

17 June 2016

## CELESIO AG / SAINSBURY'S PHARMACY BUSINESS

Further Submission of the Parties in relation to Possible Remedies  
and in response to the Provisional Findings

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## OVERVIEW

The parties hereby provide a further submission that addresses:

- certain concerns and issues that were raised by the CMA at the Response Hearings on Tuesday 24 May 2016, which the parties were not in a position to fully address in their response to the Provisional Findings (“PFs”) or their response to the Notice of Possible Remedies, respectively, both of which should be read in conjunction with this further submission; and
- a number of the substantive points that were raised in the CMA’s Remedies Working Paper (the remaining points raised in that paper were dealt with in a separate submission that was submitted to the CMA on 16 June 2016).

This submission is structured as follows:

**Section 1:** Executive summary.

**Section 2:** By failing to consider the intensity of rivalry that Sainsbury’s (as opposed to any other pharmacy) exerts on Lloyds, the CMA has misapplied the Enterprise Act.

**Section 3:** The SLC test requires the CMA to establish that (a) competitive pressure from Sainsbury’s likely drives superior pre-merger QRS at Lloyds’ stores such that (b) the loss of that pressure will allow/incentivise Lloyds to worsen QRS at its stores (generating adverse effects).

**Section 4:** There are no precedent concerns should the CMA correctly apply the SLC test and find insufficient evidence of SLC in any local area.

**Section 5:** Sainsbury’s offers, at best, a very attenuated competitive constraint (in general) on the QRS parameters of its rivals at the local level.

**Section 6:** Sainsbury’s and Lloyds are not close rivals.

**Section 7:** There is an incoherence of CMA reasoning across *Poundland/99p* and this case.

**Section 8:** The economic evidence does not suggest a clear relationship between variation in Lloyds’ performance on QRS parameters and local competitive conditions.

**Section 9:** There is no evidence to suggest the Transaction would cause Lloyds to depart from its strategy of setting most relevant QRS parameters at the national level.

**Section 10:** There is no evidence that the parties’ rivalry currently leads to better outcomes for customers at the local level on any of the seven QRS parameters identified by the CMA.<sup>1</sup>

**Section 11:** The CMA has put misplaced reliance on hypothetical store closure “diversion ratios” as the (missing) evidence of close pre-merger competition in some (or all) of the 13 areas.

**Section 12:** The CMA has similarly put misplaced reliance on a qualitative assessment of local area maps.

**Section 13:** There is no prospect of material adverse effects to support an SLC finding.

**Section 14:** The Remedies Working Paper suggests that the CMA has failed to properly consider the merits of a behavioural remedy.

**Section 15:** The scope of the proposed behavioural remedy can be expanded to address any concerns regarding its breadth and/or efficacy.

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<sup>1</sup> Opening hours; range of services; staffing levels and training; waiting times; location; store refurbishments; prescription collection.

## 1 Executive summary

### 1.1 Misapplication of the SLC test

Without prejudice to its submissions on remedies, Celesio remains deeply concerned that the PFs are fundamentally flawed. In particular:

- The PFs feature a misdirection as to the relevant statutory question the CMA must ask itself under section 36 of the Enterprise Act (the “**Act**”), by focusing on the degree to which Lloyds flexes variables (improves its non-price offer) at local level due to competition generally, and disregarding evidence as to the extent (if any) that such flexing (improvement of non-price offer) can reasonably be attributed to Sainsbury’s (rather than Boots, various independents, other community pharmacies, or indeed Tesco, Asda or Morrison’s).
- The Sainsbury’s-specific evidence – at best – establishes that Sainsbury’s is a weak competitor across local markets, with no evidence of the presence of a local Sainsbury’s pharmacy having a material impact on any aspect of Lloyds’ retail offer. Similarly, there is no evidence that Sainsbury’s takes the presence of local competitors into account when determining its own retail offer (in fact, there are only a small handful of variables that Sainsbury’s flexes locally at all).
- While the CMA should not have to quantify adverse effects, for the SLC finding to be reasonable, it must nevertheless articulate the nature of the adverse effects that the CMA believes will likely flow from the Transaction, given the particular merger parties and facts in this case (including the degree of regulation, Lloyds’ predominantly nationally-set offer, the lack of a national SLC theory and the lack of evidence that what Lloyds does flex locally can be, and sometimes is, driven specifically by Sainsbury’s, among others).
- Finally, even if there were evidence of a “Sainsbury’s effect” on Lloyds (which there is not), the CMA has failed to take account of this relevant consideration: the materiality of any alleged adverse effect, and whether the predicted harm to consumers (if any) is sufficiently serious to justify: (i) a finding that there has been a *substantial* lessening of competition (the “S” in SLC); and (ii) a structural remedy of divestiture, rather than the more proportionate behavioural remedy that has been proposed.

### 1.2 Absence of probative evidence of the kind required to support an SLC finding

The PFs overlook the lack of general evidence (either economic or documentary) of the kind needed for a rational SLC finding – namely, that Sainsbury’s (in general) closely constrains Lloyds to such an extent that it is reasonable to infer (in the absence of specific evidence) that Lloyds delivers an incrementally superior non-price (“**QRS**”) pre-merger retail offer due to the presence of a Sainsbury’s pharmacy in one or more particular local areas.

- This is necessary under the SLC test, because the removal of this incremental “Sainsbury’s-specific” pressure (and its consequent QRS benefit for Lloyds’ customers) is the basis for the posited post-merger adverse effect on QRS. As per CMA guidance,<sup>2</sup> this should be the key to the CMA’s hypothesis that the lessening of competition is “substantial”.

<sup>2</sup> In particular, the CMA’s Merger Assessment Guidelines (CC2) state at Paragraph 4.1.3 that: “[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]

- In this respect, the PFs fail to identify any direct local-level evidence regarding the existence of this Sainsbury's effect in any of the 13 provisional SLC areas. Nor do the PFs identify any indirect evidence that, in general across the areas of overlap between Sainsbury's and Lloyds, pressure from Sainsbury's appears to drive superior QRS at Lloyds, which might then arguably be extrapolated to the 13 local areas in question. Instead, the PFs cite (albeit selectively) a coherent and consistent body of evidence, much of it CMA-generated, either positively showing *no* effect of Sainsbury's on Lloyds (e.g. entry/exit volumes) or *not* showing any reliable positive effect.
- The CMA errs in its local SLC market analyses when (in the absence of other probative evidence) it relies upon survey "store closure" diversion ratios (and inferences from maps) as the evidentiary plank to support the existence of close local competition between the parties in certain geographic areas. Such survey evidence, whilst informative, is at its core a *hypothetical* question about an *extreme* event (full store closure). It cannot properly be used decisively to establish that, in the real world pre-merger, Sainsbury's is driving Lloyds to perform better on QRS and substantiate an SLC finding. In other CMA Phase II retail merger cases, such as *Ladbrokes/Coral* and *Poundland/99p*, survey data has been an important *supplement* to an already critical mass of probative evidence that the retail chain merger parties in such cases are generally close competitors across local overlap areas (a.k.a. "nationally"). This enables the CMA to find in other cases that there are likely to be numerous customers in certain overlap areas that *are* marginal as between the two merger parties' closely-competing retail offers who would likely switch from one to the other in response to a QRS-worsening, which drives those parties to offer superior QRS to keep or win these customers, including from their close competitor, the other party. Having established this, the limitations of "forced diversion" (store closure) survey results of all (not marginal) customers do not prevent extrapolation of the diversion results to this known marginal group. But in this case, the PFs manifestly fail to show customers are marginal between these highly differentiated parties on their in-store QRS retail offer. Absent this pre-requisite, the survey results are no more profound than revealing what all customers would do if the store were closed, which is not a theory of harm.
- Celesio is not disputing the CMA's capacity (generally speaking) to assess conflicting evidence by weighing it "in the round". However, in this case there is no weighing to be done: the PFs do not cite any probative evidence that – beyond being a "competitor" – Sainsbury's is a particularly close competitor exerting such pressure on Lloyds to an extent that makes Lloyds deliver better QRS outcomes for its customers (economic impact, monitoring/benchmarking), while there is ample evidence to the contrary. It is wholly untenable to gloss over and obfuscate this gross asymmetry in evidence by invoking an "in the round" weighing exercise. Instead, Celesio submits that the CMA cannot reasonably come to an ultimate SLC decision on the basis of the body of evidence that is discussed in the PFs and/or that has otherwise been put to Celesio for comment. Celesio's submissions on remedies are without prejudice to this point.

### 1.3 The PFs create incoherence in CMA Phase II retail merger analysis

As set out below, the PFs foreshadow an outcome that is illogical and difficult to reconcile when set against the contemporaneous approach of the CMA in other retail merger cases.

- For instance, while both the PFs and the provisional findings in *Ladbrokes/Coral* conclude in favour of SLC, the latter cite a body of convincing evidence which establishes: (i) relatively close pre-merger competition between the merger parties nationally (across *all* local overall areas); (ii) flexing of PQRS in response to competitive pressure as between the merger parties; and (iii) consequently, a rational (provisional)

expectation of material adverse effects sufficient to warrant a finding that the lessening of competition would be substantial in a number of local markets. However, it is extremely difficult to reconcile that rational and well-substantiated approach with what has been done in these PFs. This is reflected (by way of example) in the very different treatment of evidence in relation to refurbishments between the two cases (which is discussed further in Section 10.4 below).

- Equally, the PFs foreshadow an illogical outcome when set against the decisions in *Poundland/99p* and *Sports Direct/JJB Sports*, to name only two of the recent relevant Phase II clearance cases that have featured mergers of much closer competitors at national level (across *all* local overlap areas). Despite this, in those other cases, the CMA/Competition Commission (“CC”) carefully examined the evidence on the likelihood (and materiality) of adverse effects, before determining that there was no expectation that the lessening of competition in those cases would be substantial. What the CMA/CC did not do in those cases was find an SLC based on a very selective or simplistic view of the evidence – specifically, they did not find an SLC simply because the transactions might result in a merger to monopoly or quasi-monopoly in some local areas, or (for instance) due to the fact that the *average* survey diversion ratio from 99p to Poundland was over 40% in surveyed areas (with survey-based diversions between Poundland and 99p of up to 65% in some areas).<sup>3</sup>

#### 1.4 Failure to properly consider the merits of a behavioural remedy

The parties believe that: (i) a behavioural remedy would be an effective and proportionate cure if an SLC finding is maintained; (ii) the CMA’s provisional views on this point (as outlined in the Remedies Working Paper) are inadequate and unreasonable. In particular:

- The CMA has stated that the proposed behavioural remedy is not capable of effectively addressing the SLC identified in the PFs, and can therefore be dismissed without a due consideration of its merits.<sup>4</sup> The proposed behavioural remedy has been dismissed by the CMA in this manner because it addresses only one non-price aspect – namely, opening hours – whilst the CMA is provisionally of the view that “there [will] remain... scope and incentive [for Lloyds] to flex a number of aspects of quality, range and service [in addition to opening hours] in response to competitive conditions at the local level”.<sup>5</sup> Even if this general conclusion was supported by the evidence (it is not), this submission will show that there is no rational basis for concluding that competitive pressure *from Sainsbury’s* at the local level is currently driving any aspect of Lloyds’ in-store (QRS) retail offer (including opening hours). Consequently, there is no rational basis for concluding that the Transaction is likely to result in any material adverse effects for customers. In the absence of material adverse effects, the CMA’s provisional SLC finding cannot be reasonably sustained, at least not in a form that would render the behavioural remedy proposal moot.
- Furthermore, the parties have strengthened the viability of the proposed behavioural remedy by: (i) confirming that they are open to such a remedy being in place for a longer duration; (ii) unilaterally lodging applications to move the core opening hours to either end of the day (where this is not already the case) at all its stores in the 13 provisional SLC areas, which will ensure that customers are adequately protected against

<sup>3</sup> Similarly, the average survey diversion ratio was 61% in *Sports Direct/JJB Sports*. By contrast, the PFs in this case suggest that the CMA believes it is appropriate to find an SLC in local markets where the survey diversion ratio is 40% or higher, based on the example of Cardiff.

<sup>4</sup> Remedies Working Paper, paragraph 96.

<sup>5</sup> Remedies Working Paper, paragraph 95.

reductions in opening hours with minimal (or no) need for additional enforcement or monitoring by the CMA; and (iii) suggesting that the behavioural remedy could be expanded to cover the range of additional pharmacy services offered by Lloyds.

- Finally, it is irrational for the CMA to claim “a behavioural remedy that addresses all potential impacts on quality would be difficult to specify”,<sup>6</sup> given the PFs fail to clearly articulate the nature of any such “impacts on quality” which could reasonably be expected to flow from the Transaction. If the CMA had expressed its misgivings in a transparent and coherent manner, then the parties would have had a genuine opportunity to craft an appropriate behavioural remedy to address any other likely adverse effects (beyond opening hours) – but that was not the case. Lloyds may not be able to assuage the CMA’s concern about something as vague as a possible “reduction in the quality of service” with a behavioural remedy – but nor can the CMA reasonably continue to rely on vague and unsubstantiated assertions to justify an SLC finding if it is to fulfil its responsibilities as a rational decision-maker in this case.<sup>7</sup>
- Celesio therefore respectfully urges the CMA fundamentally to reconsider the reasonableness of its PFs and consequent remedial issues, without prejudice to the parties’ other points on remedies.

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<sup>6</sup> Remedies Working Paper, paragraph 97(c).

<sup>7</sup> Provisional Findings, paragraph 8.1(b).

## 2 **By failing to consider the intensity of rivalry that Sainsbury’s (as opposed to any other pharmacy) exerts on Lloyds, the CMA has misapplied the Enterprise Act**

The PFs reflect a fundamental misapplication of the Act. Section 36 of the Act requires the CMA to decide: (i) whether there is a “relevant merger situation”, in this case Celesio’s acquisition of Sainsbury’s pharmacy business (the “**Transaction**”); and (ii) whether the “creation of that situation may be expected to result in a substantial lessening of competition” (“**SLC**”).

In this case, the CMA’s SLC theory of harm is that the Transaction may be expected to result in horizontal unilateral effects in local markets, leading to (increased) unilateral market power and adverse non-price effects at Lloyds’ stores, such as lower quality, range or service (“**QRS**”).<sup>8</sup> This theory of harm does not and should not turn on how hard or “closely” Lloyds competes with community pharmacies, or even other supermarket pharmacies (such as Tesco, Asda, Morrison’s), but how closely it competes specifically with Sainsbury’s (which pertains to the relevant merger situation). In other words, it is essential to understand the nature and extent of the rivalry *between the parties*, because it is that rivalry which will be lost as a result of the Transaction.

On what parameters, and how closely, Lloyds competes with *non-merger* parties is a second-order question (relevant to the degree of third party constraints that might be available to replace any competition lost as a result of the Transaction); the first-order question is whether the merger of Lloyds and Sainsbury’s, in particular, may be expected to result in a loss of competition, and whether that lost competition is substantial because it likely translates into adverse effects for customers.

### 2.1 **The wrong question: whether any local-level merger to monopoly in the pharmacy sector creates an SLC expectation**

The PFs erroneously focus on the extent to which Lloyds could (and in a few cases does) flex any variables locally in response to competition generally, rather than in response to competitive pressure from Sainsbury’s. In this way, the CMA appears to be asking: “what are the likely consequences of any local-level merger to monopoly in the pharmacy industry?” or “what would be the consequences of a loss of rivalry between Lloyds and another community pharmacy operator at the local level?”<sup>9</sup> even though it appears to accept (consistent with a wide array of evidence) that there is material differentiation between community pharmacies and supermarket pharmacies. The PFs therefore show that the CMA is misdirecting itself on the relevant question under section 36 of the Act, leveraging generic evidence that is pertinent to the generic question posed at the start of this paragraph, but not to the question of the merger situation in this case.

### 2.2 **Still the wrong question: whether any local-level merger to monopoly between Lloyds and a (generic) supermarket pharmacy creates an SLC expectation**

At best, the CMA is asking: “what are the likely consequences of a loss of rivalry between Lloyds and any (generic) supermarket pharmacy?”. For example, while ostensibly asking the correct legal question in **bold** text, the PFs then segue immediately into conflating this with the wrong question, as follows:

“In the previous section we considered how pharmacies in general compete at a local level. In this section we focus on ***the extent to which the Parties compete with each other and particularly***

<sup>8</sup> See Enterprise Act 2002, Explanatory Notes, paragraph 133.

<sup>9</sup> See Celesio Response Hearing Transcript, p 29.

*the extent to which supermarket pharmacies compete with more traditional high street pharmacies and vice versa.*<sup>10</sup> [emphasis added]

Lloyds accepts that there is some contextual value in establishing the degree of competition between pharmacies generally, and between supermarket and community pharmacies more specifically; the evidence on these points is not irrelevant. But it is not reasonable for the CMA to conclude, based on a host of generic evidence, that Sainsbury's and Lloyds, in particular, are such close competitors that the Transaction may be expected to give rise to adverse effects and represent a likely SLC in any local area.

This is particularly the case where good specific evidence exists for Sainsbury's individually, but that evidence is replaced in the PFs by more generic evidence on the role of supermarket pharmacies more generally (or even, in some cases, on the role of supermarket pharmacies *other than* – i.e. specifically excluding – Sainsbury's). This is especially pertinent given the overwhelming lack of any direct evidence that Lloyds and Sainsbury's do actually compete directly with each other. The CMA cannot reasonably take evidence concerning the nature of competition between pharmacies generally – or even between Lloyds and other supermarket pharmacies as a category (particularly when Sainsbury's itself is excluded from that category) – and rely on such evidence to establish an expectation of an SLC, to the exclusion of probative direct evidence which clearly shows the lack of any specific material competitive effect that *Sainsbury's* has on Lloyds (see: the CMA's entry/exit study, margin analysis, and refurbishment analysis). This approach is simply wrong, and cannot rationally be sustained.

### **2.3 The evidence “in the round”**

While an “in the round” assessment might be pertinent to resist a challenge as to the weight the CMA might assign to any one item of evidence (in circumstances where some good evidence did, for sake of argument, suggest particularly intense rivalry exerted by Sainsbury's on Lloyds, and some pointed the other way), such an approach presupposes there actually being some probative evidence that the CMA can cite to establish the relevant propositions. However, the parties are not aware of *any* probative evidence which establishes:

- the general proposition that the parties are particularly close competitors across all local areas (i.e. nationally); *or*
- notwithstanding that the parties are not generally very close competitors, the proposition that Sainsbury's nonetheless drives Lloyds to deliver superior QRS outcomes at its local stores in certain overlap areas.

With this in mind, Section 3 below discusses the CMA's failure to meet this general evidentiary burden in more detail. Subsequently, in Section 10 below, this submission clearly sets out the CMA's lack of specific evidence – parameter by parameter – which might suggest that Sainsbury's is the competitive source of Lloyds' current incentive to improve its locally-flexed QRS retail offer to customers.

## **3 The SLC test requires the CMA to establish that (a) competitive pressure from Sainsbury's drives superior QRS at Lloyds' stores and (b) the loss of that pressure will allow/incentivise Lloyds to worsen QRS at its stores**

### **3.1 The relevant legal question and burden of proof**

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<sup>10</sup> Provisional Findings, paragraph 7.6. See also Part C, paragraph 2.1 of the parties' response to the PFs, where the parties made this point in more detail.



The CMA does not believe that the Transaction is likely to result in an SLC at the national level, and is instead focusing on local competitive effects.<sup>11</sup> Due in large part to the highly regulated nature of pricing in the pharmacy sector, the CMA is not concerned about the impact of the merger on prices, but is instead focusing on non-price effects (i.e. the scope for any worsening of QRS). In these two respects, the views of the parties and the CMA are aligned.

However, the relevant legal question under section 36 of the Act is whether the CMA has adduced sufficient evidence to show that, in the 13 provisional SLC areas, it is pre-merger competitive pressure *from Sainsbury's* that is currently driving superior QRS outcomes at Lloyds' stores.<sup>12</sup> In this respect, the CMA's theory of harm falls far short of the mark. Yet it is clear that the burden of proof lies with the CMA – the parties do not need to positively establish that the loss of their rivalry will not increase the ability or incentive of Lloyds to worsen QRS at the local level. Rather, the CMA must be satisfied it has adequate evidence to cogently reach the opposite conclusion, on the balance of probabilities.

### 3.2 Sainsbury's-specific evidence on Lloyds' locally-set QRS

At the Celesio response hearing on the afternoon of Tuesday 24 May, Mr Cormac Tobin indicated that Celesio was “somewhat at a loss to understand the true nature of the CMA's concerns.”<sup>13</sup> Celesio's opening remarks at the response hearing focused on opening hours, because this was the parameter on which the PFs seemed to focus (being the only factor in relation to which the CMA cited evidence of a Sainsbury's effect on Lloyds, and the only factor in relation to which any possible incentive to vary QRS was discussed).

However, during the course of the Celesio response hearing, the Panel Chairman stated that “there were other areas that were of concern to us other than opening hours.”<sup>14</sup> The Chairman went on to clarify:

“We have looked at a range of services. We have looked at staffing, training and refurbishments, as you have already mentioned. The other things. Location, although that is a medium-term issue because you cannot respond immediately in competitive terms by changing your location, is a factor. There is collection of prescriptions and that kind of thing.

But I think we felt - and, again, I note your comments about the competitive edge document - that it did indicate that there are competitive parameters here. Whether you actually act on those or not in relation to 100-hour opening or not is another issue. What it does show is that you are sensitive to those competitive levers.

The concern we have here... is that in a situation where you go to either a monopoly or a quasi-monopoly, there will be an incentive to pull some of those levers.”<sup>15</sup>

Similarly, in the Remedies Working Paper, as part of its cursory dismissal of the viability of a behavioural remedy, the CMA notes that it has “provisionally concluded that pharmacies had the incentive to improve the quality of their offer to try to attract additional customers, and that this was likely to manifest itself in pharmacies improving the quality of their offering.”<sup>16</sup>

Both these statements clearly suggest that the CMA's focus in this case has not been on the specific rivalry between the parties, or on what consequences may flow (in terms of the

<sup>11</sup> Provisional Findings, paragraph 23.

<sup>12</sup> Specifically, given the focus in this case on the scope for any worsening of QRS, consideration must be given to the nature and extent of rivalry between the parties in relation to those QRS parameters (such as opening hours) that they actually flex at the local level. This has been assessed in Section 10 below.

<sup>13</sup> Celesio Response Hearing Transcript, p 10.

<sup>14</sup> Celesio Response Hearing Transcript, p 28.

<sup>15</sup> Celesio Response Hearing Transcript, p 29.

<sup>16</sup> Remedies Working Paper, paragraph 93.

worsening of QRS parameters) from the loss of that rivalry. The Panel Chairman's reference to Celesio's historical Competitive Edge document – which was created in 2011, and has not been actively used by the business for some time – is telling. That document may, as the Chairman suggests, indicate that there are parameters on which Lloyds responds to competition (in the general sense) at the local level. But it certainly does not show that Lloyds responds to competition *from Sainsbury's* on those parameters: indeed, the Competitive Edge document does not refer to Sainsbury's at all. Moreover, as previously submitted:

- the Competitive Edge document [REDACTED], 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;<sup>17</sup> and
- the approach outlined in the Competitive Edge document was effectively superseded by the competitive risk analysis carried out by Lloyds the very next year (2012), in which Lloyds [REDACTED].<sup>18</sup> Indeed, Lloyds' risk analysis specifically states: [REDACTED].<sup>19</sup> The PFs fail to give (any apparent) weight to that risk analysis, or even to properly acknowledge the context provided by Celesio.

Similarly, whilst the CMA's provisional conclusion as expressed in the Remedies Working Paper – that *pharmacies generally* have the incentive to improve the quality of their offer to try to attract additional customers, and that this was *generally* likely to manifest itself in *pharmacies* improving the quality of their offering – may be true as a general (abstract) proposition, the reliability of that proposition is far from sufficient to justify an SLC finding. The question here is not: if Lloyds (in the abstract) obtained either a monopoly or a quasi-monopoly position in any local area, will it have an incentive to pull some of its competitive levers in a way that adversely affects customers? Rather, the appropriate question is: if the competitive pressure and rivalry from Sainsbury's is lost as a result of the Transaction, will Lloyds consequently have a materially greater incentive to pull some of its "competitive levers" in a way that adversely affects customers – i.e. by worsening specific QRS parameters?<sup>20</sup>

It is also far from novel, and certainly would not be the first Phase II retail market case where the CMA/CC found that a creation of a local (near)-monopoly in the relevant market did not result in an SLC (most recently, see *Sports Direct/JJB Sports* and *Poundland/99p*).

#### **4 There are no precedent concerns should the CMA correctly apply the SLC test and find insufficient evidence of SLC in any local area**

In a nutshell, the case in the PFs for the "worst" of the 13 areas is based on a set of propositions that are mainly not in dispute: (i) the parties both operate pharmacies; (ii) all pharmacies compete for volumes to an extent, despite regulation; and (iii) in the 13 provisional SLC areas, the parties' stores are geographically close and there are few other nearby rivals. Yet the PFs then go on to conclude – without any meaningful economic or documentary evidence – that therefore, the removal of the parties' rivalry in the 13 provisional SLC areas must be significant, and is likely to lead to adverse effects (in terms of a worse QRS offer at Lloyds' stores). There is a clear flaw in the CMA's reasoning here – it appears to assume that all pharmacies are alike, or at least not sufficiently differentiated to justify any kind of "weighting" of the competitive

<sup>17</sup> Parties' Response to the Provisional Findings, Part C, paragraph 1.4.

<sup>18</sup> Parties' Response to the Provisional Findings, Part C, paragraph 1.4.

<sup>19</sup> Lloyds document, memorandum regarding "Portfolio Risk Score - Updated Criteria" dated 13 March 2012, page 2.

<sup>20</sup> The answer to these questions could clearly be very different: even if Lloyds did behave differently in areas where it has a monopoly or quasi-monopoly (which is not established), the relevant question is whether the addition of a Sainsbury's to such areas would have any material impact on the QRS of Lloyds' offer. There is no evidence that this is the case. This may be unusual for a local markets overlap case, but it is what the extensive evidence (a good deal of it generated by the CMA) suggests.

constraint exerted by different types of competitors (such as supermarket pharmacies). But pharmacies are not all alike; the evidence in this case clearly shows that at least Sainsbury's (if not all supermarket pharmacies) offers quite a differentiated proposition for customers compared to community pharmacy operators.

Indeed, the relevant merger situation at hand is unique in the industry to date, and amongst CMA Phase II (and Phase I) retail merger cases, as it involves a combination of two operators who are active in the same sector but who have highly differentiated customer propositions. Accordingly, any decision in this case should not have direct "read-across" to a hypothetical merger within the community pharmacy sector more broadly, where – location and all else being equal – there is a vastly closer degree of competition between operators in local overlap areas.<sup>21</sup>

But the issue to be decided here is not whether a merger to monopoly of the only two community pharmacies in a local area may be expected to result in an SLC. The issue is whether the Transaction – the merger of Lloyds and Sainsbury's pharmacy business – is problematic. To address this issue, the CMA must give due credence to Sainsbury's unique characteristics (in its own right and in its capacity as a supermarket pharmacy) and to the actual nature of the rivalry (or lack thereof) between the parties.

## **5 Sainsbury's offers at best a very attenuated competitive constraint (in general) on the QRS parameters of its rivals at the local level**

All else being equal, the less intense the competitive pressure that Sainsbury's is bringing to bear on the QRS parameters of its rivals locally (i.e., by expending – or not expending – effort to outdo the retail offerings of other nearby pharmacies), the less impact one would expect from the loss of that pressure on Lloyds when the Sainsbury's pharmacy business is acquired.

As Sainsbury's has repeatedly told the CMA (in full awareness of its obligations of candour when providing information to the CMA), it does not as a matter of policy (or knowingly in practice) flex *any* aspects of its pharmacy offer in response to local competition. The CMA has acknowledged this submission in its PFs,<sup>22</sup> and has expressly stated that it "found only limited evidence from internal documents that Sainsbury's sets parameters for its in-store pharmacies in response to competition...".<sup>23</sup> Indeed, even this overstates the situation – as explained in Section 10 below, the "limited evidence" cited by the CMA is *not* in fact evidence of flexing in response to competition.

Moreover, the CMA repeatedly acknowledges in the PFs that Sainsbury's has less *scope* than most pharmacies to compete on QRS parameters at the local level. For example:

- "The ability to flex the offering at supermarkets such as Sainsbury's is somewhat more limited than the flexibility at Lloyds because of the particular characteristics of supermarket pharmacies."<sup>24</sup>
- "We consider that Sainsbury's has less scope to respond to competitor pressures at a local level."<sup>25</sup>

<sup>21</sup> Lloyds has no criticism of previous decisional practice involving it (e.g. Lloyds/IPCC), where "2 to 1" and "3 to 2" combinations of community pharmacy operators in local areas were found to give rise to a realistic prospect of SLC. Whether pharmacy operators such as Lloyds agreed with the OFT approach or not, it at least formed a predictable basis for M&A planning in the industry, and Lloyds' premise (misplaced, in the event) of a Phase I remedies package in this case.

<sup>22</sup> Provisional Findings, paragraph 7.29.

<sup>23</sup> Provisional Findings, paragraph 7.43.

<sup>24</sup> Provisional Findings, paragraph 7.32.

<sup>25</sup> Provisional Findings, paragraph 7.58.

In circumstances where Sainsbury's has expressly stated that it does not flex any aspects of its offer in response to local competitive conditions, the CMA has not found any material evidence to the contrary, and the CMA has acknowledged that Sainsbury's has less scope than most pharmacies to flex its local retail offering, the parties submit that it would be irrational to conclude that the Transaction may be expected to result in an SLC, unless there is strong evidence that:

- the parties are particularly close competitors (to the extent that the loss of their rivalry is likely to be significant, notwithstanding the fact that [REDACTED]; and/or
- the presence of a Sainsbury's pharmacy in close geographic proximity to a Lloyds pharmacy is somehow otherwise driving superior QRS standards at the Lloyds pharmacy (such that the Transaction may be expected to lead to a worsening of one or more QRS standards).

## 6 Sainsbury's and Lloyds are not close rivals

As mentioned above, it is essential to understand the nature and extent of the rivalry between the merger parties, because it is that rivalry which will be lost as a result of the merger. Accordingly, evidence of the degree to which Lloyds and Sainsbury's are *close* competitors will be highly informative. If the weight of the evidence shows that Lloyds and Sainsbury's are particularly close competitors, then – all other things being equal – the loss of their rivalry is more likely to increase or facilitate the exercise of market power by the merged firm. However, the inverse is also true: if the weight of the evidence shows that the parties are not close competitors, then the loss of their rivalry must be considered less significant.

The parties accept that they both operate pharmacy businesses, and therefore compete to some extent. However, the parties have repeatedly asserted that they are not close competitors, and this claim is overwhelmingly supported by the evidence. For instance, see the parties' previous submissions, including: the parties' Initial Joint Submission, Part H, section 3; the parties' Joint Submission to the Statement of Issues, section 5.1.1; and the parties' response to the PFs, Part C section 1.1.

The parties' submissions on closeness of competition appear to have been broadly accepted in the PFs. For instance, the CMA noted the following:

“...the results of the research they [the Parties] conducted also appears to suggest that the closest competitors to Lloyds are independent pharmacies along with other major chains, rather than supermarket pharmacies. For example, Sainsbury's research found that both high street chains and independent pharmacies were more highly regarded than supermarkets in delivering the type of service favoured by pharmacy customers. Similarly, when Lloyds asked customers about the type of healthcare purchases they would make at each store, Lloyds was perceived as more similar to a local pharmacy than a supermarket. In another piece of analysis, 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 [REDACTED].”<sup>26</sup> [emphasis added]

In addition, the CMA's entry/exit analysis did not “identify a statistically significant impact of entry or exit of either of the Parties on the other.”<sup>27</sup> As the CMA explains, “the only exception to this is entry (or exit) by Lloyds within 3 miles of a Sainsbury's branch in rural areas, which resulted in a 5% *increase* in Sainsbury's sales volumes. Although this result is statistically significant, it has

<sup>26</sup> Provisional Findings, paragraph 7.73.

<sup>27</sup> Provisional Findings, paragraph 7.96(c).

the wrong sign and could suggest that in general the Parties are not close competitors.<sup>28</sup> [emphasis added]

The results of the CMA's entry/exit analysis in this case are in stark contrast to those discussed in the *Poundland/99p* decision,<sup>29</sup> where the CMA's econometric analysis showed that "local events involving Poundworld, 99p or Poundland had a similar and substantial negative impact... on the sales of the existing Poundland or 99p stores".<sup>30</sup> [emphasis added]

Moreover, in *Poundland/99p*, in order to reach the conclusion that the parties were close competitors, the CMA relied not just on its entry/exit analysis, but on a breadth of corroborating evidence, including: "Poundland's benchmarking documents, published analyst reports, research commissioned by the parties and other retailers, and the views of competitors",<sup>31</sup> as well as entry/exit analysis and diversion ratios, all of which supported the conclusion that the parties were close competitors. In fact, the CMA considered that "the evidence available... strongly supported the view that the large SPP retailers (Poundland, 99p and Poundworld) were each other's closest competitors".<sup>32</sup> [emphasis added] By contrast, supermarkets were not considered to be close competitors to pound shops, but rather to only provide "some competitive constraint", despite Poundland regularly benchmarking its prices against the supermarkets, and at least some of the supermarkets having responded to "single price point" offerings by pound shops – for instance, Tesco introduced a "Brand Outlet" aisle selling products for £1, and Asda has a specific "£1 shop" range.<sup>33</sup>

## 7 Incoherence of CMA reasoning across *Poundland/99p* and this case

It is at best extremely difficult to reconcile, in a coherent manner, the approach to closeness of competition in the *Poundland/99p* decision with the approach that is outlined in the PFs. For instance, it is not clear why supermarkets were discounted as competitors to pound shops in that decision – despite clear evidence of rivalrous behaviour and direct competitive activity (such as price monitoring) – yet, in this case, where there is *no* clear evidence of direct competitive activity between Lloyds and Sainsbury's supermarket pharmacy business (and where neither party has ever monitored the other – with Lloyds benchmarking its p-med pricing primarily in relation to Boots, for example), the parties are nonetheless considered to be sufficiently close competitors to raise competition concerns. If the CMA were to suggest that supermarkets are "outside" the pound store (single price point retailer) product market while Sainsbury's is "inside" the retail pharmacy product market, that would be to rely on the binary fallacy of market definition, which the CMA itself warns against in differentiated retail markets.<sup>34</sup>

It is even more difficult to understand how the CMA could unconditionally clear the merger of Poundland and 99p, between closest retail competitors in an unregulated market, where there was greater scope for competition on both price and non-price aspects, and very shortly thereafter take issue with this Transaction, between highly differentiated competitors who are not particularly close rivals, in the absence of any evidence that the parties have a material

<sup>28</sup> Provisional Findings, Footnote 120.

<sup>29</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015).

<sup>30</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015), paragraph 6.78(a).

<sup>31</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015), paragraph 4.7.

<sup>32</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015), paragraph 6.78.

<sup>33</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015), paragraph 6.81.

<sup>34</sup> See CMA, *Merger Assessment Guidelines*, section 5.3.2, footnote 63: "[a]n over-reliance on concentration measures to indicate changes in market power, in particular where products are differentiated, has been termed the 'binary fallacy': the assumption that all firms in the market exercise competitive constraints upon one another in proportion to their market shares, but that firms outside the market exercise no constraint at all."

impact on each other's decisions on QRS, and who operate in a regulated market where the scope for competition even on non-price factors is at best "muted".

From a policy perspective, it is highly undesirable for the CMA to be adopting such an incoherent approach when dealing with retail merger cases at Phase II. If the CMA's Final Decision is written in the same vein as its PFs in this matter, then parties who are considering future retail mergers will be faced with an inconsistent and unpredictable body of CMA decisions. Notwithstanding that the CMA does not consider its Reports to be "precedents" in any formal sense, in practice they are the best (if not only) transaction planning guide that commercial parties have, and provide the starting point for new Phase I inquiries in similar markets (both for potential merger parties and the CMA).

## **8 Economic evidence does not suggest a clear relationship between variation in Lloyds' performance on QRS parameters and local competitive conditions**

As the CMA itself concludes, "[o]verall, our own empirical analysis and the analysis provided by the Parties suggests that there is substantial variation in quality parameters between local Lloyds stores, including on: opening hours; average waiting times; years since refurbishment; locum hours; and mystery shopper ratings. We do not find a clear relationship between individual quality variables and indicators of competition in a local area."<sup>35</sup> [emphasis added] This is very important, given that the CMA's theory of harm is predicated on the belief that a loss of competition in connection with the Transaction is likely to cause Lloyds to worsen its QRS offering to customers. This conclusion is also difficult to reconcile with the CMA's finding that "in practice, Lloyds would be likely to improve its offering on at least some... parameters were the level of competition in an area to increase."<sup>36</sup>

The parties do not submit that this economic evidence is necessarily determinative. However, in circumstances where Sainsbury's is at best a very weak competitor on QRS parameters at the local level and the parties are not particularly close rivals, the lack of any wider relationship between Lloyds' performance on individual QRS parameters and local competitive conditions is highly informative. It suggests that: (i) any *general* competitive responses by Lloyds at the local level in connection with the relevant QRS parameters may be relatively weak (or else a clear relationship would be apparent); and (ii) Lloyds is highly unlikely to locally flex the relevant QRS parameters *at all* in response to competitive pressure from Sainsbury's (if there is no clear *general* relationship, then there is even less likely to be any relationship between Lloyds' performance on the relevant QRS parameters and the presence of a weak and differentiated competitor like Sainsbury's).

Indeed, the lack of a relationship between the degree of competition and local variation of retail offer has rightly been regarded as influential in decisions by the CMA's predecessors, and is enshrined in the CMA's commentary on retail mergers, as follows:

"In Sports Direct/JJB Sports (sports retail), the CC carried out a local margin concentration analysis to examine whether Sports Direct varied any aspects of its retail offer on a local basis, and if so, whether these variations were related to the presence of a nearby JJB store. Since Sports Direct had a national pricing policy, the CC considered other aspects of the retail offer that might vary on a local basis, such as store staffing levels, stock deliveries, store opening hours, store maintenance and refurbishment, and stock shortages. The CC did not find a relationship between the degree of competition and local variation of the retail offer."<sup>37</sup> [emphasis added]

<sup>35</sup> Provisional Findings, paragraph 7.52. Similarly, the CMA "did not identify a clear relationship between margin and concentration." See: Provisional Findings, paragraph 7.51.

<sup>36</sup> Provisional Findings, paragraph 7.57. Repeated and cited in the Remedies Working Paper, paragraph 94.

<sup>37</sup> CMA – Commentary on retail mergers (CC2Com2), paragraph 3.19.

In the *Sports Direct/JJB Sports* case, the CC found that certain QRS parameters *did* vary “significantly at a local level”.<sup>38</sup> However, the CC “did not find any evidence that Sports Direct varies any aspect of PQRs in response to local competition”, and therefore concluded that Sports Direct could, but did not, vary aspects of its offering in local stores depending on local competitive conditions.<sup>39</sup>

Given that Sports Direct *could* have varied some its QRS parameters in response to local competition (even though it did not currently), the CC had to assess whether Sports Direct’s incentives to flex QRS parameters locally might increase as a result of its proposed acquisition of the JJB Sports stores.<sup>40</sup> In order to make this assessment, the CMA examined each of the QRS parameters where Sports Direct’s offering varied across similar stores in different local areas, and “considered whether the current methods used by Sports Direct to determine the variable for each store could be modified to respond to changes in local competitive conditions, and whether Sports Direct would have an incentive to do so as a result of the store transfers”.<sup>41</sup>

Notably:

- Since the CC found no evidence that Sports Direct flexed the relevant QRS variables in response to changes in local competition prior to the store transfers, it assumed that the benefits before the store transfers were outweighed by the costs.<sup>42</sup>
- Given the relatively small change in the number of Sports Direct’s “monopoly” areas as a result of the store transfers, the CC did not think it likely that the transfers would have increased significantly Sports Direct’s incentives to flex the relevant QRS parameters in response to changes in local competition, and therefore surmised that the costs of doing so were likely to continue to outweigh the benefits.<sup>43</sup>

Ultimately, the CC concluded that “the store transfers were unlikely to result in a significant change to any aspect of Sports Direct’s PQRs in any local area”.<sup>44</sup> It is extremely difficult to reconcile the CC’s approach in the *Sports Direct/JJB Sports* case to the approach that has been adopted by the CMA in this matter. In fact, the CMA appears to have completely disregarded the logical inferences from its own economic evidence (such as that regarding the lack of any clear relationship between variations in Lloyds’ performance on QRS parameters and local competitive conditions), despite the fact that such evidence has been relied on in the past to clear transactions involving far closer competitors than Lloyds and Sainsbury’s (indeed, in *Sports Direct/JJB Sports*, the parties were deemed to be each other’s closest competitors, and the only active players in the relevant product market).<sup>45</sup>

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<sup>38</sup> Competition Commission, Report on the acquisition by Sports Direct International plc of 31 stores from JJB Sports plc (2010), paragraph 8.16.

<sup>39</sup> Competition Commission, Report on the acquisition by Sports Direct International plc of 31 stores from JJB Sports plc (2010), paragraph 8.17.

<sup>40</sup> Competition Commission, Report on the acquisition by Sports Direct International plc of 31 stores from JJB Sports plc (2010), (“**Sports Direct/JJB**”), paragraph 8.18.

<sup>41</sup> Sports Direct/JJB, as above.

<sup>42</sup> Sports Direct/JJB, paragraph 8.19.

<sup>43</sup> Sports Direct/JJB, paragraph 8.21.

<sup>44</sup> Sports Direct/JJB, paragraph 8.22.

<sup>45</sup> Sports Direct/JJB, Summary, paragraph 5.

## 9 No evidence to suggest the Transaction would cause Lloyds to depart from its strategy of setting most relevant QRS parameters at the national level

In the *Poundland/99p* case, the CMA considered whether the proposed merger would increase Poundland's incentives to set PQRs locally rather than nationally.<sup>46</sup> Specifically, the CMA focused on the change in the number of stores where Poundland faced limited competition from the competitors identified in its assessment of the closeness of competition, and the proportion of Poundland's total estate that these stores comprise, with a view to assessing the impact of the merger on the variation in competition.<sup>47</sup> In the end, the CMA's results did "not appear to show a material change in the variation in competition faced by Poundland",<sup>48</sup> and so the CMA concluded that the merger was unlikely to have a material effect on Poundland's incentives to set PQRs locally rather than nationally.<sup>49</sup>

It is difficult to understand why the CMA has not conducted a similar analysis in this case, given Lloyds currently sets both pricing and the vast majority of its non-price (QRS) parameters at the national level (and the CMA has provided no convincing evidence as to why Lloyds' incentives would be changed post-merger, given the weak competitive constraint currently posed by Sainsbury's pharmacies). If the CMA did not believe that Lloyds would change its existing strategy, and begin to set parameters locally that are currently set nationally as a result of the Transaction, then there would of course be no need to undertake such an analysis.

However, many of the QRS parameters which the CMA appears to be concerned about *are* currently set nationally by Lloyds, namely: staff training (national standard), staffing levels (national model applied at all stores), waiting times (national target applied at all stores) and prescription collection services (offered at every Lloyds pharmacy).<sup>50</sup> In fact, of those QRS parameters on which the CMA believes pharmacies in general compete (as discussed in the next section), Lloyds only sets opening hours, additional pharmacy services, location and refurbishments at the local level. If the CMA were to take an approach consistent with its recent decision in *Poundland/99p*, it would necessarily find that the Transaction will *not* likely have a material impact on Lloyds' incentives to set the relevant QRS parameters locally rather than nationally, due to the general lack of closeness of competition between the parties and the small number of provisional SLC areas relative to Lloyds' total estate.

## 10 No evidence that the parties' rivalry currently leads to better outcomes for customers at the local level on any QRS parameter

In the PFs, the CMA concludes that pharmacies (not Sainsbury's and Lloyds in particular, but pharmacies *in general*) currently compete at the local level on the following seven QRS parameters:

- a) location;
- b) staffing levels and staff training (which jointly affect quality of advice);
- c) waiting times;
- d) store refurbishments;
- e) provision of prescription collection services;

<sup>46</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015), paragraph 6.113.

<sup>47</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015), paragraph 6.117.

<sup>48</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015), paragraph 6.123.

<sup>49</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015), paragraph 6.126.

<sup>50</sup> PFs, Table 6: Lloyds' view on how it responds to local competition.



- f) range of services; and
- g) opening hours.<sup>51</sup>

In the Remedies Working Paper, the CMA confirms that its concerns are tied to these seven parameters, noting that “we considered that pharmacies currently had the incentive to compete at the local level on opening hours, range of services, staffing levels and staff training (which jointly affected quality of advice), waiting times, location, store refurbishments, and provision of prescription collection services...”.<sup>52</sup>

Putting aside for the time being the obvious flaw with the CMA’s concerns, which is addressed elsewhere in this submission (i.e. that the current incentives of pharmacies in general have little to do with whether the acquisition of Sainsbury’s pharmacy business is likely to materially increase Lloyds’ ability and incentive to worsen the QRS of its retail offer at the local level in the future), it is also clear that:

- Sainsbury’s is generally, at best, a weak competitor on QRS parameters at the local level (as discussed in Section 5 above);
- Sainsbury’s and Lloyds are not particularly close competitors (as discussed in Section 6 above); and
- the economic evidence in this case does not show a clear relationship between Lloyds’ performance on QRS parameters and the local competitive conditions (as discussed in Section 8 above, and in detail in sections 2.2 and 2.3 of the parties’ response to the PFs).

If the *inverse* were true – if Sainsbury’s and Lloyds were very close competitors, and Sainsbury’s had a history of competing strongly on QRS parameters at the local level, and there was a clear, strong relationship between Lloyds’ performance on QRS parameters and local competitive conditions – then there might be some scope to *infer* that the rivalry between Sainsbury’s and Lloyds is currently leading to better QRS outcomes for customers at the local level, at least in the absence of evidence to the contrary. But that is not the case here.

Accordingly, it is necessary to consider whether, despite all the general evidence to the contrary, there is anything which might directly and specifically suggest that competitive pressure from Sainsbury’s is currently influencing for the better the way in which Lloyds sets *any* of the relevant seven QRS parameters (or vice versa). Without direct and specific evidence to show that competitive pressure from Sainsbury’s is having a material influence on Lloyds in relation to one or more of these seven parameters, and that Lloyds would have the incentive to worsen its QRS offer in the absence of competition from Sainsbury’s, it would be irrational for the CMA to ignore the overwhelming weight of the general evidence in this case.

### 10.1 Location

The CMA itself appears to have concluded that at least one of the seven relevant QRS parameters is highly unlikely to be influenced by rivalry between the parties, namely: location. The CMA has expressly concluded that “we do not consider that this is an important competitive parameter given the specificities of this case”.<sup>53</sup> [emphasis added]

Moreover, although both parties may have the incentive to improve location where possible, Sainsbury’s clearly has no ability to do so (it cannot move its pharmacies in the 13 SLC areas to be closer to local GPs). The CMA has noted that:

<sup>51</sup> PFs, paragraph 7.55.

<sup>52</sup> Remedies Working Paper, paragraph 93.

<sup>53</sup> Provisional Findings, Appendix F, paragraph 54.

- “In our view, Sainsbury’s pharmacies do not have the ability to compete on location...”<sup>54</sup>
- “...relocations of pharmacies are regulated and require approval before a move takes place...”<sup>55</sup>
- “We do not consider that Sainsbury’s would relocate its stores to benefit pharmacy customers, given that this business represents a small part of its turnover.”<sup>56</sup>

This means that, although Lloyds does have the ability and incentive *in general* to improve its location (e.g. by moving closer to the GP surgery – particularly if a rival does so), there is no prospect that the presence of Sainsbury’s is what drives the convenience of Lloyds’ location in any of the proposed SLC areas. That is, there is no reason to believe that, post-merger, Lloyds will worsen its location because it no longer faces competitive pressure from Sainsbury’s in those areas. Similarly, there is no evidence to suggest that competitive pressure from Sainsbury’s might have caused Lloyds to improve its location in any of these areas, absent the Transaction.

Given the CMA has expressly found that location is not an important competitive parameter in this case, and that Sainsbury’s pharmacies cannot compete on location (and, in particular, cannot locate or relocate to move closer to a GP surgery), it would be irrational to conclude that the loss of competition pressure from Sainsbury’s flowing from the Transaction is likely to result in any adverse effects for consumers in connection with this QRS parameter.

## 10.2 Staffing levels and staff training

### **Staffing levels**

Lloyds determines its staffing levels according to a national model that is consistently applied in every one of its stores. This model is based on a model that looks at [§]. The primary focus is on patient safety and achieving consistently high quality customer service across Lloyds’ estate. Lloyds does not take local competitive conditions directly into account as part of its model to determine staffing levels, and does not otherwise vary staffing levels in response to the actions or presence of competitors.<sup>57</sup>

Equally, it is not Sainsbury’s policy to flex its staffing levels in response to local competitive conditions. In line with this stance, the CMA has expressly concluded that “Sainsbury’s does not currently compete at the local level by flexing the number of staff working in the store...”,<sup>58</sup> and “[w]e do not consider that Sainsbury’s currently competes on this parameter”.<sup>59</sup> In addition, the CMA has noted that “there is no evidence in any Sainsbury’s internal document seen by the CMA that Sainsbury’s flexes staffing levels in response to competition.”<sup>60</sup>

### **Staff training**

Lloyds operates a central training scheme that is rolled out to all pharmacy staff across its businesses: all staff have access to the same training as their peers, and there is no variation on the type, quality or availability of training given to Lloyds’ staff at a local level.

<sup>54</sup> Provisional Findings, paragraph 7.59.

<sup>55</sup> Provisional Findings, paragraph 7.41.

<sup>56</sup> Provisional Findings, paragraph 7.42.

<sup>57</sup> In fact, under Lloyds’ model, the presence of close competitors in a local area could actually *reduce* staffing levels – if competition materially reduced Lloyds’ prescription volumes at a store, the model would prompt fewer staff to be employed there (because the store would not be as busy, and would not need as many staff to achieve a consistently high level of service).

<sup>58</sup> Provisional Findings, Appendix F, paragraph 110.

<sup>59</sup> Provisional Findings, Appendix F, paragraph 115.

<sup>60</sup> Provisional Findings, paragraph 7.44(c).

Nor is the presence or absence of local competitors a driver for the provision of staff training by Lloyds. In the PFs, the CMA states that “*Lloyds’ internal guidance on entry responses states that area managers should ‘update staff Performance Reviews and [personal development programme]s’ and ‘refocus on staff training’ where there is potential for new entry*”.<sup>61</sup> [emphasis added] This is presumably another reference to the Competitive Edge document (as discussed above – although the CMA does not cite its source), and a misleading one at that, given the fact that this historical document has not been actively used by Lloyds for a number of years and can in no way be accurately characterised as current “internal guidance”. Moreover, the reference in the Competitive Edge document to staff training was simply a reminder to managers of the *normal* training requirements applicable to every Lloyds pharmacy and staff member, and not a suggestion that pharmacies in particular areas were to be given access to different or better staff training in response to local competition.

Furthermore, any deliberate reduction in the quality of staff training by Lloyds would be highly unethical (given the role that pharmacy staff play in providing medicines and health services to the community), and contrary to Lloyds’ overarching strategy to be (and its brand positioning as) a leading healthcare provider.

Sainsbury’s has also submitted that it trains its pharmacy staff on a consistent national basis, and does not vary the level of training given to staff at the local level.<sup>62</sup> The CMA has concluded that “[w]e do not have direct evidence to suggest that Sainsbury’s competes at a local level by varying its staff training with local competitive conditions”.<sup>63</sup>

Finally (and perhaps most telling of all), the CMA has expressly stated that “[w]e do not have strong evidence that either party currently competes on this parameter [i.e. staff training]...”.<sup>64</sup> [emphasis added]

### **Conclusions on staffing levels and training**

Accordingly, whilst the CMA may be correct in its conclusion that pharmacies, *in general*, can compete on staffing levels and staff training, the evidence is very clear that Sainsbury’s does not compete with Lloyds in this way.

There is also no evidence to suggest that Lloyds might have a materially increased incentive to change its approach from a national one as a result of the Transaction – and to suggest otherwise would be speculative. Indeed, it would be appropriate to adopt the approach taken by the CMA in the *Poundland/99p* case on this point. In that case, the CMA considered not only the merging parties’ current behaviour but also their incentives, and concluded that “there is no evidence that the Parties vary [staffing] in response to local competition despite there currently being no apparent material costs to doing so. This implies that the incentives to vary these in response to local competition must also be limited regardless of the degree of variation in market structure”.<sup>65</sup>

Furthermore, even in *Sports Direct/JJB Sports*, where (unlike in this case) the CMA found that “staff work more hours in Sports Direct stores that face competition from a JJB within 2 miles”, the CMA did not conclude that the merger would therefore result in a worsening of competition in relation to staffing. The CMA instead recognised that overlap areas could share other characteristics which caused the variations observed – for example, overlap areas might be

<sup>61</sup> Provisional Findings, Appendix F, paragraph 119.

<sup>62</sup> Parties’ Further Submission dated 23 March 2016, Part B, Section 4.6.

<sup>63</sup> Provisional Findings, Appendix F, paragraph 122.

<sup>64</sup> Provisional Findings, Appendix F, paragraph, 123.

<sup>65</sup> CMA, Report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited (2015), Appendix F, paragraph 131(b).

those areas with greater demand for sports goods, and this greater demand may lead to a need for more staff.<sup>66</sup>

In the absence of any evidence to suggest that either Lloyds or Sainsbury's materially vary their staffing levels or training in response to local competitive conditions (let alone in response to competitive pressure from each other), it would be irrational to conclude that: (i) competitive pressure from Sainsbury's currently drives Lloyds to deliver better outcomes for customers in relation to staffing levels or staff training; or (ii) the loss of competitive pressure from Sainsbury's on Lloyds is likely to result in any adverse effects for customers in connection with this QRS parameter.

### 10.3 Waiting times

#### ***No evidence that Lloyds flexes waiting times in response to local competitive conditions***

The CMA has found that pharmacies appear to be able to influence waiting times,<sup>67</sup> and believes that pharmacies, in general, can compete on this parameter. This is true for Lloyds, but only to an extent: Lloyds has a consistent national target for waiting times of [X], but does not flex its position on this target in response to local competitive conditions. In other words, Lloyds aims to ensure that *all* its pharmacies have an average customer waiting time of [X] or less, regardless of how many (or how few) competing pharmacies are nearby. Lloyds has set this target because it believes waiting times are important to its customers, and that if a customer waits for too long at *any* Lloyds pharmacy (including one with no other competing pharmacies nearby), then the experience may undermine the customer's perception of the Lloyds pharmacy brand.

The CMA notes that "the Competitive Edge document shows that, where there has been a store opening, pharmacies are encouraged to review their performance to ensure they are meeting their target of [X] average waiting time."<sup>68</sup> Putting aside for one moment the relevance of this historical document, which has not been actively used by Lloyds for a number of years, the Competitive Edge document does not suggest that Lloyds *flexes* its position on waiting times in response to local competitive conditions. Quite the opposite: pharmacies are merely encouraged to ensure they are meeting the consistent national target of [X] or less (which they should have been doing in any event). There is no evidence to suggest that Lloyds tries to deliver a superior outcome for customers in relation to waiting times beyond this standard target – i.e. competition from other pharmacies (let alone Sainsbury's) does not make Lloyds strive to ensure that customers only wait for [X] rather than [X]. Nor is there any evidence that Lloyds "relaxes" its approach to achieving its [X] waiting time target in local areas where it faces less competition.

The CMA has noted that there is "significant variation" in Lloyds' performance on waiting times across local areas, and suggests that this "demonstrates that waiting times do vary at a local level".<sup>69</sup> Celesio submits that this variation is natural, and reflects the unique circumstances at each of its pharmacies. Most importantly, there is no evidence to suggest that the variation in waiting times at Lloyds pharmacies is influenced by local competitive conditions: the CMA's own analysis has not found a relationship between Lloyds' customer waiting times and "indicators of competition in a local area".<sup>70</sup>

<sup>66</sup> Competition Commission, Report on the acquisition by Sports Direct International plc of 31 stores from JJB Sports plc (2010), Appendix F, paragraphs 12 to 13.

<sup>67</sup> Provisional Findings, paragraph 7.31(e).

<sup>68</sup> Provisional Findings, paragraph 7.44(e).

<sup>69</sup> Provisional Findings, paragraph 7.52.

<sup>70</sup> Provisional Findings, paragraph 7.44(e).

***No evidence that Lloyds flexes waiting times in response to competitive pressure from Sainsbury's***

Even if the CMA had found a relationship between waiting times and local competitive conditions in general (which it has not), there is no evidence whatsoever that competitive pressure *from Sainsbury's* influences Lloyds' approach to waiting times at the local level.

Importantly, as the CMA acknowledges, waiting times are "of lesser importance" in supermarket pharmacies such as Sainsbury's, where most customers drop off their prescriptions at the start of their grocery shopping and collect their medicines at the end.<sup>71</sup> For this reason, Sainsbury's has [redacted] in response to local competitive conditions.

The only evidence of any kind in relation to Sainsbury's performance on waiting times identified in the PFs was summarised as follows: "Sainsbury's monitored waiting times in a customer satisfaction survey conducted in September 2015."<sup>72</sup> This statement by the CMA is highly misleading. Sainsbury's assumes that the CMA is referring to its internal document titled "Audit of Customer Satisfaction Surveys September 2015", although the PFs do not cite a source. A copy of that document is enclosed with this submission (as Annexure 1) for ease of reference. The CMA's statement about this document is misleading, because it is clear on the face of the document that the underlying surveys were carried out at an *OPD* pharmacy – specifically, the Sainsbury's *OPD* pharmacy at the James Cook University Hospital.<sup>73</sup> Sainsbury's carried out the survey at this *OPD* pharmacy because waiting times [redacted]. Waiting times can be a KPI for NHS trusts in the *OPD* context because one of the benefits that hospitals hope to achieve by outsourcing the *OPD* service to third parties is a reduction in waiting times.

However, the rationale for surveying *OPD* customers on waiting times (as Sainsbury's has done at James Cook University Hospital) does not apply in relation to Sainsbury's supermarket pharmacies. This is why, as has been previously stated, Sainsbury's [redacted] (which are the focus of the CMA's remaining concerns in this case). The CMA effectively acknowledged that the *OPD* sector constitutes a different market in the PFs, and in practice, these two parts of Sainsbury's pharmacy business are run quite differently in many respects.<sup>74</sup> Moreover, even in the *OPD* context, there is no suggestion that Sainsbury's ever used the information it collected in September 2015 to improve its performance on waiting times in response to local competitive conditions.

***No evidence that the merged firm might have an increased incentive to worsen waiting times as a result of the Transaction***

There is also no evidence to suggest that the merged firm might have an increased incentive to alter waiting times as a result of the Transaction. Although in broad terms one can expect that fewer staff would likely result in longer waiting times, many pharmacies already operate with only a single pharmacist, meaning that pharmacist costs cannot be saved, regardless of what waiting time is considered acceptable. Therefore, it is far from clear that accepting an increase in waiting times would result in significant cost savings – and therefore no evidence that Lloyds would have an increased incentive to reduce staffing in this way. Moreover, even if such an incentive existed in relation to waiting times *in general* for Lloyds, there is no evidence that such an incentive would be driven by whether a Lloyds store faces competition *from Sainsbury's*,

<sup>71</sup> Provisional Findings, footnote 82.

<sup>72</sup> Provisional Findings, paragraph 7.44(e).

<sup>73</sup> For instance, see page 1, question 1: "Is this your first time visiting Sainsbury's pharmacy at James Cook University Hospital?" [emphasis added] James Cook Hospital is managed by the South Tees Hospitals NHS Foundation Trust – one of the three NHS trusts with whom Sainsbury's holds an *OPD* pharmacy contract.

<sup>74</sup> Provisional Findings, paragraph 7.222: "We assessed whether the merger is likely to give rise to an SLC in the OPD market through horizontal unilateral effects. The OPD market is discussed in Section 2." [emphasis added]

given that, as set out above, waiting times are not a very relevant factor for Sainsbury's due to its nature as a supermarket pharmacy (with customers who are typically also doing a grocery shop).

### **Conclusion on waiting times**

Given Lloyds' universal [X] waiting time target, the lack of any relationship between Lloyds' waiting times and local competitive conditions, and the fact that Sainsbury's does not compete on waiting times, it would be irrational to conclude that the Transaction is likely to result in any adverse effects for customers in connection with this QRS parameter.

## **10.4 Store refurbishments**

### ***No evidence that Lloyds flexes its refurbishment schedule in response to competitive pressure from Sainsbury's***

The CMA suggests that pharmacies, in general, can compete by making changes to the store environment (above the minimum standards set by regulation).<sup>75</sup> This is true for Lloyds, to an extent: Lloyds has confirmed that it might accelerate a refurbishment for reasons of local competition in some circumstances.

But Lloyds has *never* accelerated or implemented a refurbishment in response to competitive pressure *from Sainsbury's*, nor is there any evidence which suggests that Lloyds would react this way in the future. The CMA has not identified any documentary evidence which might cast doubt on this position, and the CMA's own economic analysis shows that there is no statistically significant relationship between the entry of a new Sainsbury's pharmacy and the timing of Lloyds' refurbishments (see: the Parties' previous submissions in their response to the PFs, Part C, paragraph 2.2 on this point). The CMA has claimed that the "absence of a statistically significant effect does not provide evidence that there is no effect",<sup>76</sup> but this demonstrates a fundamental misunderstanding of the burden of proof in this case. No reasonable decision-maker could possibly conclude that Lloyds refurbishes its stores faster due to the entry of a Sainsbury's pharmacy simply because there is no evidence to prove the *lack* of any such relationship. In the absence of any evidence to support a positive finding, the only reasonable option is to conclude that no such relationship has been established.

In fact, the only economic evidence that the CMA has identified in this regard relates to a possible relationship between the timing of Lloyds' refurbishments and the entry of supermarket pharmacies *other than Sainsbury's* (and even then, only when these supermarkets are very close by – less than 0.2 miles away). The CMA has concluded that its findings in relation to that group of firms can be applied to Sainsbury's – but, in the circumstances, this view is clearly indefensible.

Moreover, the CMA has expressly noted that "we were not able to control for other factors which might be driving the timing of refurbishments, so cannot conclude that competition is causing stores to be refurbished more quickly".<sup>77</sup> [emphasis added] This applies to the CMA's *entire* economic analysis in relation to refurbishments, not just the aspects involving Sainsbury's. If the CMA cannot conclude that any kind of competition is causing Lloyds to refurbish its stores faster, it certainly cannot conclude that competitive pressure *from Sainsbury's* has that effect.

It is also important to remember that Sainsbury's pharmacy business does *not* compete via refurbishments, even if other pharmacies may do so. Sainsbury's pharmacy refurbishments are

<sup>75</sup> Provisional Findings, paragraph 7.31(h).

<sup>76</sup> Provisional Findings, Appendix G, paragraph 32: "we consider that absence of a statistically significant effect does not provide evidence that there is no effect."

<sup>77</sup> Provisional Findings, paragraph 7.50.

only carried out as part of overall store refurbishments,<sup>78</sup> and accordingly, the CMA has expressly concluded: “[w]e do not consider that Sainsbury’s currently competes on this variable...”.<sup>79</sup> Sainsbury’s has never refurbished one of its pharmacies in response to local competitive conditions, and there is no evidence whatsoever to suggest that Sainsbury’s is likely to alter its approach in the future.

***No evidence that the merged firm might have an increased incentive to delay refurbishments as a result of the Transaction***

Nor has any analysis been carried out of whether the loss of competitive pressure from a Sainsbury’s pharmacy could even *in principle* be expected to provide an incentive for Lloyds to slow refurbishments. In particular, there is no analysis of what costs would be saved by postponing a refurbishment – still less any consideration of the sensitivity of customer demand to such refurbishments, and whether the Transaction would make a material difference to whether or not such a delay might be profitable for Lloyds.

***Deficiency of evidence relative to other contemporary retail merger cases***

If the approach to refurbishments in this matter is compared to the CMA’s recent Provisional Findings Report in the *Ladbroke’s/Coral* case,<sup>80</sup> there is a stark difference between the types of evidence the CMA is drawing upon to support conclusions that refurbishments occur faster in response to competition. In *Ladbroke’s/Coral*, the CMA noted:

“Coral submitted that its policy was to refurbish some of its LBOs in response to significant changes in local competition (which we call ‘competitive events’)...[and] Ladbroke’s had a similar policy until 2013. In both cases, the manager of the LBO affected by the competitive event is required to submit an application for additional capex providing information about the performance of his/her LBO, the competitive situation in the local area, and the expected impact of the competitive event.”<sup>81</sup> [emphasis added]

In other words, in *Ladbroke’s/Coral*, the CMA has found direct evidence that both parties have refurbished their stores in response to local competition (presumably in some cases in response to competition from each other, although the discussion of that specific point is redacted). This is vastly different to, and more substantial than, the evidence (or lack thereof) which the CMA has cited in this case. Instead, the CMA has pointed to *indirect* economic evidence which suggests there *might* be a meaningful correlation between Lloyds’ refurbishments and local competition – but only if supermarkets *other* than Sainsbury’s are used as a proxy for Sainsbury’s (and only within 0.2 miles, despite the Parties’ stores being significantly further than 0.2 miles away from each other in many of the 13 provisional SLC areas). This approach is unsound, and cannot reasonably be adopted in the Final Report.

***Conclusion on refurbishments***

In conclusion, given the foregoing, it would be irrational to conclude that: (i) competitive pressure from Sainsbury’s currently drives Lloyds to deliver better outcomes for customers by refurbishing its pharmacies faster than it would otherwise; or (ii) the loss of competitive pressure from Sainsbury’s is likely to result in any adverse effects for customers in connection with this QRS parameter.

<sup>78</sup> The only exception is where Sainsbury’s is required, following a regulatory inspection, to take action to meet the *minimum standards* for a pharmacy premises. In those circumstances, Sainsbury’s only takes the minimal corrective action – i.e. minor works – in order to satisfy the inspection requirements.

<sup>79</sup> Provisional Findings, Appendix F, paragraph 95.

<sup>80</sup> CMA, Anticipated merger between Ladbroke’s plc and certain businesses of Gala Coral Group Limited, Provisional Findings Report (2016).

<sup>81</sup> CMA, Anticipated merger between Ladbroke’s plc and certain businesses of Gala Coral Group Limited, Provisional Findings Report (2016), paragraph 7.19.

## 10.5 Provision of prescription collection services

### ***No evidence that Lloyds flexes prescription collection services in response to local competitive conditions***

The CMA suggests that pharmacies, in general, may compete on prescription collection services. However, Lloyds does not flex its prescription collection service in response to local competitive conditions. In fact, Lloyds does not flex this service locally at all – Lloyds offers prescription collection in all pharmacies as a standard national service, and indeed has even recently advertised this service on television (in 2015).

Just as with waiting times, Lloyds has a consistent national approach to its universal prescription collection service: it aims to collect from as many GP surgeries as it can, in order to maximise its pool of repeat customers (i.e. grow its customer base) and strengthen its ability to retain those customers (i.e. increase brand loyalty). It is generally profitable for a Lloyds pharmacy to collect prescriptions from all the GP surgeries in its catchment area – and that is why Lloyds provides this service. Clearly there are limits: a Lloyds pharmacy will not collect prescriptions from GP surgeries which are too far away from it (i.e. outside its catchment area) and/or which do not have sufficient patients. However, this “collection radius” is driven solely by profitability (balancing the potential revenues gained against the costs of collection): Lloyds does not take the level of local competition into consideration.

Indeed, the only evidence of any kind (economic or documentary) in connection with prescription collection services that is mentioned in the PFs is Lloyds’ “Competitive Edge” document. Putting to one side yet again the historical nature of this document – which has not been actively used by Lloyds for a number of years and does not refer to Sainsbury’s – the CMA has noted it states that Lloyds pharmacies should “increase availability of a prescription collection delivery service where gaps have been identified”.<sup>82</sup> But this is not a statement which suggests that Lloyds aims to improve its offering to customers above and beyond what it would do in the absence of competition – as noted above, Lloyds offers a collection service at all of its pharmacies, and every one of those pharmacies has a clear commercial incentive to collect from the GP surgeries in its catchment area regardless of local competition (to increase customer numbers / prescription volumes and enhance brand loyalty).

### ***No evidence that Lloyds flexes prescription collection services in response to competitive pressure from Sainsbury’s***

Moreover, when one considers the specific characteristics of Sainsbury’s pharmacy business and the way it actually operates, it is very difficult to imagine how Sainsbury’s could possibly exert any competitive pressure on Lloyds in relation to collection services. The reach of Sainsbury’s prescription collection service is limited, because Sainsbury’s relies on regular pharmacy staff to informally collect prescriptions when feasible (i.e. when they are not occupied by their primary duties), using their own vehicles. This means that the reach of Sainsbury’s prescription collection service in any given local area tends to be weaker and much less comprehensive compared to specialist pharmacy operators such as Lloyds (who typically commit more dedicated staff to carrying out collections using company-owned vehicles, run collection-focused marketing campaigns and use specialised software which helps their staff know when prescriptions are due for collection).

In addition, it is not Sainsbury’s policy to improve or flex in any way its prescription collection services in response to local competitive conditions, and the CMA has not identified any evidence which might suggest that Sainsbury’s has ever done so.

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<sup>82</sup> Provisional Findings, paragraph 7.44(f).



***No evidence that the merged firm might have an increased incentive to worsen prescription collection services as a result of the Transaction***

Nor has the CMA shown that Lloyds would have an increased incentive to reduce its prescription collection services as a result of the Transaction, either in terms of the costs that would be saved, or the extent of diversion that could be expected to take place to Sainsbury's if Lloyds were to worsen its collection service (given that Sainsbury's [X]).

***Conclusion on prescription collection services***

Given that Lloyds has a consistent national approach to pharmacy collection services (which is driven by ordinary-course commercial incentives and will not be affected by the Transaction), the lack of any evidence to suggest that Lloyds or Sainsbury's tend to flex their collection offerings in response to local competitive conditions, the fact that Sainsbury's and Lloyds are not particularly close competitors and the weak and informal nature of Sainsbury's own prescription collection offering, it would be irrational to conclude that: (i) competitive pressure from Sainsbury's currently drives Lloyds to deliver better outcomes for customers in relation to prescription collection services; or (ii) the loss of competitive pressure from Sainsbury's is likely to result in any adverse effects for customers in connection with this QRS parameter.

It is also worth noting that as the use of "EPS" – the electronic prescription service which is currently being rolled out by the NHS – becomes the norm in England, the cost of "collecting" prescriptions will decline significantly, because neither Lloyds nor Sainsbury's (nor any other pharmacy operator) will need to send staff to GP surgeries to collect hard-copy prescriptions. Instead, all prescriptions will be sent to the pharmacy electronically. To look at it another way, in the very near future, it is likely that traditional prescription collection services will no longer be demanded by patients (as of May 2016, 43.3% of all prescriptions were through EPS, and this percentage is growing).<sup>83</sup> Consequently, to the extent that the Transaction does cause Lloyds to worsen its traditional collection service (which is highly unlikely, as established above), any such worsening could hardly be considered a *material* adverse effect for customers (many of whom will already be using EPS).

## **10.6 Range of services**

***No evidence that Lloyds flexes its range of services in response to local competitive conditions***

The CMA believes that pharmacies may compete in relation to their range of services – in particular, by choosing to provide additional private or locally commissioned services above and beyond the essential services that must be provided by all pharmacies.

However, Lloyds does not offer a wider range of services in response to local competitive conditions – it offers these services because they generate revenue and are profitable.

It is for this reason that Lloyds has a very simple, consistent national policy in relation to additional pharmacy services: Lloyds aims to offer as many services as it can in every pharmacy, regardless of whether there are any nearby competitors. This is Lloyds' standard national policy because it makes clear commercial sense. Lloyds will not have a greater incentive to reduce the range of services it offers in any local areas as a result of the Transaction – the Transaction will have absolutely no impact on Lloyds' incentives in this regard. Lloyds will continue to offer as many additional pharmacy services as it can at all its pharmacies – and aims to *increase* the range of additional pharmacy services offered at Sainsbury's pharmacies. Moreover, whether

<sup>83</sup> See <http://systems.hscic.gov.uk/eps/stats>.

offering such services is profitable to Lloyds or not is entirely independent from the level of local competition.

***No evidence that Lloyds flexes its range of services in response to competitive pressure from Sainsbury's***

Sainsbury's approach to providing additional pharmacy services is different: it has a consistent national range of *private* pharmacy services (for example, flu vaccinations), and lets its individual pharmacy managers determine which locally commissioned services to provide. Accordingly, in respect of private pharmacy services, Sainsbury's does not flex its private services range at the local level (let alone in response to competitive conditions).

In respect of locally commissioned services, Sainsbury's does not consider local competition when determining its range of services: such decisions are based on available resources and expertise at the local level, and the degree of local competition does not feature in that decision making process. As with Lloyds, these services are generally profitable, and therefore where the pharmacy has the skills and capacity to offer them, there is no incentive for Sainsbury's to hold these services back.<sup>84</sup>

Moreover, in respect of locally commissioned pharmacy services *and* private pharmacy services, given that Sainsbury's is a supermarket pharmacy and not a specialist pharmacy operator, Sainsbury's is [REDACTED] (despite the revenue-generating potential). It is simply not part of Sainsbury's business strategy to [REDACTED]. This point is reinforced by the submissions of third parties, as the CMA itself has noted. For instance, "Boots thought that supermarkets would provide some pharmacy services, but on the whole fewer than Boots",<sup>85</sup> whilst "Asda and Day Lewis noted that traditional pharmacies could offer more services than supermarket pharmacies".<sup>86</sup>

The CMA has identified a Sainsbury's document, "Pharmacy + Healthcare Vision", which stated that [REDACTED], and mentioned the possibility of [REDACTED].<sup>87</sup> As previously submitted, the CMA initially appears to acknowledge the context of this document; namely, that it was a strategic document prepared for the purpose of assessing how Sainsbury's might possibly [REDACTED],<sup>88</sup> but which was ultimately *not* actioned.<sup>89</sup> This context is important: the [REDACTED]. Nor is there is any evidence that: (i) Sainsbury's would have [REDACTED] would have been driven by local competitive conditions, rather than other factors. However, the CMA does not appear to take this important context into account in its provisional conclusions on this topic.

Finally, whilst the CMA notes that there is variation in the number and type of local services which are offered at the parties' pharmacies, the CMA has not found any relationship between these variations and the "indicators of competition in a local area". In other words, the CMA does not have any clear economic evidence which suggests that competition *in general* influences the range of services offered by pharmacies – let alone any evidence that competitive pressure from Sainsbury's causes Lloyds to improve its range of services.

<sup>84</sup> Sainsbury's knows that its private pharmacy services are profitable. However, it is more difficult for Sainsbury's to clearly determine the position in relation to locally commissioned services, because Sainsbury's does not track the relevant costs relative to the income generated by those services.

<sup>85</sup> Provisional Findings, paragraph 7.74(b).

<sup>86</sup> Provisional Findings, paragraph 7.75.

<sup>87</sup> Provisional Findings, Appendix F, paragraph 70.

<sup>88</sup> As it stands, penetration of pharmacy in each Sainsbury's supermarket store is low (only around 2% of total store customers use the pharmacy).

<sup>89</sup> Specifically, the CMA initially acknowledges that: "...Sainsbury's also said that 'the initiatives identified in this document were aspirational only and would have required significant investment to implement, which was ultimately unavailable'." See Provisional Findings, paragraph 7.44(d).

***No evidence that the merged firm might have an increased incentive to worsen its range of services as a result of the Transaction***

The CMA has not provided any evidence to show that Lloyds would have an increased incentive to reduce its range of services at the local level as a result of the Transaction (nor does the CMA appear to have expressly considered this proposition). In fact, the available evidence clearly shows that the Transaction is highly unlikely to affect Lloyds' incentives, particularly given that: (i) the pharmacist, who provides these services, must be on the premises at all times in order to allow for the dispensing of prescriptions in any case; (ii) all pharmacies must have a consultation room in any case; (iii) the incremental costs to Lloyds of providing the relevant services (e.g. pills, vaccinations and other materials) are more than covered by the fee offered; and (iv) a key factor underpinning the rationale for the Transaction for both parties concerns the potential for Lloyds to offer enhanced services in Sainsbury's pharmacies.

***Conclusion on range of services***

Given points discussed above, including the fact that Sainsbury's, as a supermarket pharmacy, does not focus on offering a wide range of additional pharmacy services, the lack of any economic evidence to suggest a relationship between range of services and competition, and the fact that Lloyds will have a clear commercial incentive to continue to provide the widest possible range of services regardless of the Transaction, it would be irrational for the CMA to conclude that: (i) competitive pressure from Sainsbury's currently drives Lloyds to deliver better outcomes for customers in relation to range of services; or (ii) the loss of competitive pressure from Sainsbury's is likely to result in any adverse effects for customers in connection with this QRS parameter.

**10.7 Opening hours**

The parties have made a number of previous submissions in respect of opening hours. In particular, see: the parties' response to the PFs, Part C, section 2.2. It is hard to overstate the importance of CRA's finding that the CMA's apparent discovery of a relationship between Lloyds' opening hours and the presence of a local Sainsbury's was not in fact robust – such that there is actually no reliable evidence that the presence of a local Sainsbury's pharmacy has a material impact on Lloyds' opening hours in the local area.<sup>90</sup>

***Lloyds' customers do not choose to visit Lloyds pharmacies due to their opening hours***

According to the CMA's own survey, when Lloyds' customers were asked, without prompting, "Why did you choose this pharmacy today?", a mere 0.1% mentioned the fact that Lloyds was open late or on the weekend as the first (i.e. primary) reason for their choice. In fact, only 1.4% mentioned this factor at all, even after the interviewers specifically prompted them to answer until they could not think of anymore factors which may have influenced their choice.<sup>91</sup> The parties firmly believe that these unprompted responses provide the clearest indication of what factors are truly important to customers.

Looking at the CMA survey results for the five surveyed Lloyds stores which are in the 13 provisional SLC areas, the position is even more telling. As Table 1 below shows, at four out of five of these stores, not a single customer mentioned opening hours at the first reason behind their choice of stores.

<sup>90</sup> The parties' response to the PFs, Part C, section 2.2 and Appendix 3.

<sup>91</sup> The exact question and interviewer instructions, as set out on page 37 of the DJS Survey Report, were as follows: "Q15. Why did you choose this pharmacy today? DO NOT READ OUT / CODE ALL RESPONSES / RECORD FIRST ANSWER AND OTHERS / PROMPT UNTIL CANT THINK OF ANYMORE". [emphasis added]

**Table 1 – CMA surveyed Lloyds stores in the 13 provisional SLC areas: Responses to Q15 (reasons to visit this pharmacy) – First and total mentions of “open late/weekends”)**

Lloyds store	Percent first	Percent total
Lloyds - Beaconsfield (30-32 London End)	0.82%	0.82%
Lloyds - Cardiff (44 Station Road, Llanishen)	0.00%	0.85%
Lloyds - Kidlington (18 The Parade)	0.00%	0.90%
Lloyds - Theale (27 High Street)	0.00%	0.00%
Lloyds - Warlingham (46-48 The Green)	0.00%	0.71%

Moreover, when Lloyds’ customers were subsequently asked to pick the three most important factors when deciding which pharmacy to visit from a list of eight factors in total, only 3% selected opening hours as the most important.

These survey responses suggest it is highly likely that other factors – unrelated to opening hours – are driving Lloyds customers’ decision to choose to visit its stores rather than competing pharmacies. This conclusion is consistent with the customer research that Lloyds has carried out.<sup>92</sup>

***A reduction in opening hours – by itself – is unlikely to cause Lloyds’ customers to switch to a different pharmacy***

Customers who have a preference of one pharmacy over another, when faced with a reduction in opening hours at their preferred store, may change their behaviour so they can still use their preferred store – for example, by visiting at another time, or on another day, or by using a delivery service – rather than choosing to visit an alternative pharmacy. In other words, customers can modify their behaviour in response to a change in opening hours, and still remain loyal to the same pharmacy. This choice will be available even if Lloyds reduces its opening hours at a particular pharmacy by the greatest extent possible, due to the regulatory minimum requirement at every pharmacy open for at least 40 core hours each week (or 100 core hours, depending on the licence). The choice available to pharmacy customers in response to a reduction in opening hours therefore contrasts significantly with marginal customers in the face of a price rise (the focus of most standard retail merger cases), who only have the option of switching to a different supplier of similar quality.

To take an example in relation to opening hours, consider the following scenarios. If a Lloyds store is open 10 hours a day and closes entirely, all those customers must go somewhere else to get their prescriptions. In those circumstances, the CMA’s survey diversion question is directly informative on where they are likely to go. However, if that pharmacy simply closes an hour early, it may be that only, say 5- 10% of those customers have to do anything differently at all and, moreover, many of them may simply decide to use the same pharmacy at a different time of day. For example, if 50% of customers would not divert to a different pharmacy at all under these circumstances (e.g. because they can easily visit at a different time, or obtain a home delivery), then one would expect the relevant diversions to Sainsbury’s to be about half the level seen in response to the relevant survey question (although of course this is only a very crude

<sup>92</sup> For example, see pages 43 and 45 of the presentation “Lloyds Pharmacy Brand Tracking W1 – Benchmark Wave” presentation, prepared for Celesio UK by the Nursery Research & Planning January 2015 (document titled “Lloyds Pharmacy Brand Tracking W1 – Benchmark Wave”, attached to the Merger Notice as Appendix 10(a)(iii)). This document (based on customer research) shows convenient location, collection/repeat prescription services and friendly and approachable staff as being more popular reasons for choosing Lloyds pharmacy for prescriptions. In addition, good customer service, getting served quickly, quality of advice, range and prices of products and having the products in stock all ranked above opening hours in relation to non-prescription products. In fact, compared with the rest of the market, Lloyds appeared to be chosen less often because of its opening hours (see page 46).

estimate: as the 50% who would switch may have different views on the relative merits of different rivals to the 50% who would not).

Note that this does not appear to have been taken into account in the CMA's analysis of Lloyds' incentives to reduce opening hours, which assumes that all customers using a Lloyds pharmacy in the last hour of the day would switch to rivals if the Lloyds store were to close an hour earlier (while then comparing this figure with the unadjusted survey ratios).

The parties also note that this critical level of diversion (40%) also appears to have been calculated based on data regarding customer distributions across the day, which are driven in large part not by actual customer visiting patterns, but by the fact that the 6 hour shift patterns used by DJS resulted in more surveys being conducted in the middle of the day. There is no indication that this has been adjusted for in the CMA's analysis: and if it has not, the critical diversion threshold identified (at 40%) will be too low for this same reason.

***The Transaction will therefore not materially change Lloyds' incentives to reduce opening hours***

Given that Lloyds' customers do not generally appear to choose to visit a Lloyds pharmacy based on its opening hours, and the fact that Lloyds' customers may choose to simply use their preferred Lloyds pharmacy at a different time or in a different way (e.g. using home delivery) in response to a reduction in opening hours (rather than switching to a competitor, as one might expect in response to a price rise), there is no clear reason why a change in local competition in general would result in a significant incentive to vary opening hours, at least in local areas where there are few other competitors in very close geographic proximity.

Moreover, in all of the 13 provisional SLC areas, the Lloyds pharmacies on 40-hour minimum licences are open for significantly fewer hours than the closest Sainsbury's pharmacy.<sup>93</sup> Often, the Lloyds pharmacy is open for as few as half the hours of the Sainsbury's (which could be considered roughly equivalent to charging double the price for a product in a standard retail merger case). This is hardly suggestive of a competitive dynamic which, if removed, is likely to cause Lloyds to alter its approach to opening hours. Rather, it is indicative of the fact that Lloyds primarily bases its opening hours around the hours of nearby GP surgeries (as Celesio has submitted on numerous occasions),<sup>94</sup> and beyond that, when there are few other competitors nearby (or when those competitors are highly differentiated and therefore exert a very weak constraint, such as Sainsbury's), suggests that Lloyds is already setting its opening hours at a profit-maximising level. Accordingly, it is very difficult to see how the Transaction could reasonably be expected to materially change Lloyds' incentives to reduce opening hours at any of its pharmacies.

***The existence and positioning of "core" opening hours means Lloyds' ability to reduce opening hours is severely limited***

Even if, despite the foregoing, the CMA comes to the conclusion that the Transaction is likely to materially increase Lloyds' incentives to reduce opening hours in one or more local areas, the CMA must accept that Lloyds' *ability* to implement any such reductions is severely limited. As previously submitted, no pharmacy can unilaterally alter its core opening hours (by even 5

<sup>93</sup> The CMA's concerns in relation to opening hours presumably do not apply at the Lloyds pharmacy at Sutton Coldfield Mere Green (B74 2UG, LP78, FML77), which holds a 100 hour licence and is only open for 100 hours, such that it could not reduce its opening hours under the terms of its licence.

<sup>94</sup> See, for example, Part C, section 1.3 of the parties' response to the PFs, and section 2.2 of the parties' Joint Response to the Statement of Issues.

minutes) without approval from the local authority.<sup>95</sup> 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), to ensure that it is effectively committed to the full opening hours. 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, Lloyds' 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 (although 3 months' notice of any such change would still need to be given to the local authority).

To alleviate any possible concerns that the CMA may have about Lloyds' ability to reduce its *supplementary* hours in the 13 provisional SLC areas, Lloyds has unilaterally lodged applications to move its *core* hours to the beginning and end of the day (where this is not already the case) at all its pharmacies in those areas. Once these applications are approved – and Lloyds has no reason to believe they might not be – Lloyds will be unable to reduce its opening hours by opening later or closing earlier in any of the 13 provisional SLC areas without regulatory approval. Further details of Lloyds' unilateral changes to its core opening are set out in Section 15 below.

These changes will ensure that, in every relevant local area, Lloyds' ability to alter its opening hours at all (let alone to an extent that might constitute a material customer detriment) is severely limited. The local Clinical Commissioning Groups ("CCGs") will not subsequently allow Lloyds to alter or redistribute its core hours in any area, unless Lloyds can provide satisfactory evidence to establish that such an alteration is justified due to "changes to the needs of the people in its area, or other likely users of the pharmacy, for pharmaceutical services".<sup>96</sup>

***Even if the Transaction did increase Lloyds' incentives to reduce hours, and the CMA somehow forms the view that Lloyds has the ability to implement such a reduction despite its core hours, the possibility of a small reduction in opening hours is not sufficiently material to justify an SLC finding***

See Section 13.1 below for the parties' submissions on this point.

## **11 Misplaced reliance on hypothetical store closure "diversion ratios" as local SLC evidence of close competition in some (or all) of the 13 areas**

In the previous section, it was established that there is no evidence, across the board, to suggest that the parties' rivalry currently leads to better QRS outcomes for customers at the local level, or that the Transaction would create or materially strengthen any incentive to worsen QRS locally. However, there is also no specific evidence which might establish the likelihood of such an outcome in any of the 13 provisional SLC areas. For instance, there is no documentary evidence which suggests that in certain of those 13 areas, Lloyds intends to reduce opening hours as a result of the Transaction – there is no "smoking gun" or "hot document" in relation to Kidlington, or any other local area. There is no such documentary evidence – or any other kind of evidence – because it is *not Lloyds' intention* to take that action in any local areas (nor have Lloyds' incentives to take such an action materially changed as a result of the Transaction), and the CMA does not have a reasonable basis upon which to reach a contrary finding.

<sup>95</sup> 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).

<sup>96</sup> The National Health Service (Pharmaceutical Services) Regulations 2012, paragraph 26(2). Applications for the alteration of "core" opening hours must be considered in light of paragraph 26(2) of Schedule 4 to the Regulations and "pharmaceutical need".

### 11.1 Reliance on hypothetical “store closure” diversion ratios

It bears repeating that survey “diversion ratios” are typically among, if not the, best kind of evidence in a normal UK Phase II retail merger case, which have (until this case) always involved manifestly close competitors at national level or quite obviously at local level. Despite this evidentiary aura, it does not follow that these diversion ratios can be used to establish any and all propositions that may be convenient to an SLC case.

The CMA has relied on high diversion ratios (in response to a hypothetical store closure) in three of the local areas it surveyed (Kidlington, Reading and Warlingham) to conclude that the parties “could be close competitors in specific local markets where the number of competitors was low (concentrated local markets)”.<sup>97</sup>

### 11.2 High diversion ratios in a handful of local areas do not suggest that the parties are particularly close rivals

As the CMA itself notes, the estimated diversion ratios based on the CMA’s survey suggest that the parties’ customers consider the parties “to be good alternatives to one another (with high estimated diversion between them) in areas where the stores are close together (within less than a mile) and where there are relatively few other competitors in close proximity”.<sup>98</sup> [emphasis added] If anything, these results suggest that the parties are *not* particularly close competitors: they show that customers are *only* likely to consider the parties’ respective retail offerings as substitutes in circumstances where their stores are very close together and there are few other rivals nearby.<sup>99</sup>

This conclusion is consistent with all the other evidence on closeness of competition (e.g. the entry-exit study and the margin-concentration study), which shows that, in general, the parties are not close competitors to one another. If the parties *were* particularly close competitors, one would also expect to see relatively high diversions between them in circumstances where their stores are further apart and/or there are more competitors nearby – but that is not the case here.

### 11.3 Misuse of “store closure” results as evidence that local customers are marginal as between the merger parties in response to QRS flexing

In contrast, other retail cases at the PFs stage of Phase II often already involve a range of economic, documentary and common sense evidence that the merger parties are close competitors across many (if not all) local overlap markets (i.e. “nationally”) – see *Poundland/99p*, *Ladbrokes/Coral* and *Sports Direct/JJB*.

In those circumstances, it is reasonable (when approaching survey evidence) to assume that there will be material numbers of marginal customers between the parties, who are price-sensitive and/or QRS-sensitive and will readily switch to their next-best alternative when they notice a price increase or service quality deterioration. While marginal customers typically drive competition in the general sense, and customers marginal as between the merger parties drive competition between the merger parties, it is generally accepted that it is not feasible to interview only those customers who are marginal (price or QRS-sensitive), or to ask customers what they would hypothetically do in response to a 5-10% service reduction and expect meaningful results. Instead, it is standard survey practice to ask all customers, including all the infra-

<sup>97</sup> Provisional Findings, paragraph 29.

<sup>98</sup> Provisional Findings, paragraph 7.94.

<sup>99</sup> Indeed, given the nature of the diversion questions posed in the CMA’s survey, this evidence arguably only tells you that customers in high diversion areas considered the parties’ stores to be potential substitutes if their store of choice was *permanently closed*. Consequently, there is a limit on how much can be reasonably inferred from this evidence – either in relation to the general nature of competition between the parties, or in relation to the degree to which the parties might be close competitors in a particular local area – given that Lloyds is not intending to implement store closures as a result of the Transaction.

marginal ones who would not switch away, where they would go if the store were closed (i.e. “force” them to switch), to produce a reasonable guide of the self-assessed next-best alternative. When there is *already* good evidence that significant numbers of customers are marginal between the merger parties, it is then appropriate to treat the preferences of *all* customers as a proxy for the preferences of *marginal* customers, i.e. to assume (as the CMA does) that marginal customers would likely divert according to the same pattern as the results of all customers.

However, what this perfectly reasonable assumption does not do, and cannot do, is count as evidence that there are actually any price-sensitive or QRS-sensitive marginal customers between the merger parties in the first place (let alone a material number of such customers). Further evidence is needed to establish that such marginal customers exist (and such further evidence has been relied upon in the other CMA Phase II cases cited in this submission).

In this case, the CMA is misappropriating the survey evidence if it reverse-engineers the proposition that there sufficient marginal customers between the parties in a given local market “X”, such that the parties are close competitors in local market “X”, because the “hypothetical store closure” diversion ratio in that area is high. Put differently, telling customers to imagine that a (or indeed *all*) Lloyds store(s) is closed, and then noting how many say they would, in that case, go to Sainsbury’s, is simply not good evidence that: (i) many of these customers are marginal as between the highly differentiated offers of Sainsbury’s and Lloyds; and (ii) fear of losing such marginal customers is making Lloyds deliver materially better QRS offerings at the local level.

#### **11.4 Conclusion on the probative value of diversion ratios**

Given the foregoing, it makes no sense, in effect, to: (i) force all customers to become “marginal” (i.e. propensity to switch) by asking them to imagine the Lloyds or indeed all Lloyds are closed; (ii) conclude that many customers, in the forced migration of the hypothetical, would go to Sainsbury’s; and then (iii) conclude that this means that Sainsbury’s is constraining Lloyds and driving a superior local-level QRS offer at the Lloyds store in the ordinary course of pre-merger business. Indeed, the store closure question does not take the CMA anywhere near what would be required to reasonably support an SLC finding: even the “high diversion” results merely suggest the common sense point that the parties’ pharmacies are nearby in these areas, and if one asks store visitors to imagine they knew the store was permanently closed before their journey, their unprompted response whilst in that “shut” store is to say they would go to a nearby (if not the nearest) pharmacy. These results are not surprising, nor are they probative of the relevant SLC question, which is whether Lloyds’ locally-flexed QRS offer is better (and if so, how) because of Sainsbury’s competitive pressure.

## **12 Misplaced reliance on qualitative assessment of local area maps**

The CMA decided not to survey all the potentially problematic local areas in this case, and so developed a number of filters to identify those which it believed should be scrutinised more closely. After using a range of filters to narrow the list of relevant areas down to 32, the CMA “examined maps of these 32 areas, considering characteristics of the local areas in more detail, including in relation to the location of customers and GP practices, specific features associated with the location of the pharmacies, journey routes and other relevant factors together with diversion estimates where available.”<sup>100</sup> According to the CMA, “[t]his enabled us to assess how

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<sup>100</sup> Provisional Findings, paragraph 7.150.



closely the Parties compete in those specific areas and the likely extent of competitive constraints provided by third parties”.<sup>101</sup> [emphasis added]

However, with respect to the CMA, looking at a map and considering the geographic characteristics of a local area does *not* enable one to properly assess the closeness of competition between two rivals, nor does it necessarily provide any meaningful insight into how the loss of such a rivalry as a result of a merger may be expected to lead to material adverse effects for consumers. Indeed, by using this map-reading exercise as the final determinant on local competition, the CMA is overlooking a plethora of hard evidence in favour of its own unsubstantiated assertions. Even in those few local areas where some customers may consider the parties’ retail offerings to be substitutes due to the extreme geographic proximity of their stores (despite the fact that the parties are generally not close competitors), something more is needed in order to establish an SLC finding. Specifically, it must be established that: (i) the parties are competing on certain aspects of their respective offerings (i.e. that competitive pressure from Sainsbury’s is causing Lloyds to perform better on certain QRS parameters); and (ii) the loss of the parties’ rivalry is likely to lead to a material worsening of one or more of those parameters in the relevant local area to the extent necessary to justify an SLC finding (i.e. that Lloyds would have an increased *incentive* to worsen QRS at these stores, *because* of the loss of rivalry from Sainsbury’s).

If these elements had been established more generally, or if Lloyds and Sainsbury’s were particularly close competitors, then it might be possible to *infer* the likelihood of adverse effects in certain local areas by looking at maps (and extrapolating from survey results). But here we have the opposite situation – Lloyds and Sainsbury’s are not particularly close competitors, Sainsbury’s is generally (at best) a weak competitor on QRS parameters, and there is no clear evidence to suggest that the loss of the parties’ rivalry is generally likely to lead to worse QRS outcomes for customers at the local level. As a result, it is irrational for the CMA to seek to draw inferences from maps (and extrapolated survey results) in order to justify an SLC finding in particular local areas, without any specific evidence to suggest that the Transaction is likely to adversely affect customers.

### **13 No prospect of material adverse effects to support an SLC finding**

Even if the CMA had established the likelihood of any adverse effects as a result of the Transaction, it has not identified any such effects which are sufficiently material to warrant an SLC finding in any local area. Specifically, even if there was clearly an increased incentive for Lloyds to reduce its offering on any of the seven QRS parameters outlined above as a result of the Transaction (which there is not), the CMA has not demonstrated how this would cause a material adverse effect to customers to support an SLC finding.

As previously submitted,<sup>102</sup> 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*. 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, even though in principle it would “affect customer welfare by reducing convenience”, 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 to warrant a local-level inquiry, let alone an SLC finding that might require a divestiture-based remedy.

<sup>101</sup> Provisional Findings, paragraph 7.150.

<sup>102</sup> Parties’ Response to the Provisional Findings, Part C, paragraph 3.3.

Similarly, in the *Sports Direct/JJB* case, notwithstanding the fact that the merger parties were found to be the only relevant competitors, the CC did not consider the prospect of store closures (leading to longer travel times for customers) or even actual price rises as a result of their merger to be sufficient for an SLC finding. The CMA concluded:

“Overall, we found no evidence that Sports Direct flexes its PQRS at the local level in response to local competition (even where it can) and we found that the store transfers have not affected significantly its incentives to do so. We found that the closure of some Sports Direct stores following the transfers have adversely affected consumer welfare, due to longer travel times, but only very slightly. We found some evidence of an actual average price rise following the store transfers, and a reduction in the pressure faced by Sports Direct to keep prices down, but only by a very small amount, and with some uncertainty surrounding our estimates... For all these reasons, we concluded that there was insufficient evidence to support an SLC on the basis of unilateral effects resulting from the store transfers.”<sup>103</sup>

It is not clear to the parties why:

- the possible detriment of customers having to walk slightly further to find a pound or sports shop because their first choice of store has been *permanently* closed – let alone the prospect of actual price rises and a reduction in pressure to keep prices down – were considered to be too insignificant to result in an SLC finding in previous Phase II retail merger cases; but
- in this case, 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) – or the hypothetical (but also unsubstantiated) reduction of other quality or service parameters, at most to the regulatory minimum – can be reasonably said to justify an SLC finding.

### 13.1 No prospect of material worsening of opening hours by Lloyds

In this case, the CMA focuses on the possibility that Lloyds might reduce opening hours at its own existing pharmacies, rather than at Sainsbury’s pharmacies, due primarily to: (i) the [§] in the Co-operation Agreement; and (ii) the fact that many Sainsbury’s pharmacies hold 100-hour licences.

As noted above in Section 10.7:

- the survey evidence in this case suggests that Lloyds customers do not choose to visit Lloyds pharmacies due to their opening hours; and
- all of Lloyds’ 40-hour pharmacies in the 13 provisional SLC areas are open for significantly fewer hours than the closest Sainsbury’s pharmacy (with the Lloyds pharmacy often open for as few as half the hours of the Sainsbury’s).<sup>104</sup>

Consequently, the CMA is focusing on what would happen to consumers of the (typically significantly) lower quality product (in terms of number of hours open) when they face a further degradation in quality. This invites the obvious question: why have these customers chosen the (significantly) lower quality product in the first place? If they consider opening hours to be an important factor, why have they not chosen to use the nearby Sainsbury’s pharmacy (which will usually be open for far longer)? The only plausible response is that other (more important)

<sup>103</sup> Competition Commission, Report on the acquisition by Sports Direct International plc of 31 stores from JJB Sports plc (2010), paragraph 8.41.

<sup>104</sup> The CMA’s concerns in relation to opening hours presumably do not apply at the Lloyds pharmacy at Sutton Coldfield Mere Green (B74 2UG, LP78, FML77), which holds a 100 hours licence and is only open for 100 hours, such that it could not reduce its opening hours under the terms of its licence.

factors have driven the customers' choice, and that any *further* reduction in opening hours by Lloyds (putting aside the unlikelihood of such an action given the lack of any material change in its incentives) is therefore unlikely to be viewed as significant by those customers.

As previously submitted in the parties' response to the PFs dated 23 May 2016, it is hard to conceive how the CMA could reasonably conclude that the prospect of a pharmacy closing 6 minutes earlier each day (as per the CMA's illustrative example in the PFs of a 1% reduction in opening hours)<sup>105</sup> is sufficiently material to warrant an SLC finding in any local area.<sup>106</sup>

Given the hypothetical reduction of opening hours in this case would not remove a pharmacy as an option for customers – as discussed in Section 10.7 above, many customers could change their habits by visiting the pharmacy at a different time – it would be entirely irrational and completely at odds with previous retail merger decisions for the possibility of a small reduction in opening hours (where there is no clear evidence the Transaction will materially change Lloyds' incentives to implement such a reduction, particularly given the low diversions from Lloyds to Sainsbury's found in relation to variations in opening hours) to result in an SLC finding.

### **13.2 No other material adverse effects are articulated in the PFs**

The parties have not been given the opportunity to comment on the materiality of any other possible adverse effects, because none are articulated in the PFs. It is certainly not possible for the parties to meaningfully comment on whether the possibility of a “reduction in the quality of service” may or may not be material – and that is the closest that the CMA has come to identifying the nature of its concerns for consumer welfare in this case.<sup>107</sup>

As noted in Section 3 above, the CMA has subsequently stated that there are areas of concern to it “other than opening hours.”<sup>108</sup> The parties genuinely believe that any such concerns are misplaced, given conclusions that must rationally be reached when one considers each of the relevant QRS parameters that might possibly be worsened following the Transaction (as the parties have done in Section 10 above). However, if the CMA were to somehow reach a contrary conclusion in relation to one or more of the relevant QRS parameters, it would still be incumbent on the CMA to describe the nature of its specific concerns for consumer welfare (e.g., hypothetically, that Lloyds might reduce its range of additional pharmacy services in one or more local areas as a result of the Transaction), so that the parties have a reasonable opportunity to comment on the strength of supporting evidence for, and materiality of, those concerns. Any failure to follow this due process could constitute procedural unfairness to the parties.

## **14 The Remedies Working Paper suggests that the CMA has failed to properly consider the merits of a behavioural remedy**

In the Remedies Working Paper, the CMA argues it had provisionally concluded (in the PFs) that “there remained scope and incentive to flex a number of aspects of quality, range and service in response to competitive conditions at the local level”.<sup>109</sup> Consequently, given the behavioural remedy proposed by Celesio in its response to the CMA's Notice of Possible Remedies addressed only one element of QRS – namely, opening hours – the CMA declared that it would not be “effective in addressing the SLC we have provisionally found”.<sup>110</sup> For this reason, the

<sup>105</sup> Provisional Findings, paragraph 7.111.

<sup>106</sup> Parties' Response to the Provisional Findings, Part C, paragraph 3.3.

<sup>107</sup> Provisional Findings, paragraph 8.1(b).

<sup>108</sup> Celesio Response Hearing Transcript, p 28.

<sup>109</sup> Remedies Working Paper, paragraph 95.

<sup>110</sup> Remedies Working Paper, paragraph 96.

CMA declared that it would not even consider “whether the [behavioural] remedy itself would address any specific concerns we have highlighted in regard to opening hours.”<sup>111</sup>

The parties remain firmly of the view that if an SLC finding is maintained, then a behavioural remedy would be an effective and proportionate cure. They also believe that the CMA’s approach (thus far) to assessing the merits of a behavioural remedy, as outlined in the Remedies Working Paper, is both inadequate and unreasonable.

The shortcomings of the CMA’s provisional SLC finding have been addressed in the previous sections of this submission (and in the parties’ previous submission in response to the PFs), and need not be repeated. However, those shortcomings are inherently linked to the inadequacy of the CMA’s reasons for dismissing a behavioural remedy out-of-hand. Both rely on the CMA’s belief that, after the Transaction, “there [will] remain... scope and incentive [for Lloyds] to flex a number of aspects of quality, range and service in response to competitive conditions at the local level”.<sup>112</sup> This quote is worth repeating, because it perfectly embodies what is wrong with the CMA’s approach in this case.<sup>113</sup> Given that (as discussed in detail in the preceding sections) there is no rational basis for concluding that competitive pressure from Sainsbury’s at the local level is currently driving any aspect of Lloyds’ retail offer (see Section 10 in particular for a thorough assessment of each of the relevant QRS parameters) – and consequently, no rational basis for concluding that the Transaction is likely to result in any material adverse effects for customers – it is therefore impossible for the parties to comprehend how the CMA can reasonably claim that it has “not been able to devise a behavioural remedy that would address all of the adverse effects arising from the SLC” that it has provisionally found, and “a behavioural remedy that addresses all potential impacts on quality would be difficult to specify”.<sup>114</sup>

In light of the above, the parties wish to challenge the CMA’s decision to dismiss the notion of a behavioural remedy without properly considering its merits in this case. If the CMA had, in the PFs, expressed its concerns regarding possible adverse effects in a transparent and coherent manner, or articulated the specific nature of the “potential impacts on quality” which it believes are likely to flow from the Transaction, then the parties would at least have had a reasonable opportunity to craft an appropriately tailored behavioural remedy for any concerns beyond opening hours. It is inappropriate for the CMA implicitly to criticise the parties for failing to correctly pin the tail on an invisible donkey.

## **15 Scope of a behavioural remedy can be expanded or tailored to address any concerns regarding its breadth and/or efficacy**

In the hope that the CMA will reconsider its approach to date, the parties refer to and repeat their relevant submissions in response to the CMA’s Notice of Possible Remedies regarding the efficacy and proportionality of a behavioural remedy in this case. In that response, Lloyds stated that it would undertake:

<sup>111</sup> Remedies Working Paper, paragraph 96.

<sup>112</sup> Remedies Working Paper, paragraph 95.

<sup>113</sup> This quote from the Remedies Working Paper reflects a fundamental misapplication of s 36 of the Act, as it suggests that an SLC finding is justified because the merged firm will continue (i.e. “remain”) to have the ability (i.e. “scope”) and incentive to flex aspects of its QRS in response to local competitive conditions. First, whether Lloyds *continues* to have an incentive and the ability to flex QRS post-merger is irrelevant – the correct question is whether the Transaction will materially increase Lloyds’ incentive and ability to do so (if the Transaction does not change the status quo in this regard, there is no reasonable basis for an SLC finding). Second, whether Lloyds has the ability and incentive to flex its QRS in response to local competitive conditions is equally irrelevant – the correct question is whether Lloyds currently flexes its QRS in response to competition *from Sainsbury’s* at the local level (i.e. whether Lloyds has a better QRS retail offer due to the presence of Sainsbury’s), and whether the Transaction, by removing that competitive dynamic (should be proved to exist, which it has not) is likely to have adverse effects on customers which might justify an SLC finding. The proper approach to applying the legal test under s 36 of the Act is dealt with in further detail in Sections 2 and 3 above.

<sup>114</sup> Remedies Working Paper, paragraph 97(c).

- not to reduce the opening hours below those that were in place immediately prior to the date of the BSA (or such other date to be agreed with CMA);
- at any Lloyds pharmacy identified on the maps contained in Annex M to the PFs;
- for a period of three years, which is equal to the typical duration of a Pharmaceutical Needs Assessment, or such other period as deemed by the CMA to be appropriate, proportionate and reasonable in the circumstances;
- unless consent is sought and received from the CMA (for example, as a result of a material change in circumstances in a particular local area).

The parties still believe that such an undertaking would be sufficient to directly address the perceived adverse effects of the provisional SLC finding (which, as previously submitted, appear to the parties to be of extremely limited scope). If, however, after a proper consideration of the merits of this behavioural remedy (which was not undertaken in the Remedies Working Paper), the CMA forms the view that the proposed undertaking is deficient in some way, there are a number of its aspects which can be enhanced.

**15.1 Duration of any behavioural remedy**

First, there is the duration of the undertaking – three years was the initial proposal. However, as indicated in the parties’ previous submission in response to the Notice of Possible Remedies, Lloyds would be willing to accept any other duration that is deemed by the CMA to be necessary and proportionate in the circumstances.

**15.2 Unilateral changes to core opening hours and the reduced (arguably non-existent) need for monitoring or enforcement by the CMA**

Second, there is the cost of monitoring and enforcing the undertaking, and the risk that it may not successfully prevent Lloyds from worsening its QRS. In order to demonstrate its willingness to address the CMA’s concerns and ensure that customers are adequately protected with minimal (or no) need for additional enforcement or monitoring by the CMA, Lloyds has unilaterally lodged applications to move its core opening hours to either end of the day (where this is not already the case) at all its stores in the 13 provisional SLC areas. The list of relevant stores in relation which such applications have been lodged is set out in Table2 below.

[REDACTED]

Area Name	[REDACTED]	[REDACTED]	[REDACTED]
Beaconsfield	[REDACTED]	[REDACTED]	[REDACTED]
Bracknell	[REDACTED]	[REDACTED]	[REDACTED]
Cardiff	[REDACTED]	[REDACTED]	[REDACTED]
Christchurch	[REDACTED]	[REDACTED]	[REDACTED]
Kempston	[REDACTED]	[REDACTED]	[REDACTED]
Kidlington	[REDACTED]	[REDACTED]	[REDACTED]
Leeds	[REDACTED]	[REDACTED]	[REDACTED]
Liverpool	[REDACTED]	[REDACTED]	[REDACTED]
Luton	[REDACTED]	[REDACTED]	[REDACTED]
Reading	[REDACTED]	[REDACTED]	[REDACTED]
Sandy/ Potton/ Biggleswade	[REDACTED]	[REDACTED]	[REDACTED]
Sutton Coldfield	[REDACTED]	[REDACTED]	[REDACTED]

Area Name	[X]	[X]	[X]
Warlingham	[X]	[X]	[X]

Moreover, at the Lloyds Mere Green pharmacy (B74 2UG, LP78, FML77), Lloyds is already prohibited from reducing its opening hours under any circumstances, due to the terms of its 100-hour licence.

Once these moves of core hours have been approved, Lloyds will be unable to open later or close earlier at *any* of its pharmacies in the 13 provisional SLC areas, without obtaining approval from the local CCG. In effect, the local CCGs and NHS England area teams will monitor and enforce the undertaking – there would be very little (if anything) required of the CMA above and beyond the role played by these bodies. In fact, each NHS England area team “will monitor the opening hours for all [pharmacy] contractors operating in its area so that compliance with their terms of service can be ascertained”.<sup>115</sup> If it is found that a pharmacy contractor “is not open, or has not been open, in line with its contracted hours”, then the relevant NHS England area team will take action to address the discrepancy.<sup>116</sup> To the extent that the CMA was inclined to monitor Lloyds’ opening hours itself, those hours are published online (both on Lloyds’ own website and on NHS Choices), and the process for changing them is tightly restricted by regulation. For instance, a copy of any application to alter a pharmacy’s core hours must be sent to the local “pharmaceutical committee in whose area the contractor’s premises are located”, so that the committee’s views can be obtained.<sup>117</sup> The local pharmaceutical committee represents all the pharmacy contractors in the relevant local area, so all of Lloyds’ local competitors will have advance notice of any attempt by Lloyds to alter its core hours.

Even without a behavioural remedy, this unilateral step should effectively mitigate any risk that Lloyds might seek to reduce its opening hours to a material extent following the Transaction to the detriment of customers. This is because the relevant CCG and the NHS England area team will not subsequently allow Lloyds to alter or redistribute its core hours in any local area, unless Lloyds can provide satisfactory evidence to show that such an alteration is justified due to “changes to the needs of the people in its area, or other likely users of the pharmacy, for pharmaceutical services”.<sup>118</sup>

### 15.3 Scope of behavioural remedy could be expanded to cover other QRS parameters (but the parties have not been provided with enough information regarding probable adverse effects to do this exhaustively)

Third, the proposed behavioural remedy could also potentially be expanded to cover the *range* of pharmacy services offered at Lloyds’ stores in each of the 13 SLC areas. Specifically, Lloyds could undertake:

- not to voluntarily cease providing any additional pharmacy services (including any locally-commissioned and private services); and
- to re-apply for permission to keep providing any additional pharmacy services it currently provides,

<sup>115</sup> NHS England, Procedure for dealing with changes to pharmacy and dispensing appliance contractors’ opening hours (2014), paragraph 71.

<sup>116</sup> NHS England, Procedure for dealing with changes to pharmacy and dispensing appliance contractors’ opening hours (2014), paragraph 73.

<sup>117</sup> NHS England, Procedure for dealing with changes to pharmacy and dispensing appliance contractors’ opening hours (2014), paragraph 24.

<sup>118</sup> The National Health Service (Pharmaceutical Services) Regulations 2012, paragraph 26(2). Applications for the alteration of “core” opening hours must be considered in light of paragraph 26(2) of Schedule 4 to the Regulations and “pharmaceutical need”.

at all of those stores, for the duration of the remedy (whether it be 3 years, or a longer period if the CMA does not believe 3 years is sufficient). This undertaking would not impose any burden on Lloyds because, as explained in Section 10.6 above, the additional private and locally commissioned services provided by pharmacies are *profitable activities* for Lloyds, and it therefore has a commercial incentive to supply such services at every one of its pharmacies (and no incentive to withdraw such services). Accordingly, the risk of Lloyds failing to comply with such an undertaking (and therefore the need for it to be vigorously monitored and enforced) is very low.

Lloyds is willing to discuss with the CMA what other changes, if any, might be necessary to improve the viability of a behavioural remedy. If Lloyds could genuinely discern from a close reading of the PFs any other *specific* adverse effects that were of apparent concern to the CMA, Lloyds would be very willing to address those adverse effects with further expansions to its behavioural remedy proposal. But Lloyds cannot reasonably be expected to craft a behavioural remedy proposal to assuage the CMA's concern about something as vague as a possible "reduction in the quality of service" – and nor can the CMA reasonably continue to rely on such a concern to justify an SLC finding if it is to fulfil its responsibilities as a rational decision-maker in this case.<sup>119</sup>

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<sup>119</sup> Provisional Findings, paragraph 8.1(b).