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***Case No COMP/
M.716 – GEHE /
LLOYDS***

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**REGULATION (EEC) No 4064/89
MERGER PROCEDURE**

Article 9(3)b
Date: 22/03/1996



Brussels, 22/03/1996 – C(96)728

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 9(3)(b) DECISION

**Commission Decision
of 22/03/1996
referring case No. IV/M.716 – GEHE / LLOYDS
to the competent authorities of the United Kingdom
pursuant to Article 9 of Council Regulation No 4064/89
(Case No. IV/M.716 – GEHE / LLOYDS)**

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989¹ on the control of concentrations between undertakings, and in particular Article 9(3)(b),

Having regard to the notification made by GEHE AG pursuant to Article 4 of the said Council Regulation on 08.02.1996.

Having regard to the communication received from the United Kingdom Government, dated 01.03.1996.

Whereas,

1. On 8 February 1996 GEHE AG, Stuttgart, belonging to the Franz Haniel + Cie GmbH Group, notified under the Merger Regulation the operation to acquire sole control by purchase of the whole of the share capital of Lloyds Chemists Plc., Tamworth (UK) by way of public bid announced on 7 February 1996.
2. In order to ensure the full effectiveness of any later decision, the Commission decided on 1 March 1996 to continue the suspension of the concentration in accordance with the provisions of Article 7(2) and 18(2) of the Community Merger Regulation.

1 OJ L 395, 30.12.1989; corrected version : OJ L 257, 21.9.1990

3. Also on 1 March 1996, the United Kingdom Government informed the Commission pursuant to Article 9(2) of the Merger Regulation that in its opinion the proposed concentration threatened to create a dominant position as a result of which effective competition would be significantly impeded in the markets for pharmaceutical wholesaling and retailing in the UK.
4. Lloyds Chemists Plc, (Lloyds) is also the subject of a bid by the British company, Unichem Plc, Chessington, which lapsed before 6 March. This operation falls within the competition jurisdiction of the UK authorities. On 1 March 1996 the Unichem/Lloyds bid was referred to the Monopolies and Mergers Commission (MMC) for further investigation and report under the provisions of the Fair Trading Act 1973.

I. THE PARTIES

5. GEHE represents the pharmaceutical division of the Haniel Group (turnover 12800 MECU) and represents about 63 % of group sales. GEHE is active primarily in pharmaceutical wholesaling and the manufacture of pharmaceutical products as well as in the mail order business for office and warehouse equipment. In 1993 GEHE acquired the French pharmaceutical wholesaler, OCP, and in 1995 GEHE bought the UK pharmaceutical wholesaler and retailer, AAH plc. (Case Nos IV/M.328 and M.571) AAH owns a retail chain of pharmacies in the UK called Hills Pharmacy (Hills).
6. LLOYDS is a healthcare group engaged in the retail, distribution and manufacture of pharmaceutical, medical, healthfood and related products. At the wholesale level, Lloyds distributes pharmaceutical products through its subsidiary, Daniels Pharmaceuticals. At the retail level, Lloyds sells pharmaceutical products through a large chain of pharmacies trading under the name of Lloyds Chemists. Lloyds trades exclusively in the UK, generating turnover of about 1400 MECU of which approximately 75 % relates to pharmaceuticals.

II. THE OPERATION

7. The proposed concentration will combine the retail and wholesale businesses of GEHE and Lloyds in the UK for pharmaceutical products. GEHE is currently the UK largest wholesaler and Lloyds the third largest, behind Unichem. At the retail level, Lloyds currently owns the second largest UK chain of pharmacies, behind Boots, whereas GEHE owns the third largest. After the acquisition the combined GEHE group will be the largest wholesaler and retailer of pharmaceutical products in the UK.

III. CONCENTRATION OF COMMUNITY DIMENSION

8. Through the public bid for Lloyds GEHE seeks to own the whole or sufficient share capital of Lloyds to acquire control of Lloyds within the meaning of Article 3(1) of the Merger Regulation.
9. The undertakings concerned have a combined aggregate worldwide turnover in excess of 5000 MECU. Each party has a Community-wide turnover in excess of 250 MECU (Haniel/Gehe 12300 MECU, Lloyds 1400 MECU). The parties do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation has Community dimension in accordance with Article 1(2) of the Merger Regulation.

10. The proposed operation therefore represents a concentration of Community dimension. This notification does not constitute an EEA cooperation case in accordance with Protocol 24 of the EEA Agreement on cooperation in the field of control of concentrations.

IV. ASSESSMENT

A) Relevant product markets.

11. The principal businesses being combined through GEHE's acquisition of Lloyds are pharmaceutical wholesaling and retailing. Although both GEHE and Lloyds are to a certain extent active in the manufacture of human and veterinary pharmaceutical products, the operation is of a complementary nature in this regard and poses no concerns on competition grounds. Consequently, all subsequent competition analysis will examine solely the position with regard to the retailing and wholesaling of pharmaceutical products in the UK.

Pharmaceutical products

For the purposes of examining pharmaceutical wholesaling and retailing, it is useful to subdivide pharmaceuticals into three separate categories:

- Prescription branded: Pharmaceuticals that are only provided on a prescription basis and which are only available from a specific manufacturer on a branded basis.

- Generic : Pharmaceuticals that may only be sold on a prescription basis, but for which the original patent has expired and which are consequently available from a variety of manufacturers.

- OTC : (over-the-counter) Pharmaceutical products that may be purchased on a non-prescription basis and which as a result are also sold in other outlets than pharmacies, eg multiple grocers, drugstores.

Pharmaceutical wholesaling :

12. With regard to the supply side structure for pharmaceutical wholesaling in the UK, three companies are active as full-line, national suppliers, namely GEHE, Unichem and Lloyds. According to the parties, there are in addition a further 26 regional wholesalers active of which 14 are full-line and 12 short-line suppliers. A full-line wholesaler is a supplier that distributes a complete range of pharmaceutical products. A short-line supplier distributes a smaller range of pharmaceuticals, typically those which are in heavy or regular demand, as well as generics.

The market structure² is as follows:

Table 1 Structure UK Pharmaceutical Wholesaling

Company	1993		1995	
	value £m	%	Value £m	%
GEHE	958	33,6	1149	34
Lloyds	104	3,6	296	9
Sub-Total	1062	37.2	1445	43
Unichem	884	30,6	1115	33
Regionals (26) (average)	940	32,2 (1,2)	835	24,6 (0,9)
TOTAL	2886	100	3395	100

Source: Parties notification/excluding Boots

13. The UK demand side for pharmaceutical wholesaling is characterised by three main categories of customers, namely

- retail pharmacists,
- dispensing doctors and
- hospitals.

According to the information at the Commission's disposal about 80 per cent of pharmaceuticals (excluding OTC products) are sold to retail pharmacists. Under 5% is purchased by dispensing doctors and somewhat above 15% is sold to hospitals. Only about a half of hospitals' requirements are supplied by wholesalers with the other half being typically purchased directly from the manufacturer, often through the National Health Services Supply Authority (NHSSA). On the other hand retail pharmacists purchase over 80 per cent of their requirements from wholesalers. The purchasing pattern of dispensing doctors parallels that of the retail pharmacies.

14. UK pharmaceutical wholesalers require to be authorised by the Medicines Control Agency in accordance with the requirements of the Medicines Act 1968 and Council Directive 92/25³. Authorization criteria include: the suitability of the warehouses for stocking pharmaceutical products, the warehouse equipment, the supply organisation, the security measures and the adequacy of the record-keeping in the event of product recall.

15. In general, the cost of pharmaceutical products to UK patients is met by the National Health Service (NHS) unless specifically prohibited under Regulation. The "Drug Tariff" contains a list of prohibited pharmaceutical products which are not subject to reimbursement.

2 excluding Boots since this company does not supply any third party with pharmaceutical products

3 OJ No. 113, 30.04.92, and as transposed into UK law.

16. Under the Pharmaceutical Price Regulation Scheme (PPRS), a voluntary agreement between the Department of Health and the Association of the British Pharmaceutical Industry (ABPI), wholesalers can obtain a standard discount of 12.5% on the NHS list price when purchasing pharmaceuticals from manufacturers. In principle the 12.5% margin is available to cover distribution costs, but in practice wholesalers pass on part of this margin to the retail level by selling pharmaceutical products to pharmacists at the list price less a discount. This discount is typically calculated on a sliding scale based on the monthly turnover of the pharmacy with the wholesaler. Consequently, price competition at the wholesale level is effectively determined by the discount structure adopted by an individual wholesaler.
17. Under the NHS, pharmacists are in principle remunerated for dispensing pharmaceutical products by a flat dispensing fee. The NHS is aware that chemists purchase pharmaceuticals on a discount basis from wholesalers. In order to reduce NHS expenditure part of the discount granted by the wholesaler is recovered under the so called "claw-back" arrangements.
18. Under the claw-back system the normal, full NHS reimbursement to the dispensing chemist is reduced by an average amount called the target discount rate. In practice the discount rate is also calculated on a sliding scale based on the number of prescriptions filled by the pharmacist. The current average discount rate is 7.74%. This discount rate is recalculated every year on the basis of a statistical enquiry carried out with selected pharmacies.
19. Price competition between wholesalers is therefore determined by the sliding scale established by the wholesaler to determine the discount obtained by the pharmacist on the monthly volume of orders placed with the wholesaler. Different wholesalers have similar discount structures as is evident from the summary provided by the notifying parties and contained in Table 2 in Annex.
20. For generics and OTC-products wholesalers can and do negotiate bulk discounts with their suppliers. This leads to certain economies of scale and again the share given to retailers is determined individually by competition. Most wholesalers, including the parties publish standard lists of discounts to retailers based on total purchases of all kinds which do not vary significantly across the country.
21. However, non-price competition parameters are also important. These include primarily, loan guarantee schemes, extended credit terms and computer ordering facilities. These are discussed in greater detail below.

Pharmaceutical Retailing :

22. The structure of the UK pharmaceutical retailing sector is indicated in Table 3 below. There are approximately 12000 separate retail pharmacists in the UK. 4000 belong to about 50 different chains⁴ and the remaining 8000 are represented by independent pharmacies. The chains operated by Boots, Lloyds, GEHE and Unichem predominate and together represent approximately 2800 pharmacies with the other chains representing about 1100 stores.

4 A chain is defined here as having more than 5 pharmacies.

Table 3 Structure UK Pharmaceutical Retailing

Company	1995		1995	
	Store Number	%	Value* NHS	%
Boots	1140	9.4	420	11.2
Lloyds	920	7.6	270	7.2
GEHE/AAH/Hills ⁵	351	2.9	65	1.7
Unichem/Moss ⁶	383	3.2	80	2.1
Sub-Total	2794	23.0	835	22.2
Other chains	1126	9.3	2925	77.8
Independents	8218	67.7		
<u>GRAND TOTAL</u>	12138	100	3760	100

23. The supply of ethical pharmaceuticals accounts for the bulk of retail chemists turnover, the rest comprising sales of non-prescription and OTC medicines and other standard retail products such as toiletries etc. Based on information available to the Commission about 70% or more of the turnover to the independent (i.e. non-chain) pharmacists is accounted for by prescription medicines.
24. The charge, if any, paid by patients for their prescription medicines is fixed by the UK Government and is the same wherever dispensed. Service levels also vary little. Most outlets keep very few of the 10 000 plus prescription items in stock but rely instead on the twice daily deliveries from wholesalers to promptly supply customer's needs. As such there is little incentive for consumers to travel far to have prescriptions filled. Indeed, it would seem that pharmacists prefer central locations for example in the 'high street' in close proximity to doctor's surgeries. Consequently, at the retail level competition is primarily based on location and service, but not price.
25. Some economies of scale enable larger groups of pharmacies to derive advantage from centralised administration, advertising and direct purchase of OTC goods. However, the most important benefit would seem to be greater purchasing leverage with wholesalers in relation to the discount factor.

Conclusion

26. In conclusion, although the two are vertically related, pharmaceutical wholesaling and pharmaceutical retailing are different services with different customers satisfying different delivery needs. From the regulatory viewpoint, the two services are separately

5 including 68 franchise outlets

6 including 21 franchise outlets

licensed and supervised. Wholesaling and retailing are clearly not substitutable services. The Commission therefore considers pharmaceutical wholesaling and pharmaceutical retailing as two separate but related relevant product markets.

B) Geographical Reference Markets.

Pharmaceutical Wholesaling :

27. Pharmaceutical wholesaling has both national and regional characteristics.
28. At the national level, the regulatory environment for licensing and supervision is the same throughout the United Kingdom. The same NHS list prices apply throughout the UK. Given the need for a continental wholesaler to be able to supply on a twice daily delivery basis over 10000 prescription items⁷ to local UK pharmacists, effective wholesale distribution from continental Europe cannot be considered a feasible and realistic option in commercial terms. Indeed, GEHE, which is by far the largest pharmaceutical supplier in Europe, chose to enter the UK market through acquisition and not by organic growth from a continental base.
29. For these reasons and as indicated in the Commission decision in Case No IV/M.571 GEHE/AAH⁸, the geographical reference market cannot currently be considered to be wider than the United Kingdom.
30. On the other hand, the current UK market structure as well as the logistics and economics of efficient supply indicate that pharmaceutical wholesaling also has a strong regional dimension.
31. The Map in Annex shows that leading wholesalers, other than the merging parties and Unichem, are regionally based. Examination of the regional distribution of market share for the three existing full-line distributors also shows strong regional variation (cf Table 4 in Annex) as demonstrated by the examples below:

GEHE:	East Anglia	23,2 %	West Midlands:	43,1 %
Lloyds:	Wales	2,5 %	Scotland:	17,3 %
Unichem:	East Anglia	21,9 %	S.E.England:	40,8 %
32. The need for a full-line wholesaler to ensure twice-daily deliveries places severe constraints on the distance from which efficient delivery can take place and all three national wholesalers have a network of regional depots, from which they supply customers on a regional basis.

⁷ Whether these are parallel imports for branded prescription pharmaceuticals or generics. Although estimation is difficult, the parties have estimated these imports at approximately 6.5% of the total UK market.

⁸ At the time of Case IV/M.571 GEHE/AAH, the Commission was unaware of the significance of regional supply logistics within the UK. Nor was it necessary for the valid assessment of that operation to determine whether wholesaling markets were regional or national since prior to its acquisition of AAH, GEHE had no presence within the UK.

33. The discount scheme strongly encourages local pharmacies to place as large a part as possible of their monthly order requirements with a single wholesaler. Otherwise, the progressive nature of the discount scheme means that a pharmacist who places turnover with more than one wholesaler loses valuable discount. In fact, the investigation carried out by the Commission shows that over 80% of the pharmacists questioned consider it unfeasible to operate with more than one full-line wholesaler. This coupled with the need for frequent and reliable delivery would also seem to point to a regional market for the pharmacist's normal requirements. The Commission is aware that pharmacists sometimes purchase pharmaceutical products directly from the manufacturer, but even so this is usually only a fairly small part of their overall requirements, eg less than 10%.
34. In 1992 the Monopolies and Mergers Commission conducted two investigations⁹ into pharmaceutical wholesaling and retailing in the UK. In one of these cases, the MMC concluded that the merger led to a significant reduction in competition in the Highlands and Grampian regions of Scotland. As a result the parties concerned were required to divest one of their depots in Scotland. This too would seem to indicate that the competent UK authorities considered that the geographical reference market for pharmaceutical wholesaling was regional.

Pharmaceutical Retailing :

35. In a series of previous decisions¹⁰ involving retailing in the food sector, the Commission has considered that the geographical reference market is determined by a radius corresponding to 10-20 minutes travel by motor car. In their notification the parties state that for pharmaceutical retailing local markets may be even smaller.
36. Customers at pharmacies are often old or sick people who are unable to travel far. Similarly, for urgently required medicines, consumers are unwilling to undertake long journeys. Moreover, the fact that the price of prescription medicines is the same and is reimbursed by the NHS wherever the prescription is filled, means that no price incentive to travel exists.
37. Entry to pharmaceutical retailing requires a licence to dispense NHS-doctors' prescriptions at the premises concerned¹¹. Licence applications are examined by local health authorities (FHSA- Family Health Services Authorities) on the basis of the local need for another chemist's store. In assessing this need the FHSA employs the 'neighbourhood' concept. These are small local areas determined on the basis of social factors such as the purchasing behaviour of the local population, but they also take into account the local topography.
38. In the notification, the parties, when assessing the horizontal overlap between the AAH and Lloyds chain of pharmacies, have conducted their preliminary analysis on the basis

9 AAH/Medico Pharma, CM 1950 May 1992 and Unichem/McCarthy and Lloyds/McCarthy CM 1845, February 1992.

10 IV/M.27 Promodes/Dirsa, IV/M.179 SPAR/Dansk Supermarked, IV/M.558 La Rinascente Cedis Migliarini, etc.

11 Even if an existing pharmacy is relocated only a short distance a new licence is in principle required.

of local areas determined by a radius of 2 miles. A more detailed analysis was subsequently carried out using smaller catchment areas reflecting the existing practice of the FHSA in delimiting neighbourhoods.

Conclusion :

39. The geographical reference market for pharmaceutical wholesaling is certainly no wider than the UK as a whole and there are indications that it may be regional within the UK. As regards pharmaceutical retailing, the geographical reference market is a small area with a radius of at most one or two miles and, with respect to the FHSA criteria, probably smaller still.
40. It is therefore clear that the geographical reference market for pharmaceutical wholesaling, whether it be on a regional or on a national basis, and the geographical reference market for pharmaceutical retailing, which is of a very local nature, represents distinct geographical reference markets limited to the UK. The territorial nature of both these relevant product markets therefore satisfies the requirement for referral as set in Article 9(3) of the Merger Regulation.

C) Competition assessment

Pharmaceutical Wholesaling :

41. Based on the information submitted by the parties in their notification, the combined GEHE/LLOYDS entity will have a market share of 38% (GEHE 28%, Lloyds 10%), followed by Unichem (27%) and Boots (18%). The 26 remaining wholesalers have a market share of 18%. Although Gehe/lloyds and Unichem have a total market share of 65% on this basis, the Commission considers that this figure understates their combined importance.
42. Prior to the present concentration, Boots has for many years been the largest retailer of pharmaceutical products in the UK. Parallel to its pharmaceuticals business, Boots also has a substantial¹² retail trade in related and other products eg toiletries, etc. Boots only distributes pharmaceuticals to its own network of chemists. It does not supply any third party¹³. Although Boots clearly has the logistics and experience necessary to enter the wholesale market, it has never done so. In this light it is appropriate to exclude Boots as an actual competitor for wholesaling.
43. Excluding Boots, Gehe/Lloyds and Unichem would have a combined market share of 76% (46% and 33% respectively). The other 26 wholesalers would have a corresponding total market share of 25%, or 0.9% on average each. Gehe/lloyds and Unichem would thus have a market size about 50 and 40 times larger than the remaining average wholesaler. It is true that this comparison somewhat overstates the 'free' market position of the two leading suppliers, since it does not exclude internal sales by Gehe/Lloyds and Unichem to their own pharmacies.

12 The parties estimate that Boots non-prescription business is about 80% of its total turnover

13 Indeed Boots even purchases a very small percentage of its requirements from AAH, essentially for medicines that are infrequently demanded. Purchases from AAH appear to have grown in the last three years.

44. In the notification, GEHE has provided a regional breakdown of wholesale pharmaceutical sales to independent third parties(Table 4) in which estimated internal sales are excluded. On this basis, Gehe/Lloyds and Unichem have combined regional market shares varying from 50.6¹⁴ to 86.8% with a UK average of 71.2%. In the following regions their combined market share is 70% or more:

West Midlands	70.0%
North	72.6%
Yorkshire & Humberside	74.1%
Scotland	79.1%
South East	79.6%
South West	86.8%
(UK average	71.2%)

45. While the combined Gehe/Lloyds entity has greater market share than Unichem, the size and spread of Unichem's activities¹⁵ are such that Gehe/Lloyds is unlikely to acquire a position of single dominance. However, the two together dominate the market. The question arises therefore whether there would be sufficient incentive for GEHE and Unichem¹⁶ to engage in effective competition and whether the market structure is such as to permit anti-competitive parallel behaviour by the two.
46. Lloyds is currently the third largest and only other national wholesaler in the UK. It has been an effective competitor and has grown rapidly¹⁷ in the last 3-5 years. Through the present concentration or through the parallel Unichem bid for Lloyds, the most vigorous market competitor will be lost to one of the two market leaders.

Actual competitors

47. After the concentration there will be no other full-line or even short-line national distributor outside the duopoly pair (GEHE/Lloyds & Unichem). Other distributors only operate regionally. In overall turnover terms they are very much smaller than either of the duopoly parties. It is true that as a regional wholesaler and on the basis of regional geographical reference markets, they can have a more important market position than indicated on a simple turnover comparison. The Commission has not yet been able to establish precise regional market shares for the regional wholesalers. These can be no larger than the complement of that of the duopoly and will often be much smaller, depending upon the number of regional suppliers and the degree of direct supply. Based on the available information it would seem that the regions in which other wholesalers have market shares exceeding 10% are few, if any. In fact, the parties notification does not identify any region in which an individual regional wholesaler has a regional market share exceeding 10%.

14 This ignores Northern Ireland where Unichem has no market share.

15 excluding Northern Ireland

16 The same applies of course if Unichem were successful in its own bid for Lloyds.

17 albeit primarily through acquisition and not organic growth.

48. In their notification the parties emphasise the perceived advantages of regional wholesalers. According to the parties, regional wholesalers, due to their more limited customer network and personal knowledge of market conditions, can respond more flexibly to customer needs and through personal client contact achieve greater customer loyalty. This may be true and indeed the Commission's own investigations provides some evidence to support this view, but given their strong regional presence, there seems no a priori reason why the duopoly pair could not match this level of service. On the other hand, the Commission's investigations has shown that the two remaining national suppliers enjoy other more enduring and more tangible advantages opposite the regionals.
49. Compared to the regionals, the two national suppliers have two significant advantages: economies of scale in investment and purchasing, and their much greater financial strength.
50. The duopoly pair will achieve economies of scale through their ability to invest in modern warehousing with computer-controlled, automatic picking systems. Their greater market size increases their buying power and the negotiable discounts achieved in respect of OTC and generics purchases. Whilst they do not in principle enjoy any price advantage for branded medicines subject to PPRS Margin Control, their national distribution enables them to secure single channel or exclusive distribution arrangements for certain manufacturers' hospital products. Even if the price is fixed by the PPRS Margin Control scheme, their greater buying power may allow them to secure better payment terms, i.e. extended credit.
51. The Commission has also come across some evidence that the nationals (and Boots) are privileged by certain manufacturers in respect of major products which have reached the end of patent protection. To secure the continued use of these branded products, the manufacturers concerned supply the branded products to fulfil prescriptions written generically, making good the price differential between the brand and the drug tariff price for the generic¹⁸. Retailers who prefer the familiar branded drug, will thus favour GEHE and Unichem compared to the regionals.
52. Their financial advantages would also appear to be important. Their access to capital on the stock exchange means that their borrowing costs are lower, facilitating investment in premises, equipment and also permitting business expansion through the acquisition of wholesale competitors and forward integration into retail pharmacy. During their visit to the Commission, senior GEHE executives underlined the importance to their business of purchasing retail chains.
53. In particular, because of their greater financial strength the nationals can provide loan guarantees on a more cost effective basis. The provision of loan guarantees is a widespread practice. The Commission understands that AAH has around 70 MECU of loan guarantees outstanding. A loan guarantees are useful for example where an individual pharmacist decides to refit his premises. The availability of the loan guarantee means that pharmacist can obtain finance on better terms. The Commission understands that a frequent condition of the loan guarantee is that the pharmacist places 70% or more of his monthly requirements with the guarantor, thus effectively tying the

18 This has been dubbed the 'Beanland syndrome' after the name of the person who described the system in the *Pharmaceutical Journal* in the 1980's.

customer to his distributor. Similarly, extended payment terms may also be offered by the nationals to their customers. Because of their smaller financial size, regionals are typically either unable to provide the service or only at greater cost. The Commission's investigations have confirmed the inability of some regionals to compete against the loan guarantees schemes of the nationals.

54. At the same time the nature of the discount scheme is such as to limit the ability of a chemist to make effective use of more than one full-line wholesaler. It is true that every pharmacist needs a back-up service for urgent supplies where either the pharmaceutical product is temporarily out of stock with the normal supplier or where the usual distributor suffers a transport failure. Consequently, regionals may have a role to play in providing a back-up or emergency service without ever effectively challenging the role of the primary supplier.
55. This picture would appear to be confirmed by the findings of the Commission's own enquiries with individual chemists. Although in some cases regional distributors could respond more quickly, in general they were assessed as being less competitive with regard to the following parameters: lesser service, lower discount, incomplete product range, absence of computer facilities, no supply of hospital products. Indeed, in some cases there was no valid alternative regional supplier to GEHE/Lloyds/Unichem. Furthermore, some regional suppliers evaluated as full-line by the notifying parties were considered as short-line by the customer.
56. The Commission also notes that in the last 5 years, the number of regional suppliers has broadly halved despite market growth at the retail level.
57. In the light of the available evidence the Commission therefore has serious doubts as to the ability of the existing regional suppliers to constrain anti-competitive parallel behaviour by GEHE and Unichem.

Potential competition

58. Entry to pharmaceutical wholesaling requires regulatory approval. Any new entrant would therefore require a licence to engage in pharmaceutical retailing. However, in practice licence procurement does not seem to present a significant entry barrier. On the other hand, ab initio entry would seem to be difficult on general grounds. This is underlined by the observation that market growth has been primarily by acquisition rather than by organic growth. For example, GEHE itself chose to enter the UK market in this way.
59. Boots would seem to be the best placed company to enter the market for pharmaceutical wholesaling. Although Boots has a long tradition as the largest retail chemist in the UK, it never appears to have considered entering the market for wholesale supply to independent chemists. Given the extensive nature of its own chain of chemists, there may not be a strong incentive to do so. Similarly, although some of the major food retailers (eg Sainsbury, Tesco) have established pharmacies within their own stores, it does not seem likely that they would enter the market for pharmaceutical wholesaling. By way of parallel example, the major food retailers do not appear to be significant forces for the supply of consumer retail products to independent grocers, although they clearly have the logistics to do so.

60. Based on the evidence currently available to the Commission, it seems unlikely that a joint dominant position of GEHE and Unichem caused by the acquisition of Lloyds would be capable of challenge in an adequate, timely and effective manner.

Structural conditions for anti-competitive parallel behaviour

61. Based on its findings to date, the Commission considers that structural conditions are conducive to the emergence of anti-competitive parallel behaviour.
62. Although the successful bidder for Lloyds will become the larger, both GEHE and Unichem have broadly similar market positions and both cover the whole of the UK.¹⁹ In the Commission's experience symmetric market positions are stimulus to the creation of joint dominance. Moreover, other competitors are much smaller and for the reasons described above would seem incapable of adequately challenging the two leaders.
63. In their notification, the parties have characterised the UK as a mature market where future growth will be determined by pressure to reduce costs. This would appear to render market entry unattractive on general grounds, but it would also provide an incentive for the 2 leaders not to engage in active competition against each other. The only effect would be to promote an upward spiral in the level of the discount granted to independent chemists which would act to their common disadvantage. On the other hand, if they were able to reduce the level of discount to retailers and this were in turn to result in a commensurate reduction in the overall target discount rate under the claw-back arrangements, this would produce a major adverse impact on the level of health costs reimbursed through the NHS.
64. In particular, the Commission considers that, as opposed to their competitive position w.r.t. the regionals, the main parameter of competition between GEHE and Unichem would prove to be the level of the discount scheme. Here, pricing is very simple and apparently very transparent. The level of discounts are well-known to the major players (cf Table 4) and would seem to change infrequently, perhaps only annually in line with the review of the claw-back arrangements.
65. The Commission also understands that recently certain products²⁰ were removed by the nationals from the discount scheme. This may be indicative of a certain market power and requires further investigation. At the same time the loan guarantee schemes and the availability of computerised ordering equipment -subsidised by the wholesaler- has the effect of deterring switching.
66. General market conditions are conducive to the emergence of anti-competitive parallel behaviour and the probability of this behaviour would be heightened by the loss of the market's most vigorous competitor.
67. In conclusion, on the basis of the available information, the Commission considers that the proposed concentration threatens to create a dominant position in pharmaceutical wholesaling as a result of which effective competition will be

19 Excluding Northern Ireland for Unichem

20 eg refrigerated products

significantly impeded either, in a distinct market consisting of the UK as a whole, or, in a series of distinct regional markets, all within the UK.

Pharmaceutical Retailing

68. At the national level the horizontal overlap between GEHE and Lloyds is relatively small: to AAH's existing share of 3.3% of outlets, Lloyds will add a further 7.1%, giving a total of 10.4%. AAH/Lloyds will become the largest national chain, somewhat ahead of Boots' 9.3% and far in advance of Unichem's 2.9% national share of outlets.
69. However, competition at the retail level is highly localised and therefore it is necessary to consider the situation 'on the ground'. According to the parties preliminary analysis, there are 66 areas in which a Lloyds chemist lies within 2 miles of an AAH pharmacy. In the parties more detailed analysis for these 66 areas tracking the FHSA 'neighbourhood' methodology, they consider that there are only 15 areas in which a Lloyds pharmacy falls within the same catchment area as an AAH outlet.
70. The parties have provided detailed street maps for each of these 15 catchment areas identifying pharmacies, dispensing doctors and doctors' surgeries. The parties claim that in each of these areas, sufficient alternative outlets remain after the merger and that no dominant position is created.
71. At this stage the Commission has been unable have full regard to local purchasing behaviour, topography and other relevant factors. However, in at least 3 of the 15 areas²¹, the AAH and Lloyds pharmacies are located closely together and there would appear to be no alternative pharmacy within half-a-mile distance.
72. The Commission recognises that as far as the consumer is concerned, given the degree of NHS control over drug prices, there is muted scope for price competition at the local level. But a question mark remains with regard to the adequacy of local competition in service terms. Furthermore analysis at the retail level must be placed in the context of the degree of vertical integration in the market. More specifically, an examination of the wholesale supply arrangements for competing independent chemists in these areas appears necessary, for the reasons explained below.
73. Pharmaceutical retailers who are vertically integrated upwards need have no concerns about the adequacy of their supply or wholesale purchase arrangements. This is not the case for an independent chemist in local competition with a pharmacy owned by his wholesaler. If competition is not effective at the wholesale level, this will feed through into the retail level through the vertical integration. There will be no commercial incentive for dominant wholesalers to engage in competitive supply to an independent chemist competing for custom against the local pharmacy owned by the wholesaler. This could induce supply discrimination between integrated and non-integrated retailers, aggravating the entry barriers into retailing which are already high due to the regulatory constraints.
74. Discrimination could take place in two forms: price and service. First the wholesaler could derogate from the normal published discount scheme when calculating the rebate

21 Normanton, Chippenham and Durrington

provided to a competing independent pharmacist²². Second, there could be reduced competition on service levels with the duopoly wholesalers supplying their own outlets more frequently than, or in preference to, those of other retailers or perhaps reducing the number of deliveries in areas where they were dominant.

75. In conclusion the Commission considers that the proposed operation threatens to create a dominant position for pharmaceutical retailing as a result of which effective competition would be significantly impeded in at least a small number of distinct local markets within the UK which require detailed investigation, and that, taken more widely, the consequences of vertical market integration also require an in-depth examination.

V. Referral

76. It follows from the above that the conditions for referral under Article 9(3)b of the Merger Regulation are fulfilled with regard to pharmaceutical wholesaling and retailing.
77. The Commission considers it appropriate to refer this case to the competent authorities of the United Kingdom with a view to the application of that state's national competition law.
78. The geographical reference market for pharmaceutical retailing is clearly local. The effects of the present concentration with regard to pharmaceutical retailing are therefore entirely confined to the territory of the United Kingdom. As regards pharmaceutical wholesaling, it is true that the geographical reference market has been left open pending further examination and may be national or regional in scope. Nevertheless, even were this market to cover the whole of the UK, the Commission considers that good grounds exist for also referring this aspect of the case to the United Kingdom authorities. The operational need for a regional presence to secure reliable and rapid delivery of a wide range of pharmaceutical products has the result that the economic consequences of the merger will be materially limited to the territory of the United Kingdom.
79. At the same time and within its power of discretion, the Commission notes that this case concerns one of two competing bids, both with similar characteristics, of which the other falls under UK jurisdiction. Having regard to the scale of the bids and their importance for financial markets, the Commission considers it desirable that they be dealt with by the same agency and under the same jurisdiction, subject to the proviso below, thus ensuring a coordinated timetable for their assessment and evenhandedness of treatment.
80. In their discussions with the Commission the notifying parties have drawn attention to the fact that under UK national competition law, the assessment criteria for merger control are more widely drawn and are not primarily limited to competition concerns. In this light they consider that referral to the competent UK authorities could result in a

22 The Commission understands that there is some variation in actual discount around that published. For example, where a wholesaler has a particularly strong regional position, actual discounts conform closely to nationally published discounts. Similarly, the published terms are not exceeded where the pharmacy benefits from a loan guarantee scheme.

change of the assessment criteria of the concentration that might be detrimental to their interests.

81. A non-confidential summary of the UK request was provided by the Commission to the parties on 8 March. This information was supplemented by an extensive detailed discussion with GEHE executives and its legal adviser on 11 March at which the Commission explained the UK position and also set out the results of the Commissions investigations and preliminary case findings. The company submitted a further document on 12 March arguing that no distinct UK market existed and that there was no threat to the creation of a dominant position. The Commission has examined this document and does not consider that it presents any fact of law or element of competition assessment sufficient to reverse the results of the above analysis.
82. As regards the parties' observation that the assessment criteria under UK national competition law for merger control are more widely drawn than those under European Union competition law, the Commission notes that in accordance with Article 9(8) of the Merger Regulation, the Member State concerned, in applying the provisions of Article 9 of the Regulation, may take only the measures strictly necessary to safeguard or restore effective competition on the market concerned. This provision is binding on the United Kingdom. Consequently, upon referral the UK competition authorities are obliged in their assessment to fully respect the provisions of Article 9(8) of the Merger Regulation.
83. The parties have also observed that in the Notes to Council Regulation (EEC) No. 4064/89 re Article 9, the Commission and Council state that when a specific market represents a substantial part of the common market, the referral procedure provided for in Article 9 should only be applied in exceptional cases.
84. The Commission recognises that pharmaceutical wholesaling in the UK constitutes a substantial part of the common market. However, the Commission considers that the circumstances of the present case are indeed exceptional for two reasons. First, there is a concurrent bid for the target company which is presently being examined by the competent UK competition authorities. The importance of these operations on financial markets and the attendant need for a coordinated timetable and coherent competition assessment have been described above. Second, although it would be possible for the Commission to initiate proceedings in relation to pharmaceutical retailing, this would, however, militate against the desirability of examining the two concurrent bids on a coordinated timetable and render a coherent competition assessment between the two pharmaceutical wholesaling and retailing, it is difficult to see how such separate assessments could usefully be carried out. In conclusion, the Commission considers that the present case is of an exceptional nature and fully satisfies all the requirements for referral to the United Kingdom authorities.

has adopted this decision:

Article 1

The notified concentration between GEHE AG and LLOYDS Plc is hereby referred to the competent authorities of the United Kingdom pursuant to Article 9 of Council Regulation N° 4064/89 with regard to the wholesaling and retailing of pharmaceutical products in the United Kingdom.

Article 2

This decision is addressed to the United Kingdom.

For the Commission,

(signed)

Karel VAN MIERT

Member of the Commission

Table 2 : UK pharmaceutical wholesaler discount schemes

Wholesaler	Monthly qualifying Purchases in £ and range discounts			
	Range 1	Range 2	Range 3	Range 4
AAH Pharmaceuticals (GEHE)	0-3600 0 %	3600-15750 10 %	15751-30000 11%	30000 + 10,75%
Graham Tatford	0-3400 0%	3400-14250 10%	14251+ 11%	
Mawdsleys	0-2750 0%	2750-15000 10,5%	15000–50000 11,25%	50000+ 10,5%
Rowland & Co	0-1500 0%	1500-15000 8,5%	15000+ 11%	
Sants	0-2500 0%	2500-10000 8%	10001-15000 10%	15001+ 11%
UniChem	0-3600 0%	3600-16000 10%	16000+ 11%	
Daniel (Lloyds)	0-2599 0%	2600-15000 10%	15000-20000 12%	20000-50000 11,5%

Source: Parties notification

UK Pharmaceutical wholesaling: 1995 regional market shares⁽¹⁾

Region	Market Size (2)	AAH mkt share %	Lloyds mkt share %	AAH + Lloyds	Unichem share %	AAH + Lloyds + Unichem	Other Regionals
East Anglia	140,8	23,2	5,5	28,7	21,9	50,6	49,4
East Midlands	277,4	22,1	12,3	34,4	24,6	59,0	41,0
North	240,1	33,6	5,6	39,2	33,4	72,6	27,4
North West	467,8	25,4	2,7	28,1	32,9	61,0	39,0
Northern Ireland	149,0	32,7	3,4	36,1	0,0	36,1	63,9
Scotland	405,7	39,8	17,3	57,1	22,0	79,1	20,9
South East	1146,8	36,1	2,7	38,8	40,8	79,6	20,4
South West	335,3	42,1	5,0	47,1	39,7	86,8	13,2
Wales	273,2	36,8	2,5	39,3	37,2	76,5	23,5
West Midlands	327,1	43,1	2,7	45,8	24,2	70,0	30,0
Yorkshire & Humberside	360,2	30,8	10,3	41,1	33,0	74,1	25,9
<i>Total</i>	<i>4123,4</i>	<i>33,8</i>	<i>4,9</i>	<i>38,7</i>	<i>32,5</i>	<i>71,2</i>	<i>28,8</i>

(1) Retail Chemist & Doctor Market excluding self distribution for Hills, Moss, Lloyds & Boots

(2) in millions of pounds sterling

REGIONAL FULL-LINE WHOLESALERS

PRINCIPAL AREA OF OPERATIONS

