions.

Table 1: Relationship between Lloyds/Sainsbury's urban store opening times / extended hours service / stop smoking service, and number of competitors

	Table 1a	Table 2a	Table 3c
	Store opening hours, Lloyds urban	Extended hours service, Lloyds urban	Stop smoking service, S'bury's urban
Number of Lloyds stores within 1.5 miles of an existing store			
1 Lloyds store	-5.917** (2.812)	-0.108* (0.0557)	0.144 (0.280)
2 Lloyds stores	-6.613** (2.987)	-0.0927 (0.0609)	0.0433 (0.246)
3 Lloyds stores	-2.483 (4.992)	0.00711 (0.0952)	0.852*** (0.284)
4 Lloyds stores	-12.70* (6.980)	-0.0582 (0.153)	0.161 (0.389)
5 Lloyds stores	3.543 (12.82)	0.0139 (0.165)	1.143 (0.718)
6 Lloyds stores	-21.74** (8.789)	-0.233 (0.146)	0.402 (0.460)
7 Lloyds stores	-3.482 (13.34)	-0.0801 (0.267)	/
8+ Lloyds stores	-24.99** (11.97)	-0.209 (0.184)	/
Number of Sainsbury's stores within 3 miles of an existing store			
1 Sainsbury's store	2.840 (2.750)	0.00761 (0.0557)	-0.570* (0.309)
2 Sainsbury's stores	3.674 (4.418)	0.0389 (0.0781)	-0.424 (0.375)
3 Sainsbury's stores	12.27 (10.14)	-0.0132 (0.142)	0.542 (0.498)
4 Sainsbury's stores	10.93 (6.807)	0.233 (0.169)	0.0554 (0.425)
5 Sainsbury's stores	8.781 (11.17)	0.245 (0.248)	/
6 Sainsbury's stores	9.251 (13.47)	0.439 (0.277)	/
Number of large multiple chain stores within 1.5 miles of an existing store			
1 large multiple chain store	1.797 (3.846)	-0.0732 (0.0866)	-0.177 (0.303)
2 large multiple chain stores	-1.763 (3.358)	-0.0378 (0.0773)	0.162 (0.382)

	Table 1a	Table 2a	Table 3c
	Store opening hours, Lloyds urban	Extended hours service, Lloyds urban	Stop smoking service, S'bury's urban
3 large multiple chain stores	5.588 (4.113)	-0.0380 (0.0870)	0.0682 (0.416)
4 large multiple chain stores	-0.0126 (4.857)	-0.118 (0.101)	0.291 (0.438)
5 large multiple chain stores	-6.233 (4.846)	-0.203** (0.0967)	0.626 (0.418)
6 large multiple chain stores	-8.615* (4.954)	-0.102 (0.112)	0.633 (0.485)
7 large multiple chain stores	0.707 (6.023)	-0.0248 (0.141)	-0.115 (0.438)
8+ large multiple chain stores	8.524 (8.363)	0.103 (0.166)	0.677 (0.534)
Number of small multiple chain stores within 1.5 miles of an existing store			
1 small multiple chain store	3.949 (4.477)	0.133 (0.0911)	1.114 (1.015)
2 small multiple chain stores	-2.669 (4.247)	0.00208 (0.0791)	1.555 (1.131)
3 small multiple chain stores	-4.090 (4.004)	-0.0228 (0.0805)	1.359* (0.729)
4 small multiple chain stores	2.058 (4.854)	0.190* (0.103)	2.963*** (1.056)
5 small multiple chain stores	7.602 (6.415)	0.204* (0.117)	0.723 (0.465)
6 small multiple chain stores	-3.011 (5.241)	-0.0373 (0.106)	1.346 (0.837)
7 small multiple chain stores	2.248 (6.239)	0.0711 (0.115)	1.416 (0.927)
8+ small multiple chain stores	5.206 (5.719)	0.193* (0.101)	1.446 (0.962)
Number of supermarket stores (excluding Sainsbury's) within 3 miles of an existing store			
1 supermarket store	-2.007 (4.432)	0.0338 (0.0931)	-0.277 (0.456)
2 supermarket stores	4.104 (4.495)	0.167 (0.101)	-0.622 (0.385)
3 supermarket stores	6.380 (5.224)	0.0904 (0.104)	-0.0254 (0.426)
4 supermarket stores	5.903 (5.256)	0.0736 (0.109)	-0.668* (0.372)

	Table 1a	Table 2a	Table 3c
	Store opening hours, Lloyds urban	Extended hours service, Lloyds urban	Stop smoking service, S'bury's urban
5 supermarket stores	4.311 (6.154)	0.000148 (0.115)	-0.0364 (0.452)
6 supermarket stores	9.737 (7.088)	-0.0584 (0.133)	-1.437 (0.877)
7 supermarket stores	-0.997 (10.25)	0.0148 (0.276)	-0.741 (0.710)
8+ supermarket stores	46.65*** (10.53)	0.720*** (0.220)	/
Number of GPs within 3 miles of an existing store in urban areas and within 5 in rural ones	-0.110 (0.145)	-0.0003 (0.003)	-0.0139 (0.0102)
GP volumes within 3 miles of an existing store in urban areas and within 5 in rural ones	0.483 (4.756)	0.016 (0.106)	0.244 (0.628)
Constant	53.58 (60.53)	-0.130 (1.366)	-4.100 (8.529)
Regional dummies	Yes	Yes	Yes
F-test on whether Lloyds dummies are jointly insignificant and equal to zero ^[4]	1.90 p=0.060	0.92 p=0.50	3.00 ^[6] p=0.01
F-test on whether Sainsbury's dummies are jointly insignificant and equal to zero ^[4]	0.63 p=0.70	0.84 p=0.54	2.14 p=0.08
F-test on whether large multiples dummies are jointly insignificant and equal to zero ^[4]	1.61 p=0.12	1.20 p=0.30	1.40 p=0.21
F-test on whether small multiples dummies are jointly insignificant and equal to zero ^[4]	1.39 p=0.20	2.74 p=0.01	1.80 p=0.09
F-test on whether supermarket dummies are jointly insignificant and equal to zero ^[4]	5.43 p=0.00	2.93 p=0.004	1.87 p=0.09
Test of whether the CMA's restrictions are accepted ^[4]	3.05 p=0.00	1.68 p=0.013	6.83 p=0.00
R-squared	0.28	0.22	0.79
Number of observations	333	338	78

Source: CRA analysis.

Notes:

[1] Standard errors in parentheses.

[2] Levels of statistical significance: * p<0.10, ** p<0.05, *** p<0.01.

[3] Variables with "/" are omitted due to collinearity.

[4] Presents test statistic, followed by p-value.

[5] The data and STATA do-files the CMA provided did not enable us to replicate exactly the results in the tables of Appendix G.

[6] This result is exclusively being driven by the "3 Lloyds stores within 1.5 miles" variable. Excluding this variable from the test results in a test statistic of 0.62 (p-value 0.69).

13 provisional SLC areas

Maps with rival locations and travel distances/times to the focal Lloyds

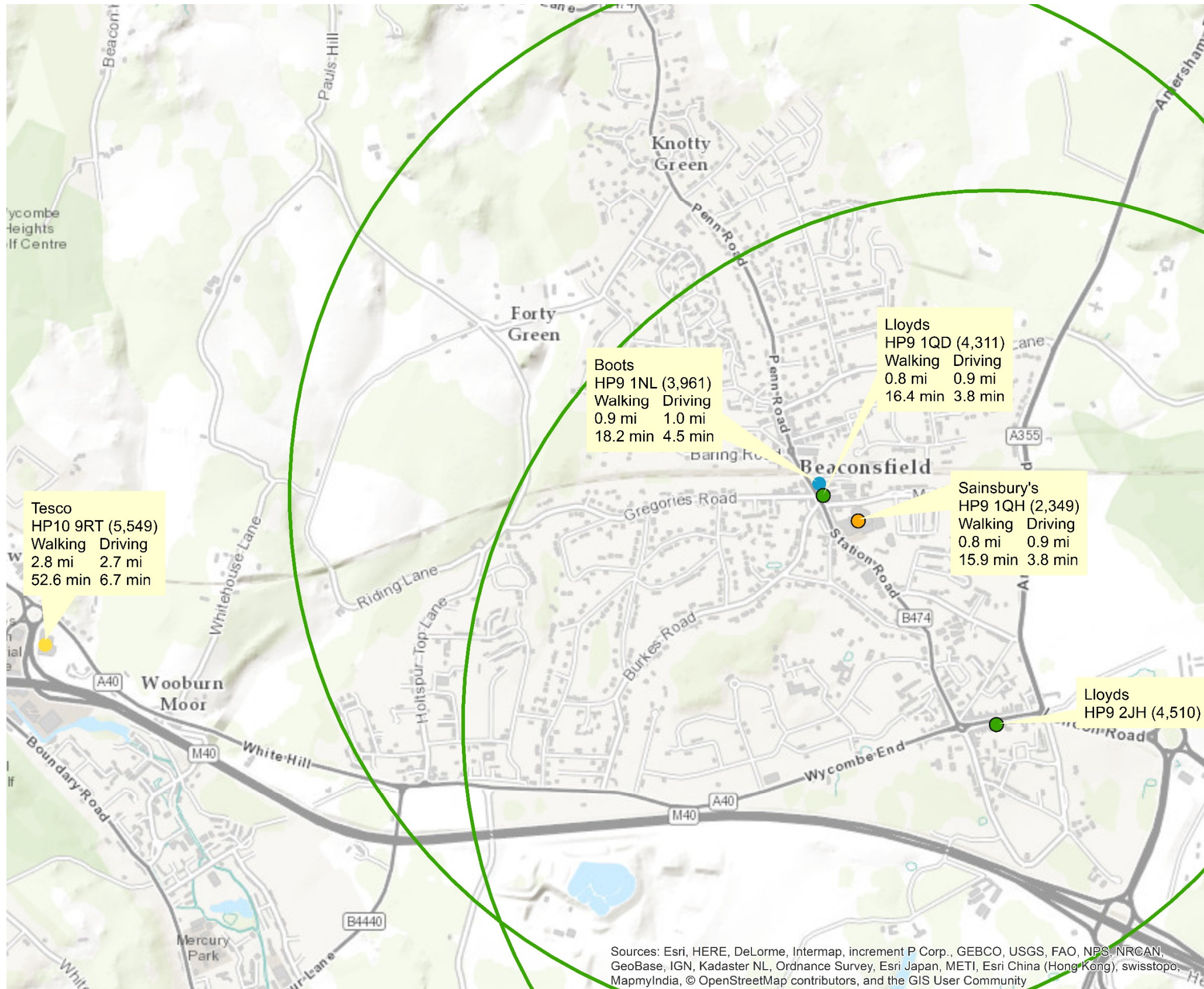
Each map shows the focal Lloyds (i.e. the Lloyds stores identified by the CMA as of concern) and the location of rivals (focusing on the Lloyds catchment area) including:

- Name
- Postcode
- Monthly prescription volumes (in brackets after the postcode)
- Walking time and distance from the Lloyds (both for the fastest route) – based on postcode location of the rival
- Driving time and distance from the Lloyds (both for the fastest route) – based on postcode location of the rival

In Christchurch the map centres only on one of the two Lloyds stores in question (the Highcliffe Medical Centre branch, which is closest to Sainsbury's) and in Biggleswade only on one of the two central Biggleswade Lloyds stores (again, the branch closest to Sainsbury's: maps centred on the Potton and Sandy Lloyds stores' catchment areas would not show any other pharmacies).

1. BEACONSFIELD



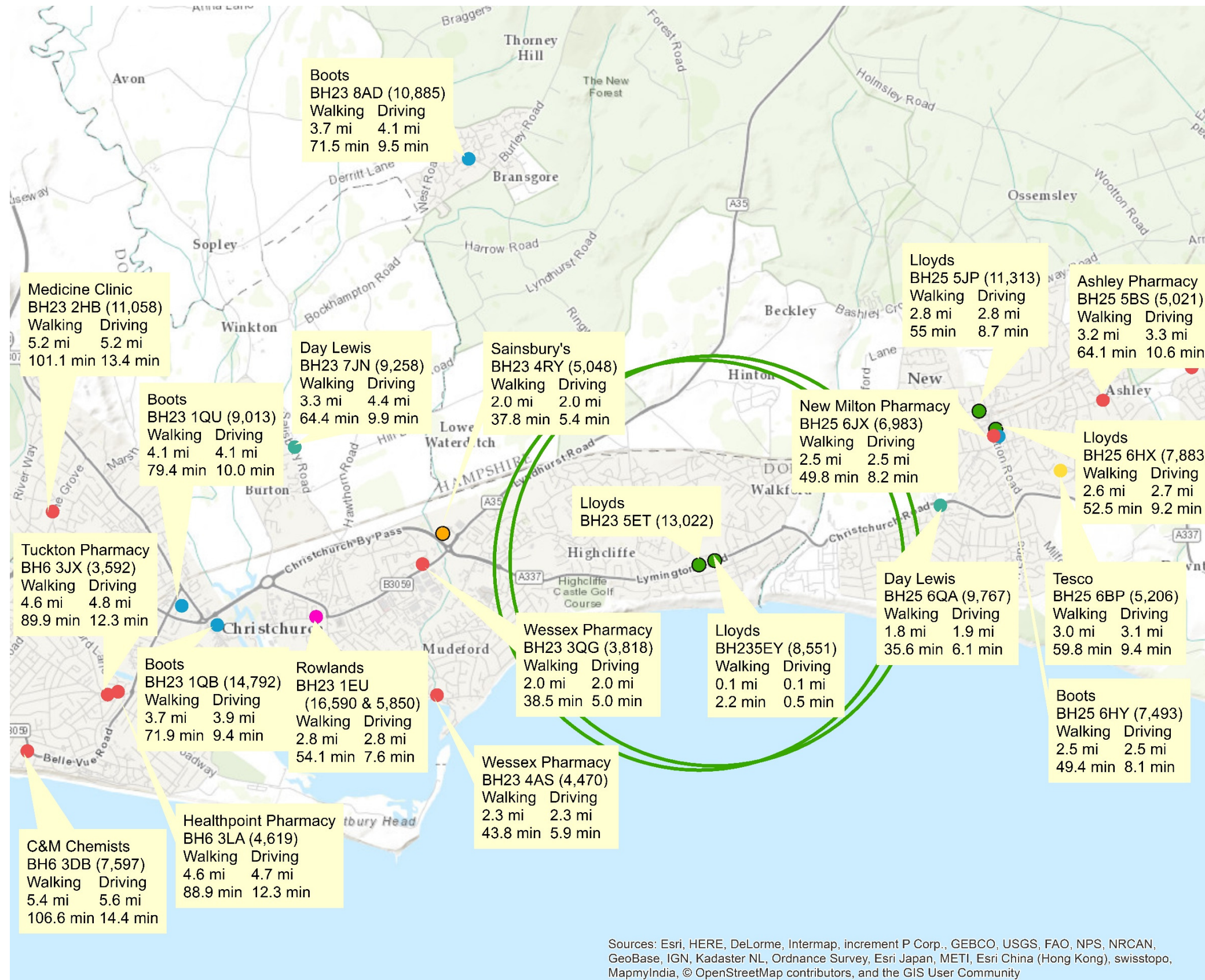


2. CARDIFF



Note: all InSync prescription volumes for both locations are recorded at the main pharmacy location on Thornhill Road.

3. CHRISTCHURCH



4. LEEDS



5. LIVERPOOL



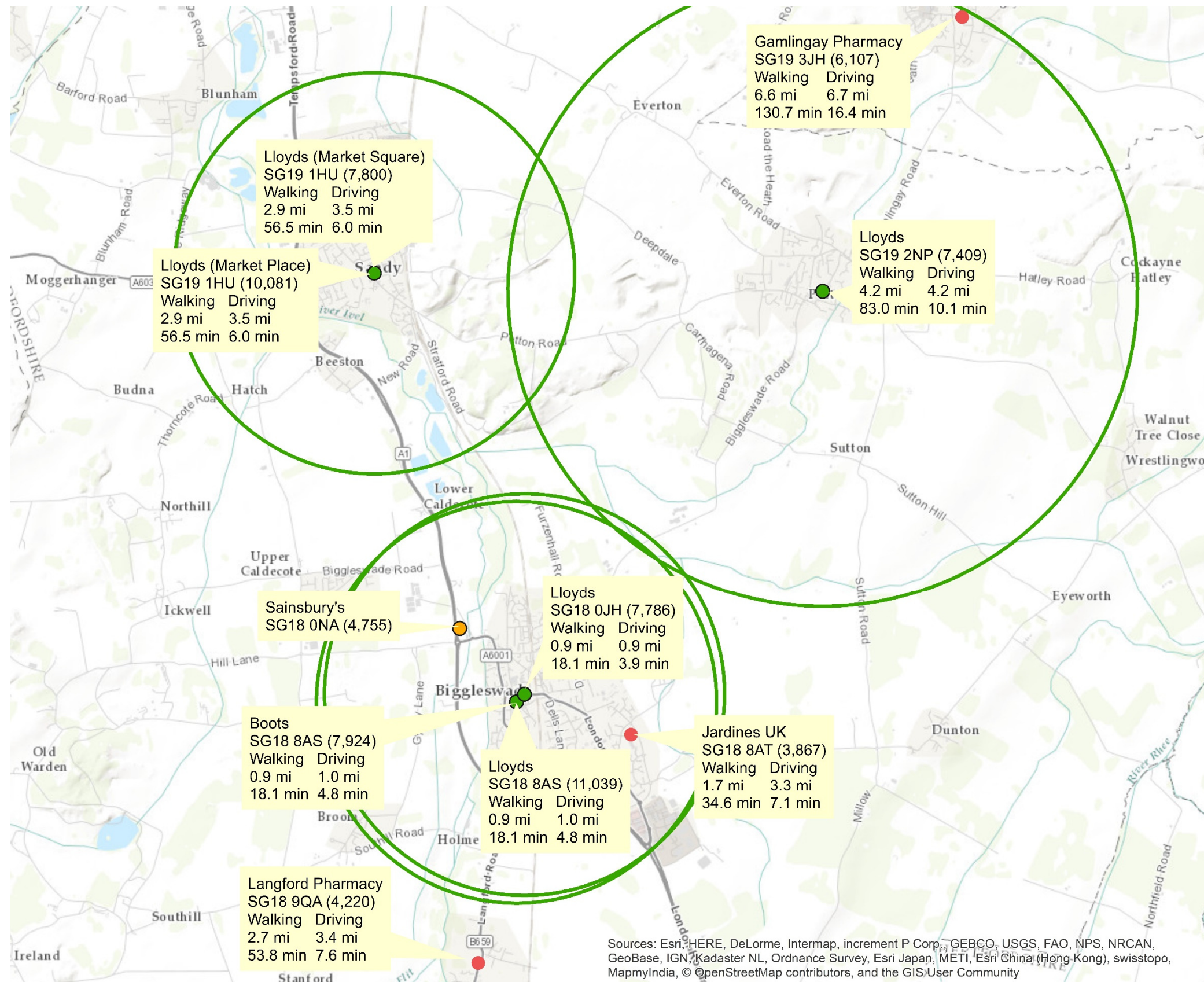
6. LUTON



7. BIGGLESWADE



8. SANDY/BIGGLESWADE/POTTON



9. SUTTON COLDFIELD

