



Neutral citation [2005] CAT 8

**IN THE COMPETITION**  
**APPEAL TRIBUNAL**

Case No: 1049/4/1/05

Victoria House  
Bloomsbury Place  
London WC1A 2EB

1 April 2005

Before:

Sir Christopher Bellamy (President)  
Professor Paul Stoneman  
Mr Graham Mather

Sitting as a Tribunal in England and Wales

**BETWEEN:**

**UNICHEM LIMITED**

Applicant

-v-

**THE OFFICE OF FAIR TRADING**

Respondent

supported by

**PHOENIX HEALTHCARE DISTRIBUTION LIMITED**

Intervener

Mr Nicholas Green QC and Ms Maya Lester (instructed by Allen & Overy LLP) appeared for the Applicant

Mr Peter Roth QC and Mr Daniel Beard (instructed by the Treasury Solicitor) appeared for the Respondent

Ms Kelyn Bacon (instructed by CMS Cameron McKenna) appeared for the Intervener

Heard at Victoria House on 14 and 18 February 2005

**JUDGMENT**  
**APPROVED BY THE TRIBUNAL FOR HANDING DOWN**  
**(SUBJECT TO EDITORIAL CORRECTIONS)**

## TABLE OF CONTENTS

<b>I</b>	<b>INTRODUCTION.....</b>	<b>1</b>
<b>II</b>	<b>BACKGROUND .....</b>	<b>2</b>
<b>III</b>	<b>THE COURSE OF EVENTS BEFORE THE OFT.....</b>	<b>10</b>
<b>IV</b>	<b>THE CONTESTED DECISION.....</b>	<b>30</b>
<b>V</b>	<b>THE PROCEEDINGS BEFORE THE TRIBUNAL.....</b>	<b>35</b>
<b>VI</b>	<b>THE EVIDENCE .....</b>	<b>36</b>
	<b>A. THE OFT’S EVIDENCE .....</b>	<b>36</b>
	<b>B. PHOENIX/EAP's EVIDENCE.....</b>	<b>46</b>
	<b>C. UNICHEM'S EVIDENCE.....</b>	<b>48</b>
<b>VII</b>	<b>THE PARTIES’ SUBMISSIONS .....</b>	<b>52</b>
	<b>A. ORIGINAL GROUND (4) .....</b>	<b>52</b>
	<b>B. UNICHEM’S SUBMISSIONS.....</b>	<b>53</b>
	<b>C. THE OFT’S SUBMISSIONS .....</b>	<b>58</b>
	<b>D. PHOENIX’S SUBMISSIONS .....</b>	<b>62</b>
<b>VIII</b>	<b>SECTION 120(4) AND THE IBA CASE.....</b>	<b>63</b>
<b>IX</b>	<b>THE TRIBUNAL’S ANALYSIS .....</b>	<b>69</b>
	<b>1. OVERVIEW .....</b>	<b>69</b>
	<b>2. THE MARKET CONTEXT .....</b>	<b>70</b>
	<b>3. ANALYSIS OF UNICHEM'S SUBMISSIONS .....</b>	<b>75</b>

## I INTRODUCTION

1. By a notice of application dated 19 January 2005 the applicant, UniChem Limited (“UniChem”) applied pursuant to section 120 of the Enterprise Act 2002 (the “Act”) for judicial review of the decision of the respondent, the Office of Fair Trading (the “OFT”) made on 17 December 2004 (the “Decision”) not to refer the proposed acquisition by Phoenix Healthcare Distribution Limited (“Phoenix”) of East Anglian Pharmaceuticals Limited (“EAP”) to the Competition Commission under section 33 (1) of the Act.
2. Section 33(1) of the Act provides:

“The OFT shall, subject to subsections (2) and (3), make a reference to the Commission if the OFT believes that it is or may be the case that:

  - (a) arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
  - (b) the creation of that situation may be expected to result in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services.”
3. UniChem asks the Tribunal to review the OFT’s conclusion, set out in paragraph 50 of the Decision, that “the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.”
4. The Tribunal’s power of review is set out in section 120 of the Act as follows:

“(1) Any person aggrieved by a decision of the OFT, the Secretary of State or the Commission under this Part in connection with a reference or possible reference in relation to a relevant merger situation or a special merger situation may apply to the Competition Appeal Tribunal for a review of that decision.

...

  - (4) In determining such an application the Competition Appeal Tribunal shall apply the same principles as would be applied by a court on an application for judicial review.
  - (5) The Competition Appeal Tribunal may -

- (a) dismiss the application or quash the whole or part of the decision to which it relates; and
- (b) where it quashes the whole or part of that decision, refer the matter back to the original decision maker with a direction to reconsider and make a new decision in accordance with the ruling of the Competition Appeal Tribunal...”

It is common ground that UniChem is a “person aggrieved” for the purposes of section 120(1).

## **II BACKGROUND**

### *The parties*

5. UniChem is a wholly owned subsidiary of Alliance UniChem plc, a European pharmaceuticals group whose shares are listed on the London and Paris stock exchanges. UniChem is involved in full-line wholesale pharmaceutical distribution throughout the United Kingdom and also operates a number of retail pharmacies through the Moss Pharmacy chain. UniChem’s United Kingdom turnover in wholesaling activities amounted to £1,931 million in the financial year ended 31 December 2003.
6. The intervener, Phoenix, is part of the Phoenix Group, based in Germany, which is active in pharmaceutical wholesaling and retailing throughout Europe. In the United Kingdom, Phoenix also operates a chain of retail pharmacies called Rowlands. Phoenix entered the United Kingdom market in 1998 with the acquisition of L. Rowland & Co based in Wrexham and Philip Harris Medical Limited in Birmingham. Phoenix’s United Kingdom turnover in the financial year to 31 January 2004 was some £682 million.
7. EAP is owned by Mr Jonathan Briggs and Mr Gregory Briggs via a holding company, Briggs Family Holdings Limited. The company’s principal activity is the wholesale supply of pharmaceuticals to retail pharmacies, dispensing doctors and hospitals through a distribution depot located in Norwich. EAP is not active in retail pharmacy.

EAP's United Kingdom turnover was some £111million in the financial year ended 29 February 2004.

8. AAH Pharmaceuticals Limited ("AAH") is the largest full-line pharmaceutical wholesaler in the United Kingdom. AAH is a wholly-owned subsidiary of Celesio AG, (formerly GEHE), a pharmaceutical wholesaling company based in Germany. Celesio also operates, through Lloyds Pharmacy Limited, the Lloyds chain of retail pharmacies. The United Kingdom turnover of AAH in pharmaceutical wholesaling activities in the financial year ended 31 December 2002 was some £2,762 million<sup>1</sup>. AAH has not intervened in these proceedings.
9. It is common ground that AAH and UniChem are the two leading full-line pharmaceutical wholesalers at national level in the United Kingdom, and the only ones with full national coverage across most sectors, including hospitals, major supermarkets and other national chains. Although Phoenix is active nationally, Phoenix does not, as we understand it, normally service customers that tender on a national basis, such as major supermarkets who currently deal centrally with either AAH or UniChem. In addition AAH and UniChem have tied retail pharmacy outlets, Lloyds and Moss respectively. According to figures supplied by Phoenix, market shares for all pharmaceutical wholesaling in the United Kingdom calculated at national level are approximately: AAH 35.4%; UniChem 27.8%; Phoenix 15.7%; and EAP 2.7%.

*The sector concerned*

10. The wholesale supply of pharmaceutical products comprises the supply of prescription-only medicines ("Ethicals"), and over-the counter ("OTC") medicines and other products. Ethicals are prescribed to patients under prescription. They can only be dispensed by dispensing doctors, retail pharmacies, or hospitals.
11. The Decision focuses on competition for the supply of Ethicals. There is no issue as regards OTC products.

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<sup>1</sup> Most recent financial information available to the Tribunal.

12. In broad terms, Ethicals can be sourced from three types of suppliers: directly from some pharmaceuticals manufacturers; from full-line wholesalers; or from short-line wholesalers. Full-line wholesalers stock a full (or very broad) range of products – perhaps some 12,000 products or more – and provide a frequent delivery service, twice a day for the majority of pharmacy customers. Short-line wholesalers stock a more limited range – about 3,000 products. Short-line wholesalers tend to operate on a next-day, courier delivery basis. They typically specialise in fast-moving products that sell in large quantities, particularly generics. Generics are pharmaceutical products which no longer benefit from patent protection.
13. Those pharmacy chains which are vertically integrated with pharmaceuticals wholesalers, such as Moss, owned by UniChem, and Lloyds, owned by AAH, tend to be supplied with all of their pharmaceuticals from within the group. Other national pharmacy chains such as the Co-op and supermarkets such as Tesco or Asda choose to source from national wholesalers (i.e. AAH or UniChem). Boots self-supplies its retail pharmacies, although UniChem apparently supplies some Boots outlets as a second supplier.
14. The pricing of branded Ethicals (i.e. Ethicals other than generics) is covered by the Pharmaceutical Price Regulation Scheme (“PPRS”) negotiated between the Department of Health and the Association of the British Pharmaceutical Industry. Under that scheme, an assumed wholesaler’s margin of 12.5 per cent is allowed off the NHS list price of the drug. Pharmacists are reimbursed by the NHS for the cost of drugs dispensed under NHS prescriptions and receive a dispensing fee. The pharmacist is reimbursed at the NHS list price less an assumed level of discount, known as the “clawback,” which is re-calculated on a national-average basis each year. At the material time the “clawback” was 10 ½ per cent. Hence, so we are told, wholesale margins for branded Ethicals tend to be within the 2 per cent range – i.e. the manufacturer’s NHS list price less 12 ½ per cent (which is the wholesaler’s buying price) less the discount which the wholesaler concedes to the pharmacist. According to the OFT, the choice of wholesaler made by the pharmacy or dispensing doctor is influenced more by levels of service than by price (Decision, paragraph 29).

*The MMC report of 1996*

15. In July 1996 the Monopolies and Mergers Commission (“MMC”), the predecessor of the Competition Commission, examined the then proposed acquisition of Lloyds Chemists by either UniChem or GEHE, the owners of AAH. Although the material in the MMC’s report (the “MMC Report”) dates from 1996 it provides useful background to the issues in this case.

16. It is relevant to note that the MMC concluded that in assessing competition it is appropriate to take account of self-supply arrangements (paragraph 2.41). On that issue the MMC said that where wholesalers own pharmacies:

“Their wholesaling businesses benefit from the fact that they have a captive market, in the form of the pharmacies in common ownership with them, which enables them to spread the fixed costs of their wholesale depots over a larger volume of sales and to achieve more economic van runs. The ownership of pharmacies also brings other benefits to a wholesaler, such as an increase in the stability and predictability of sales (which reduces risk) and in buying power.” (paragraph 2.40).

17. The MMC further concluded that the relevant geographic market is sub-national (paragraph 2.44). On that issue the MMC said:

“2.43. There remains the question of the geographical scope of the market. AAH and UniChem provide a full-line service throughout the UK (with the single exception that UniChem does not operate in Northern Ireland). They derive some benefit from doing so, eg in winning the business of retail chains which have branches in many parts of the country and wish to deal with a single wholesaler. Most other full-line wholesalers operate in only one part of the country to another. The main factor influencing the geographical scope of the market is that the frequent (usually twice-daily) delivery service to pharmacies which is characteristic of full-line wholesalers cannot be economically provided more than a certain distance from the depot. This remains true even though some wholesalers extend the reach of their depots by using trunking techniques, whereby lorry loads are dispatched to transshipment points for onward delivery by van.”

... (see also paragraphs 4.45 and 4.50)

18. In its concluding “Assessment”, the MMC said notably:

“2.270. As regards regional full-line wholesalers, we have taken the view that they are not an endangered species whether as a result of vertical integration or for other reasons. We accept, however, that at least some of these wholesalers are vulnerable given their low net margins

and that relatively small changes in the market could have a disproportionate effect on them. We would therefore urge the DGFT to keep the position under review. The DGFT will no doubt give due weight to the importance of regional wholesalers to competition in considering whether to refer to the MMC any future merger or proposed merger of either of the two national wholesalers with any other full-line wholesaler.”

19. In the event, the MMC’s recommendation was adverse to both a UniChem/Lloyds and an AAH/Lloyds merger unless certain Lloyd’s depots were disposed of. Lloyds was subsequently acquired by GEHE, now Celesio, the parent company of AAH.

*Confidential guidance given to UniChem in 2000*

20. On 7 January 2000, UniChem’s parent company, Alliance UniChem plc, applied to the OFT for confidential guidance in respect of a proposed acquisition of EAP. UniChem considered that the proposed acquisition might be subject to a reference to the Competition Commission under the terms of the then Fair Trading Act 1973 as it would create a share of supply of pharmaceuticals exceeding 25% in the East Anglia region.

21. In its application to the OFT, UniChem explained its interest in the proposed acquisition notably as follows:

“2.4 UniChem’s interest in the proposed acquisition stems firstly from its desire to enter the wholesale market in East Anglia, where it currently has very low sales penetration, and where both AAH and Philip Harris, a subsidiary of Phoenix, have a substantial presence. UniChem has no warehouse in East Anglia and intends to maintain EAP’s distribution depot, as a base from which to combine the complementary efficiencies of the two businesses. Secondly, UniChem wishes to enter the dispensing doctor market, which accounts for 51 per cent of EAP’s sales.

2.5 The dispensing doctor market is serviced in the majority of the UK by only two wholesalers – AAH and Philip Harris/Phoenix. These are the only national full line wholesalers with a credible volume of sales in the market. The proposed acquisition would give UniChem credibility in the dispensing doctor market, which would increase competition on a nationwide basis.”

22. UniChem’s submissions to the OFT in its confidential guidance application highlighted notably the emergence of a third “national wholesaler”, following the entry into the

United Kingdom market, through acquisitions, of the Phoenix Group, one of the largest wholesalers in Germany (paragraph 3.8).

23. UniChem also argued that EAP's business was concentrated in sales to dispensing doctors in which "UniChem is not active". According to UniChem, AAH and Phoenix had over 70 per cent of the total dispensing doctor market in the United Kingdom (paragraphs 4.1 and 4.2).
24. The OFT, by letter of 24 February 2000, responded to UniChem's request for confidential guidance by letter, as follows:

"Further to your request for confidential guidance concerning the above proposal, I am writing to inform you that, based on the information currently available, it seems likely that the Secretary of State would want to refer the proposed transaction to the Competition Commission (CC) for investigation."

*The proposed AAH/EAP merger in 2003*

25. On 10 October 2003, a proposed merger between AAH and EAP was notified to the OFT. That proposal was investigated by the OFT under the present Act, which came into force in June 2003. The proposed acquisition was conditional upon AAH receiving confirmation from the OFT that the proposed merger would not be referred to the Competition Commission.
26. UniChem participated in the OFT's review of the proposed AAH acquisition of EAP by responding to OFT questions and by submitting a detailed briefing paper dated 28 October 2003 setting out its comments on the proposed transaction (the "2003 briefing paper"). UniChem then had a meeting with the OFT on 5 November 2003, and following that meeting submitted a further letter dated 20 November 2003.
27. In the 2003 briefing paper UniChem submitted, essentially, that the proposed merger between AAH and EAP would give rise to a substantial lessening of competition in a number of markets and therefore should be referred to the Competition Commission (2003 briefing paper, paragraph 1.2).

28. UniChem argued in particular that discrete product markets could be identified for pharmacies and dispensing doctors (2003 briefing paper, paragraph 4.3). According to UniChem, it had had very little success in the dispensing doctor market:

“4.4 ...Despite having devoted substantial efforts in recent years to growing its share of the dispensing doctors market, UniChem has found it remarkably difficult to make in-roads across the United Kingdom, including in East Anglia, where EAP and AAH have entrenched positions, based on a long history of operating in that region. UniChem has set up a new business unit specifically to target dispensing doctors; it plainly has the expertise and resources to be a credible competitor across the United Kingdom as well as in East Anglia, yet it failed to penetrate the market. As a result its market share in East Anglia is still only 2.8%.”

29. At Appendix 1 to the 2003 briefing paper UniChem set out an isochrone analysis based on a 90-minute drive from UniChem’s Letchworth depot, and from the relevant depots of EAP (Norwich), AAH (Romford), Phoenix (Cambridge) and Mawdsley Brooks, based in Milton Keynes. UniChem argued:

“... UniChem does make a small number of deliveries to customers located more than 90 minutes from its warehouses. However, customers employing distant suppliers are required to place their orders much earlier than are those using a closer supplier. Since the cut-off time for orders is a key determinant of the quality of service that a wholesaler provides to its customers, the inevitably earlier cut-off times for more distant suppliers places them at a significant disadvantage compared to more local competitors. In addition, the higher costs associated with transporting supplies for a longer period mean that more distant suppliers will earn a lower margin on their deliveries than a more local supplier, even if the customer is prepared to pay the same price.

On top of this the more distant supplier may even be required to undercut the more local supplier to compensate the customer for the lower levels of service quality that they are able to provide...”

(2003 briefing paper, Appendix 1)

#### *The AAH Decision*

30. On 3 December 2003 the OFT issued a decision under section 33 of the Act (the “AAH Decision”) referring the proposed AAH/EAP merger to the Competition Commission.

31. In the AAH Decision the OFT's analysis of the proposed merger concentrated on the supply of Ethicals. The OFT defined the relevant geographic market, to cover, broadly, the East Anglian region (AAH Decision, paragraphs 12 to 14).
32. The OFT estimated that in the East Anglia region AAH and EAP combined would have a 25-35% share of the supply of Ethicals to independent retail pharmacies and dispensing doctors, taking into account all supply routes to the market (i.e. including short-liners) and would be the largest supplier in the area.
33. According to the OFT, a combined AAH/EAP would have had a share of 50-60% of the supply, by full-liners, of Ethicals, to independent retail pharmacies and dispensing doctors and would be the largest full-liner in the region: "The number of suppliers would reduce from four to three and would result in the loss of the major non-vertically integrated wholesaler" (AAH Decision, paragraph 24).
34. The OFT's concluding assessment in the AAH Decision was that:
  34. In the supply of Ethicals to dispensing doctors and retail pharmacies, it might be the case that in limited circumstances, Short-liners will be able to provide some constraint on the parties. The evidence suggests, however, that the most likely source of competition to the parties is expected to come from other Full-liners. These may, however, be limited in their ability to provide effective competition given the location of their depots and the ability to serve customers located some distance from those depots. Third party comments tended to suggest this was a limiting factor in certain parts of East Anglia. Further detailed investigation is required to determine how effective such competition is likely to be in constraining the behaviour of the merged business.
  35. In the supply of Ethicals to hospitals, direct supply by manufacturers may operate as a constraint on the parties in respect of a limited product range. The evidence, however, indicates that the most likely source of constraint may be expected to come from other Full-liners. It appears that the merger may create a duopoly among Full-liners in some parts of the Relevant Area and lead to a reduction in potential suppliers from four to three in other parts. Hospitals expressed particular concerns about this reduction in choice and potential adverse impact upon service levels.
  36. In these circumstances, the OFT believes that it is or may be the case that the creation of the relevant merger situation

may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services, namely the supply of Pharmaceuticals to retail pharmacies, dispensing doctors and hospitals in the East Anglia region, extending to parts of the East Midlands and the South East of England. The likely adverse effects might be expected to be: a reduction in the level of discounts paid to customers; and/or other less favourable terms of supply; and/or a general reduction in service levels.”

35. The OFT therefore referred the proposed transaction to the Competition Commission under section 33(1) of the Act. The proposed acquisition by AAH of EAP was subsequently abandoned and the Competition Commission’s examination of the transaction was set aside.
36. We note at this stage that there appear to have been two principal reasons for the reference of the AAH/EAP merger to the Commission, as appears from the AAH Decision: (1) the OFT considered that further investigation would be necessary to establish whether other full-liners (in effect UniChem and Phoenix) would be an effective competitive constraint on the merged AAH/EAP in East Anglia as regards supplies to retail pharmacies and dispensing doctors, having regard to the location of their depots and ability to serve customers located some distance from their depots (AAH Decision, paragraph 34); and (2) the OFT had concerns about competition in relation to the supply of Ethicals to hospitals (AAH Decision, paragraph 35). Since Phoenix is not active in supplies to hospitals, issue (2) does not arise in the present case.

### **III THE COURSE OF EVENTS BEFORE THE OFT**

37. The OFT has supplemented the contents of the contested Decision in this case by a full witness statement of Simon James Priddis, Director of the Mergers Branch of the Competition Enforcement Division of the OFT, dated 8 February 2005, which we refer to as “Priddis.” That statement is supplemented by two short further statements by Mr Priddis dated 14 February 2005 and 16 February 2005. We have also received witness statements from David Rowland Cole, CEO of Phoenix, dated 7 February 2005 and 16 February 2005, and Jonathan Roland Briggs, the Managing Director of EAP, dated 7

February 2005. This part of the judgment is based on the information contained in those statements.

*Phoenix's confidential guidance application of 28 April 2004*

38. Phoenix notified its intention to acquire EAP to the OFT in an application for confidential guidance dated 28 April 2004.
39. As explained in the OFT's publication *Mergers Procedural Guidance* (OFT 526, May 2003), no third parties are contacted as part of the confidential guidance process (OFT 526, paragraphs 3.11 to 3.18). There was therefore no opportunity, at that stage, for the OFT to check with third parties the facts, opinions or data put forward by Phoenix/EAP in the application for confidential guidance.
40. Phoenix's application of 28 April 2004 was supported by an eight-page briefing paper supported by several annexes prepared by Phoenix's solicitors CMS Cameron McKenna. In that submission Phoenix argued, essentially, that the relevant market was the full- and short-line wholesaling of pharmaceuticals to retail pharmacies and dispensing doctors, and that the geographic market was national. Phoenix pointed out that AAH and UniChem delivered across the whole of the East Anglian region to Lloyds and Moss pharmacies and stated:

“The vans which deliver to Lloyds Pharmacies and to Moss Pharmacies are the very same vans which also visit independent pharmacies and dispensing doctors and which seek to increase their business with all outlets – in other words, any other wholesaler delivering anywhere in East Anglia and seeking business in independent outlets faces competition from the two vertically integrated market leaders”.

(Confidential Guidance application, paragraph 14)
41. Following receipt of that submission, the OFT sent Phoenix a request for information dated 6 May 2004 to which Phoenix responded with a further submission on 2 June 2004. The submission of 2 June 2004 attached maps of East Anglia plotting, respectively, the locations of Phoenix and EAP retail pharmacy and dispensing doctor accounts, the location of Lloyds and Moss chemists owned and supplied by AAH and UniChem respectively, and the location of other customers where the supplier was unknown. Only customers of Phoenix and EAP with a monthly turnover of over

£15,000 were identified. Mr Cole explained in his second witness statement that these maps had incorrectly described the non-EAP and non-Phoenix customers as “other pharmacies” – in fact those maps also showed dispensing doctors. This had been made clear in the submission of 2 June 2004. On the basis of those maps Phoenix argued that the merged concern would still be subject to significant competition, notably from AAH and UniChem.

42. On 9 June 2004 the OFT sought answers to certain additional questions. CMS Cameron McKenna duly responded to those questions on behalf of Phoenix with a further four-page submission on 16 June 2004.
43. That submission of 16 June 2004 included the following response to questions asked by the OFT:

**“5. Why do the parties think the shares of supply for AAH and UniChem to dispensing doctors in East Anglia are so low in comparison to other areas of the country and in comparison to other customer types?”**

Dispensing doctors by definition are in rural areas, and are more likely to support their local wholesale depot and prefer a more personal service. EAP satisfies these requirements, and if it is successful with the acquisition of EAP, Phoenix intends to maintain the personal level of service, as it has done with previous acquisitions.

AAH has previously closed a local depot in Ipswich and lost local dispensing doctor business as a result.

UniChem is widely regarded as a pharmacy orientated wholesaler, largely due to its roots as a pharmacy co-operative.

The actual sub-market for dispensing doctors is only 5.42% of the market.

Both AAH and UniChem have achieved market domination in all other customer types through national distribution, vertical integration, hospital contracts and traditional origins.

Because of the reasons stated above, it is logical that AAH and UniChem should have concentrated on the much larger market segments of the other customer types.

**6. What impediments would AAH or UniChem face in increasing their share of supply to dispensing doctors in East Anglia?**

There are no impediments that either AAH or UniChem face in increasing their share of supply to dispensing doctors in East Anglia. AAH and UniChem are both very active in trying to win business in East Anglia, as indeed they are all over the country. The parties would refer back to Table 6 of Annex A of the Submission relating to AAH and UniChem growth in dispensing doctors within

East Anglia. Annex C of the Submission provides evidence of switching by dispensing doctors including from both Phoenix and EAP to AAH.”

44. A further request for additional information about short-liners was made by the OFT on 28 June 2004 to which a response was sent by CMS Cameron McKenna on 2 July 2004.

*The First Issues Letter of 29 June 2004*

45. On 29 June 2004 the OFT sent CMS Cameron McKenna an “Issues Letter” (the “First Issues Letter”) in relation to Phoenix’s confidential guidance application, in advance of a meeting arranged for 2 July 2004. In a covering letter sent with the First Issues Letter the OFT stated:

“Our assessment so far indicates that the proposed merger may raise competition concerns which warrant discussion at a Case Review Meeting (CRM). At this stage, it is anticipated that the CRM will take place on Wednesday 7 July. Therefore, you should consider our meeting as your client’s last opportunity to make representations to the case team prior to the CRM.

The Issues Paper is based on the case team’s analysis so far. The analysis is based upon facts and opinions provided by your client over the past few weeks. It is important to note that the case team has not reached a firm conclusion on any of the issues contained in the Issues Paper...”

46. The Issues Letter of 29 June 2004 included the following under the heading “Key potential competition concerns”:

“The following are hypotheses at this stage, which we are still evaluating in the light of the evidence put to us by the parties. They do not necessarily represent the OFT’s final view on these issues:

1. Data provided by the parties suggests that the merger will reduce from four to three the number of Full-liners in the East Anglia Region. This change in market structure will not only result in loss of competition between the parties, but will also contribute to reduced incentives for the remaining players to compete as strongly as before. There is therefore the risk that the merger will lead to a lessening of competition in which all firms find it profitable individually to offer less favourable terms or lower their level of service.
2. The data also shows that the parties are the strongest competitive constraint on each other because they are each

other's closest competitor both in terms of geographic location and their respective customer bases.

In terms of depot location, the closest depot to EAP's Norwich depot is the Phoenix depot in Cambridge. Therefore in terms of the level of service offered (particularly cut-off times for twice daily deliveries) the offering provided by EAP is likely to be the next best alternative for a Phoenix customer and vice versa.

In terms of customer base, both parties tend to mainly supply Independent Pharmacies and Dispensing Doctors and so compete for the same customers. In the East Anglia Region, the parties will have a combined share of supply of 21% to Independent Pharmacies and 83% to Dispensing Doctors. AAH and UniChem by contrast compete more actively in the supply to multiple pharmacies and supermarkets. Therefore for Independent Pharmacies and Dispensing Doctors, the parties represent each other's next best alternative.

AAH and UniChem are at a disadvantage geographically and have a different customer focus. They therefore do not provide as strong a competitive constraint on the parties as do the parties on each other.

3. Of the depots currently supplying the East Anglia Region, the parties' depots are located further east than AAH's depot (Romford) and UniChem's depot (Letchworth). It is therefore difficult for AAH and UniChem to offer competitive service levels to Independent Pharmacies and Dispensing Doctors located in the far east of the East Anglia Region. For these customers, the transaction will therefore reduce their choice to one effective Full-liner.

Given the above concerns, barriers to entry may not be low enough to allay the prospect of a substantial lessening of competition, namely lowering or removal of discounts, lower service levels, or offering less favourable terms, in the supply of Ethicals to Customers in the East Anglia Region.

4. Post merger, the remaining three Full-liners in the East Anglia Region may be able to tacitly or explicitly coordinate their behaviour. This might occur either through geographic market sharing or through coordination on the level of discounts or service. Prices of Ethicals are set and fixed by the drug manufacturers and the NHS through the 1999 Pharmaceutical Price Regulation Scheme (PPRS), therefore, Full-liners do not compete on the price of individual products. Nevertheless, they do compete on price via the level of discounts offered to customers. Further, the service offered by Full-liners is to all intents and purposes homogenous. Full-liners would therefore be

able to align their behaviour in the market. In addition, because customers generally do not often switch between Full-liners, there would be no short term incentive for any one firm to cheat and because of high barriers to entry coordination is likely to be sustainable.

5. The parties are invited to consider whether they might be able to offer appropriate undertakings to remedy the potential competition concerns outlined above in lieu of a reference to the Competition Commission.”

47. On 2 July 2004 a meeting was held between representatives of the OFT and of Phoenix. Following that meeting, on the same day, CMS Cameron McKenna submitted further “observations” on the OFT’s First Issues Letter. In that submission Phoenix argued in particular:

(a) the independent pharmacy or independent pharmacy chain is a model “on the wane” because of increased vertical integration by AAH and UniChem and pressure from supermarkets. Phoenix and EAP were excluded from supplying to national accounts and to the national chains of AAH and UniChem, which accounted for about half the national market;

(b) taking full-line and short-line supply together, AAH would still have a 50% share of the wholesaling market in East Anglia (excluding hospitals), UniChem would have a 19% share and EAP/Phoenix would have a 20% share;

(c) Within the independent sector the maps of East Anglia provided by Phoenix on 2 June 2004 demonstrated that:

(i) there are a large number of customers in East Anglia who are not supplied by either EAP or Phoenix;

(ii) AAH and UniChem have customers throughout the East Anglian region;

(iii) existing EAP or Phoenix customers have the real choice of switching to AAH, UniChem or another wholesaler;

(iv) AAH and UniChem are able to service the remotest parts of the East Anglian region from depots in Romford and Letchworth respectively;

(v) there are many pharmacists or dispensing doctors in the immediate vicinity of Norwich and Cambridge (where, respectively, the EAP and Phoenix depots are based) who choose to use alternative sources of supply; and

(vi) in East Anglia AAH has a share of 53% of the supply to independent pharmacies by full-liners and UniChem 23%. AAH has a share of 14% to dispensing doctors by full-liners and UniChem 1%.

48. The guidance the OFT proposed to give Phoenix and EAP was considered at an internal “case review meeting” and at a “decision meeting” held on 7 July 2004.

*The OFT’s confidential guidance assessment of 14 July 2004*

49. An internal paper dated 14 July 2004 was then prepared by the OFT case team examining the merger. The internal paper, which was signed by Miss Penny Boys, Executive Director of the OFT, included the following under the heading “Assessment”:

“34. On a national level, the merger is not expected to lessen competition. Indeed, the merger may create efficiencies that enhance competition in the supply of Ethicals to hospitals by enabling Phoenix to become a rival supplier to AAH and UniChem.

35. In the East Anglia Region, the merged entity will be the second largest Full-line wholesaler of Ethicals to pharmacies and dispensing doctors. However, this does not reflect the fact that many of these pharmacies are tied to their vertically-integrated supplier so that there is no competition for their business. In the supply of Ethicals to independent customers, the parties will be the largest Full-liner. In either case, the merger will reduce the number of Full-liners from four to three.

36. It might be the case that, in limited circumstances, Short-liners will be able to provide some constraint on the parties. However, the mostly likely source of competition to the parties is expected to come from other Full-liners. The OFT’s recent investigation in the AAH/EAP merger

indicated that Full-liners in the East Anglia Region may be limited in their ability to provide effective competition given the location of their depots and the ability to serve customers located some distance from those depots. On the basis of the available evidence, it is unclear at this stage whether other Full-liners in the region, namely AAH and UniChem, could be expected to meet the delivery and service standards required by the parties' customers should these customers wish to switch to alternative suppliers post merger.

37. In these circumstances, the OFT believes that it is or may be the case that the creation of the relevant merger situation may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services, namely the supply of Ethicals to dispensing doctors and pharmacies in East Anglia extending to parts of the East Midlands and the south east of England. The adverse effects might be expected to be: a reduction in the level of discounts paid to customers; and/or other less favourable terms of supply; and/or a general reduction in service levels.”

50. After finding that the evidence was, at that stage, insufficient to establish certain customer benefits, the OFT concluded:

“40. On these grounds, guidance should be given that on the evidence presently available it is **likely** that this merger would be referred to the Competition Commission. However, at the public stage, we **may** come to a different view:

- if there is sufficient evidence that other full-line pharmaceutical wholesalers provide an effective competitive constraint within the regional market in which the parties operate, suggesting that no substantial lessening of competition arises; **or**
- in the event that we do believe that there is a realistic prospect that the merger will lessen competition, if there is clear and compelling evidence that the merger will result in sufficiently certain merger-specific customer benefits in the hospital sector which outweigh the competition detriments which may be caused by the merger.”

51. By a letter dated 14 July 2004 the OFT wrote to Phoenix in the following terms:

“...On the evidence presently available it is likely that this merger would be referred to the Competition Commission. However, at the public stage we may come to a different view:

if there is sufficient evidence that other full-line pharmaceutical wholesalers provide an effective constraint within the regional market in which the parties operate, suggesting that no substantial lessening of competition arises; or

in the event that we do believe that there is a realistic prospect that the merger will lessen competition, if there is clear and compelling evidence that the merger will result in sufficiently certain merger-specific customer benefits in the hospital sector which outweigh the competition detriments which may be caused by the merger.”

*Contacts between Phoenix and OFT between 14 July 2004 and 22 October 2004*

52. More detailed “feedback” was given orally to Phoenix and EAP by the OFT at a meeting on 20 July 2004. The OFT explained that it had considered that the arguments advanced by Phoenix and EAP in favour of allowing the merger to proceed without a reference to the Competition Commission were plausible, but that the evidence provided thus far by Phoenix and EAP in two main areas, identified in the letter of 14 July 2004, was, at that stage, insufficient to overcome the OFT’s concerns. The OFT also indicated that Phoenix’s case for the acquisition of EAP would need to be well supported by evidence, including verification by customers, in order to avoid a reference to the Competition Commission (Priddis, paragraph 15).
53. Despite the adverse outcome of the confidential guidance process, Phoenix and EAP decided nonetheless to proceed with the proposed merger.
54. On 22 September 2004 CMS Cameron McKenna emailed to the OFT a “draft submission” in relation to the proposed public investigation of Phoenix’s acquisition of EAP and referred to a meeting that had been arranged with the OFT for 28 September 2004. That draft submission attached a “spreadsheet” prepared by Phoenix entitled “Summary of best alternative suppliers” and described as a “major new annex”. The email also refers to “additional maps”, showing the parties’ independent sector customers, which would be sent to the OFT “in the next day or so”.
55. Mr Cole explains that he supervised the preparation of the maps attached to Phoenix’s submissions. We are told that Phoenix agreed with the OFT that the maps would identify only Phoenix/EAP “first-line customers”, defined as customers purchasing in

excess of £15,000 per month (Cole paragraph 22). As for other, non-Phoenix/EAP supplied pharmacies, these were located on the basis of information on the website of the Royal Pharmaceutical Society of Great Britain and, for dispensing doctors, from “Binleys”, which lists all General Practitioners in the United Kingdom (Cole, paragraph 23).

56. To provide the “additional maps” showing the location of UniChem and AAH customers, as well as the spreadsheets showing cut-off and delivery times Phoenix relied on the existing knowledge of its staff, questioning of pharmacies and doctors, observation of competitors’ vans and discussion with locum pharmacists (Cole, paragraph 26). Mr Cole also notes that it was not possible for Phoenix to complete competitor information for all customers.
57. The spreadsheets, first sent to the OFT on 22 September 2004, are referred to at paragraph 35 of the Decision. Those spreadsheets purport to set out Phoenix and EAP retail pharmacy and dispensing doctor customers in certain post code areas, mainly IP (Ipswich) and NR (Norfolk), showing their “cut-off” times (i.e. the latest time for placing an order for a delivery the same afternoon) and the delivery times for those customers (morning and afternoon deliveries). For each Phoenix or EAP customer, the nearest independent retail pharmacy or dispensing doctor supplied by another wholesaler is identified, the other wholesalers being AAH, UniChem and Maltbys. The cut-off and delivery times for those customers, as known or estimated by EAP/Phoenix, are also shown. Average distances are then calculated, with a view to demonstrating that Phoenix and EAP’s customers are sufficiently close to an existing customer of AAH, UniChem or Maltbys for it to be feasible for those other wholesalers, or at least one of them, to supply the Phoenix or EAP customer concerned. The spreadsheets cover 133 EAP customers and 33 Phoenix customers.
58. There was some confusion in the evidence regarding the “additional maps” referred to in the email of 22 September 2004. According to the third witness statement of Mr Priddis and the second witness statement of Mr Cole, the maps originally exhibited to both Mr Priddis’ first witness statement and Mr Cole’s first witness statement were earlier “drafts” that had never in fact been sent to the OFT during the OFT’s investigation. The later evidence of Mr Priddis and Mr Cole is that on 24 September

2004, Phoenix supplied the OFT with four maps, intended to show the whereabouts of Phoenix and EAP customers, and independent customers of AAH UniChem and Maltbys in the area of East Anglia North of the A14. These maps did not include Lloyds, Moss, Co-op or Boots outlets. The first map identifies Phoenix, EAP and independent customers supplied by another wholesaler. The second map identifies some 15 independent retail pharmacies supplied by UniChem. The third map identifies retail pharmacies supplied by AAH, including Tesco outlets. The fourth map identifies one customer with three outlets supplied by Maltbys. The maps originally exhibited to Mr Priddis' first witness statement had been exhibited in error because Mr Priddis had relied on a non-confidential version of the maps supplied to the OFT on 7 February 2005 by Phoenix rather than the maps on the OFT's files.

59. On 28 September 2004 Phoenix and EAP met with the OFT by way of a pre-notification meeting in advance of the submission of a formal notification to the OFT of Phoenix's proposed acquisition of EAP (Priddis, paragraph 16).
60. On 12 October 2004 the OFT sent CMS Cameron McKenna further requests for information concerning Phoenix's draft submission. CMS Cameron McKenna responded on behalf of Phoenix on 19 October 2004 with the additional information requested, and indicated that Phoenix wished to submit a final version of its submission by the end of the week.

*The "public stage" of the OFT's investigation from 22 October 2004*

61. Phoenix and EAP formally notified the OFT on 22 October 2004 of their intention to proceed with the proposed merger and Phoenix also announced that intention publicly.
62. A final version of Phoenix's submission was sent to the OFT by CMS Cameron McKenna on 22 October 2004. This was supported by the maps and spreadsheets referred to above, which were also attached to the submission of 22 October. On the basis of that evidence, Phoenix made, notably, the following submission:

**“The location of independent sector customers served by AAH or UniChem**

18. The Office seems to be mainly concerned about the north of East Anglia and the options available to customers within this area.
19. Therefore, in addition to the maps previously provided showing the location of Phoenix, EAP and competitors’ customers throughout the whole of East Anglia (Annex 6), the parties also provide at Annex 7 maps showing only the area north of the A14 with which the Office is chiefly concerned. The maps show that both AAH and UniChem now supply independent sector customers throughout the entire East Anglian region, for example in Burnham Market on the Norfolk coast (UniChem) and Lowestoft and Gorleston on the north east (AAH).
20. The maps also show that Phoenix has very few customers in the north of East Anglia, certainly fewer than either UniChem or AAH, despite the fact that Phoenix’s depot in Cambridge is closer to the north of East Anglia than the AAH depots in Essex (Romford) and Northamptonshire (Weedon) and the UniChem depot in Hertfordshire (Letchworth). This indicates that location of the depot is not the determining factor for customers in deciding which supplier to use.
21. The parties have also produced spreadsheets (at Annex 8) showing the customer bases of each of the parties. Each customer is matched against the service that the closest other independent pharmacy is receiving. (Lloyds, Moss and the Co-op have been excluded on the basis that they are tied pharmacies and can only accept the service given by their affiliated or contracted wholesaler, respectively AAH/ UniChem/AAH).
22. The resulting analysis shows that in the area to the north of the A14:
  - EAP’s 114 first line customers (ie. Customers for whom EAP is the primary wholesaler) lie on average just 5.2 miles from another independent sector customer currently supplied on a first line basis by UniChem, AAH or Maltbys.
  - Phoenix’s 33 first line customers lie on average just 3.7 miles from another independent sector customer currently supplied on a first line basis by UniChem, AAH or Maltbys.
  - Within the Norwich (NR) postcode region the average distances fall still further to 4.6 miles for EAP and 1.2 miles for Phoenix.

23. To put these statistics into context, the average van run for all wholesalers is over 100 miles and involves many diversions involving the distances specified above or greater distances.
24. Therefore it is clear that the opportunity exists for both EAP and Phoenix customers to switch to one of (including Maltbys) three alternative suppliers as such a change would require only minor adjustments to the new supplier's existing van routes.

#### **The location of other customers of AAH and UniChem**

25. The maps at Annex 6 show the location of all customers now served by AAH or UniChem in East Anglia. In the East Anglian region 109 pharmacies are now served by AAH and UniChem. AAH and UniChem vehicles visit those sites twice a day. The same vehicles can, and do, deliver to independent sector customers on the same route as they deliver to their wholly-owned pharmacies.
26. They are carrying the same products to customers with substantially the same requirements. Whether a pharmacy is wholly-owned or independent does not matter; many of the products required are the same and there is nothing to stop AAH or UniChem competing for the business of independent sector customers along the route to, or in the area of, a wholly-owned customer. Both AAH and UniChem already compete in this way, throughout the entire East Anglian region.
27. It is important to note that AAH and UniChem are currently the only wholesalers that are able to exploit such economics of scale...

#### **Cut-off Times**

28. It has been suggested that the location of the AAH and UniChem depots places them at a disadvantage in the north of East Anglia, since the cut-off time (i.e. the latest time at which a customer can order items for the next delivery) has to be earlier than the cut-off times offered by EAP or Phoenix, whose depots are nearer to the customer.
29. The importance of this factor has been overstated. The parties estimate that some 70% of all items purchased by independent pharmacies are purchased overnight. Cut-off times for overnight deliveries are typically after the pharmacy staff have left work and are therefore not relevant as all afternoon orders are covered.
30. The spreadsheets at Annex 8 show cut-off times and delivery times for same day deliveries (30% of the requirement) for independent pharmacy customers of AAH, UniChem, Phoenix and EAP.

31. The cut-off times are not that different. For example, within the Cambridge (CB), Peterborough (PE) and Ipswich (IP) postcode areas the average cut-off times offered by a credible alternative wholesaler are actually later than or within 5 minutes of the times offered by the earlier of EAP and Phoenix and within 45 minutes of the later of EAP and Phoenix. The Office will also note that some customers do not require an afternoon delivery at all.
32. The cut-off times currently offered by EAP in the Norwich (NR) postcode area are on average 2 hours later than those offered by UniChem and AAH. Therefore Phoenix, which offers average cut-off times 30 minutes earlier than EAP, appears prima facie to be the most credible alternative supplier. However the Phoenix market penetration in this area is smaller than that of either UniChem or AAH.
33. In considering cut-off times, the Office should also bear in mind that all full-line wholesalers operate an “emergency” service, so any patient with a critical need will always have that need met, whatever the cut-off time.
34. If cut-off times were a real problem for AAH and UniChem, their market shares would reflect that. However, they have a combined full-line wholesaling market share of 50.5% of independent customers in East Anglia, including customers in the Norwich (NR) postcode (where their cut-off times are most different from those offered by Phoenix and EAP). These customers appear to have no problem with the cut-off times offered by AAH and UniChem, and source their requirements from them. A further 2.3% accept cut-off times from other wholesalers, indicating that 53% of independent customers in East Anglia are willing to accept cut-off times offered by suppliers other than Phoenix and EAP.”

*The OFT's invitation to comment*

63. On 25 October 2004 the OFT issued an “invitation to comment” notice on the Reuters Regulatory News Service. The announcement sought comments from third parties on the proposed acquisition by Phoenix of EAP by 8 November 2004. In addition, we are told that 16 customers responded to a questionnaire from the OFT, and a further 5 customers gave information after being contacted by the OFT. Of these 21 customers, 11 were independent pharmacies and 10 were dispensing doctors. The OFT also spoke with 4 pharmaceutical wholesalers (not including the merging parties) and the NHS Purchasing and Supply Agency. The OFT received “unsolicited” comments from one hospital, one short-liner and three buying groups (Priddis, paragraph 21).

*The questionnaire to customers*

64. The questionnaire sent by the OFT to customers included the following questions:

- “7. Are cut-off times important? For example would a difference in cut-off/delivery times of the following make a difference?
  - a) 10 minutes
  - b) 30 minutes
  - c) 1 hour
  - d) 2 hours
8. If so what difference would this make to your business?
9. If another full liner were to offer you a better service and/or a better discount, would you switch supplier? If you would not switch please give your reasons.
10. Are there any particular barriers to switching supplier?
11. If you decided to switch to another full liner (for whatever reason) which firm would you be most likely to switch to?
- ...
14. Do you have any competition concerns regarding the proposed transaction? If so, please explain your reasoning?”

*OFT contacts with UniChem*

65. Meanwhile, following the announcement by Phoenix of its intention to acquire EAP on 22 October 2004, on 26 October 2004 Mr Friend, a partner in Allen & Overy LLP, spoke to Mr Priddis to register UniChem’s concerns concerning Phoenix’s proposed acquisition of EAP.

66. The OFT sent a questionnaire to UniChem on 3 November 2004 seeking UniChem’s views and evidence on six matters the OFT considered relevant to the competitive assessment of the proposed transaction. That questionnaire was as follows:

- “1. Please describe the nature of your business and the extent of your relationship with the merging parties.
2. Do you have any customers in the Northern and Eastern parts of East Anglia (for example, north of the A14)? If so, please list them stating whether they are a) your own tied chains or b) independent pharmacies and dispensing doctors.

3. What cut-off and delivery times are you able to offer these customers? How many deliveries a day do they receive? Does this differ between tied and independent customers?
4. Do discounts offered vary with the distance from your depot? For example, do customers located further away receive in general larger or smaller discounts to those who are located nearby?
5. How far away from your depot are your furthest independent customers?
6. Do you have any competition concerns in relation to the proposed transaction? Specifically; what do you expect the impact of this merger to be on:
  - a) Prices/discounts
  - b) Levels of service
  - c) Your ability to compete with the merged entity

Please explain your reasoning.”

67. UniChem responded to that letter on 10 November 2004. In addition to answering the OFT’s questions UniChem submitted a more detailed briefing paper. UniChem’s briefing paper submitted on 10 November 2004 was along similar lines to the 2003 briefing paper submitted in respect of the proposed AAH/EAP merger. UniChem argued in particular:

“Although a 1.5 hour one-way drive time is not a maximum distance, UniChem is unable to provide more distant customers with the same quality of service as those located closer to its warehouse. It also endures narrower margins on such custom due to higher transport costs. As a result, UniChem does not believe that it can provide full and effective competition for customers located further than 90 minutes drive time from its warehouse. This limitation is most likely to be very similar for its principal competitors.”

That contention was supported by an isochrone analysis, prepared by RBB Economics, very similar to the isochrone analysis submitted by UniChem in 2003. That analysis identified areas of overlap between delivery areas of the main wholesalers, broken down into six “zones”. In particular a “Zone A” in the North of East Anglia in which, it was said, competition would be eliminated altogether by the proposed merger. That area encompassed “large swathes of Norfolk, including both Kings Lynn and Norwich, and a substantial part of rural Suffolk”. Similarly it was alleged that competition would also be reduced in Zones B, C, D and E marked on the isochrone. The customers in

each zone said to be affected by the reduction in competition were listed in annexes to the RBB report.

68. In a footnote to page 3 of the briefing paper, UniChem stated:

“Despite having devoted substantial efforts over recent years to growing its share of the dispensing doctors market, UniChem has found it remarkably difficult to make in-roads across the UK, including in East Anglia, where EAP and AAH have entrenched positions, based on a long history of operating in that region. UniChem has set up a new business unit specifically to target dispensing doctors; it plainly has the expertise and resources to be a credible competitor across the UK as well as in East Anglia, yet it failed to penetrate the market. As a result, its market share in East Anglia is still only 1.5%.”

69. According to Mr Priddis, when the OFT received UniChem’s briefing paper to the OFT relating to the Phoenix/EAP transaction on 10 November 2004 it quickly became clear that UniChem had applied the same reasoning and methodology to its analysis of the Phoenix/EAP merger as it had to the proposed AAH/EAP merger. In these circumstances, we are told, the OFT case team concluded that in the light of the “extensive discussion” that had taken place with UniChem a year earlier as part of the review of the AAH case, the OFT had a good understanding of UniChem’s views and the basis upon which UniChem had prepared its evidence. The OFT considered that there was no need to take up UniChem’s offer of a meeting, made in a telephone call from Allen & Overy LLP on 19 November 2004, because “there was no new information presented by UniChem that in the view of the case team required a follow-up meeting” (Priddis, paragraph 23).

70. The telephone call in question was made on 19 November 2004 by Mr Luke Ainger of Allen & Overy LLP to the relevant OFT case officer. An email sent shortly thereafter by Mr Ainger reporting on that conversation states as follows:

“I called Ingrid Nitsche (OFT case officer) this afternoon to discuss the case.

She said she had reviewed the submission and thought it was ‘very helpful and comprehensive’.

She did not envisage that the OFT would be sending UniChem any further information requests.

I raised the question of a possible meeting. She said the OFT was running to a “tight timetable” and from their perspective

didn't think a meeting would be necessary. She reiterated that the submission was comprehensive and didn't require clarification. However she said the OFT would consider a meeting if UniChem had any additional issues or concerns it wished to raise. Does anyone have views on whether there are additional issues that we have not yet raised? If not, perhaps the best course of action is to wait for the OFT's decision."

*The Second Issues Letter of 30 November 2004*

71. On 30 November 2004 the OFT issued a further "issues letter" to Phoenix (the "Second Issues Letter"). According to the OFT's *Mergers Procedural Guidance*:

"5.17 In cases that raise more complex or material competition issues, a different process will be followed. Once a case has been so identified, the parties will be advised and invited to attend an issues meeting with the Branch. To help the parties prepare for this meeting, the case officer will send an 'issues' letter to the parties. This will set out the core arguments and evidence in the case. It is intended that 'issues' letters will set out the arguments in favour of a reference so that parties have an opportunity to respond to the reasons why a reference, if it follows, has been made. That is not to say that a reference will follow in all cases in which an 'issues' letter is sent."

72. The Second Issues Letter identified six key potential competition concerns and its terms are set out below, so far as relevant:

"Issues Paper

Note – the following are hypotheses at this stage, which we are still evaluating in the light of the evidence put to us by the parties and third parties. They do not necessarily represent the provisional or final view of the OFT on these issues.

...

**Key potential competition concerns:**

1. The merger will reduce from four to three the number of Full-liners serving the East Anglia Region. This change in market structure may result in a loss of competition between the parties and may also contribute to reduced incentives for the remaining players to compete as strongly as before. There is therefore the risk that the merger may lead to a lessening in competition in which all firms find it profitable individually to offer less favourable terms or lower their level of service.
2. In terms of customer base, both parties tend to mainly supply Independent Pharmacies and Dispensing Doctors

and so compete for the same customers. In the East Anglia Region, the parties will have a combined share of supply of 21% to Independent Pharmacies and 83% to Dispensing Doctors. AAH and UniChem by contrast compete more actively in the supply to multiple pharmacies and supermarkets. Therefore for Dispensing Doctors, at least, the parties may represent each other's next best alternative.

3. The merger may create a monopoly in certain parts of East Anglia where neither AAH nor UniChem can provide an effective service. AAH and UniChem are at a disadvantage geographically and, as noted above, have a different customer focus. They therefore may not provide as strong a competitive constraint on the parties as do the parties on each other. In terms of the level of service offered (particularly cut-off times for twice daily deliveries) the offering provided by EAP may be likely to be the next best alternative for a Phoenix customer and vice versa.
4. EAP is a very efficient and flexible operator with very good levels of customer service. Large, national wholesalers do not tend to have the customer focus on small Independent pharmacies that a regional wholesaler offers. Some customers are concerned that the service offered by EAP will be of lower quality once Phoenix takes over.
5. The merger may increase the prospect of the remaining three Full-liners in the East Anglia Region tacitly or explicitly coordinating their behaviour. This might occur either through geographic market sharing or through coordination on the level of discounts or service.
6. In summary, concerns arise that the merger may create a substantial lessening of competition in the supply of Ethicals to Customers in the East Anglia Region resulting in the lowering or removal of discounts, lower service levels, and the offering of less favourable terms.”

*Events between 30 November and 9 December 2004*

73. On 2 December 2004 the OFT held an “issues meeting” with Phoenix and its advisers. We are told by Mr Cole in his second witness statement that one of the issues discussed in detail at that meeting (and at the earlier meeting of 29 September 2004) was the feasibility of reorganising van routes to accommodate new customers (Cole, paragraph 16).

74. On 3 December 2004 Phoenix made a further submission to the OFT in response to the Second Issues Letter. That further submission substantially repeated the parties' earlier submissions. However at paragraph 11 Phoenix said:

“It is misleading to suggest the 5-6 new customers make a new route viable. When a wholesaler establishes a new customer, existing van routes are adjusted to accommodate that customer. Full-liners use computerized systems to re-configure van routes on a regular basis. It is not a question of waiting to recruit 5-6 new customers and then putting on a new van route.”

75. The submission of 3 December 2004 also referred to evidence that AAH and Unichem had been canvassing Phoenix and EAP customers extensively since the proposed merger was announced (paragraph 14 and Annex 23).

76. An internal “case review meeting” or “CRM” was then held by the OFT on 9 December 2004. The CRM was chaired by Mr Priddis. We were not told who attended the CRM in this case but Mr Priddis explained that “generally” such meetings are attended by the case team considering the merger, Mr Priddis, his deputies, the senior mergers economist in the OFT, and possibly other senior OFT representatives. One attendee at the CRM is nominated to be a “devil’s advocate” (Priddis, paragraph 26).

77. In this case we are told that the attendees at the CRM received a copy of the Second Issues Letter, Phoenix’s and EAP’s full written response to the Second Issues Letter of 3 December 2004, the outline decision prepared by the case team (which apparently summarises the arguments for and against reference) and an internal economic analysis of the transaction by the OFT Mergers Branch. We are told that in this case the recommendation of the case team was that the OFT decide not to refer the transaction to the Competition Commission (Priddis, paragraph 27).

78. After the CRM took place, a separate meeting was held on the same day which was chaired by Penny Boys, the OFT’s Executive Director. Mr Priddis, as chairman of the CRM, reported on the debate at the CRM including giving the advice of the CRM that the recommendation of the case team (that the OFT should decide not to refer the transaction to the Competition Commission) was correct. Miss Boys then indicated that a draft decision not to refer the transaction to the Competition Commission should be prepared (Priddis, paragraph 28).

79. Between 10 and 16 December 2004 the case team prepared a draft decision for signature by Miss Boys. On 17 December 2004 Miss Boys approved and signed the Decision which was publicly announced on that date. On 23 December 2004 the OFT published a non-confidential text of the Decision pursuant to section 107(1)(a) of the 2002 Act (Priddis, paragraph 29).

#### **IV THE CONTESTED DECISION**

80. The substantive analysis contained in the Decision is set out from paragraph 6 onwards.
81. As regards “Horizontal issues,” the OFT said this:

##### **“Shares of supply**

###### *National issues*

24. The transaction raises no concerns at a national level. The merger will give Phoenix and EAP a combined share of full-line supply to pharmacies and dispensing doctors of 10 per cent with an increment of 1 per cent.

###### *Regional issues*

25. As mentioned above, EAP's depot is located in Norwich and Phoenix's nearest depot is located in Cambridge. The parties' closest rivals are situated in Romford (AAH) and Letchworth (UniChem). The East Anglia region is also served to a limited extent by two other independent full-liners, Mawdsley Brooks, based in Milton Keynes and, to a lesser extent, Maltbys based in Lincoln.
26. According to the parties' data on the wholesale supply of Ethicals by full-liners to pharmacies and dispensing doctors, post merger, they would have a combined share of [25-35] per cent (increment [15-25] per cent) in the East Anglia region. The merger would make them the second largest full-liner, after AAH with [40-50] per cent, with UniChem accounting for [20-30]. The total number of full-liners serving this area to any substantial extent would reduce from four to three.
27. In terms of their respective customer bases, the parties may be considered each other's closest competitors. Both EAP and Phoenix specialise in supply to dispensing doctors and smaller independent pharmacies. They cannot effectively supply chains of pharmacies (referred to as multiples – such as Superdrug, Boots and the supermarket chains) due to their lack of national coverage and they cannot supply 'tied' chains such as Moss or Lloyds since these chains are vertically integrated with UniChem and AAH respectively. Similarly supermarkets look to source from a single national supplier and so currently can only source from the two national full-liners.

28. Looking at shares of supply based upon independent pharmacies and dispensing doctors only (i.e. excluding those customers who are not free to choose Phoenix or EAP as their supplier), the parties have a combined share of supply for independent pharmacies in East Anglia of [15-25] per cent (increment [10-20] per cent) with AAH having [45-55] per cent, UniChem [15-25] per cent and Mawdsley Brooks [<5] per cent. For dispensing doctors in the same area the parties have a combined share of supply of [75-85] per cent (increment [55-65] per cent) with AAH with [10-20] per cent and UniChem with [<5] per cent and minimal sales from Mawdsley Brooks. In the decision on the anticipated acquisition by AAH of EAP (see paragraph 5 above), the OFT found that there was insufficient evidence to suggest that supply to dispensing doctors exhibits sufficiently different characteristics from supply to retail pharmacies to justify separate analysis. The OFT has not received any evidence as a result of this investigation to contradict that view. The high combined share figure is, however, indicative of the similarity in the types of customer that the parties supply. EAP contends that it has always had a strong presence in the dispensing doctors sector and Phoenix contends that the lack of a full range twice-daily delivery service from its Cambridge depot (see paragraph 32 below) means that its service is more suited to dispensing doctors in the area.
29. The price of branded Ethicals is subject to price regulation under the PPRS. Under this scheme, the Department of Health (DoH) sets a 'list price' at which manufacturers supply these products to wholesalers. The parties claim that wholesalers can offer their customers a discount, equivalent to a maximum of 12.5 per cent off the list price. The DoH then claws back most of the discount from the pharmacists (the rate of the clawback is currently around 10.5 per cent). The result of this is that the margin within which full-liners can offer differential discounts is small and as a result there tends to be very little difference in the level of discounts offered by wholesalers to pharmacies. This has been backed up by third party comment which tends to focus on levels of service as being the deciding factor in the choice of wholesale supplier.
30. In assessing whether this merger may substantially lessen competition, the OFT considers that the following considerations are relevant:
- a. What level of constraint does Phoenix confer upon EAP pre merger?
  - b. Are AAH and UniChem effective competitors in the outlying North and Eastern areas of East Anglia?
  - c. Are AAH and UniChem effective competitors in the supply of Ethicals to dispensing doctors?
31. On the basis of the evidence available, the constraint that Phoenix currently offers to EAP in East Anglia is considered to be low. Phoenix has what could be considered a surprisingly low share of supply ([<10] per cent) in East Anglia, given its apparently advantageous geographic location in the region. There are a number of reasons for this.
32. First, the Phoenix depot at Cambridge is a 'link' depot rather than a full-line depot. This means that the site at Cambridge only carries a limited range of

[2,000-4,000] lines, which can be dispatched the same day. The remaining 7-10,000 product lines need to be ordered from a feeder depot in Birmingham and can only be delivered on a next day basis. The service that Phoenix can offer from Cambridge could be considered therefore more like a quick delivery short-line service than a full-line offering.

33. In addition, although Phoenix has its own chain of tied pharmacies (Rowlands), it has no outlets in East Anglia. This puts Phoenix at a competitive disadvantage to the other players because it cannot build up the requisite network densities to operate efficiently. AAH, UniChem and EAP have hospital contracts, and AAH and UniChem have business with their own tied chains and supermarkets. This allows them to build up customer clusters which make a stand alone van route viable. For example, the OFT considers that these parties should indeed be able to offer a pharmacy near to an existing route a service at negligible marginal cost since they already make drops in the area. EAP is very successful in relatively distant geographic areas, because it can offer a drop to a customer in the same van that is going to a hospital contract. Phoenix by contrast has no volume in many areas of East Anglia. Therefore its marginal cost of servicing customers, in a new area, is by contrast relatively high since adding a new van route rather than altering an existing route is relatively expensive.
34. Regarding the question of whether AAH and UniChem are effective competitors in the outlying North and Eastern areas of East Anglia, both competitors deliver to tied chains and supermarkets in these areas already. It should therefore be relatively easy and cost effective to add one or more drops to an existing 'round'. The parties have shown that both AAH and UniChem are serving independent customers in these areas. AAH and UniChem maintain that they are unable to offer a good enough service in these areas; however, the level of service that they provide is evidently good enough for some independent customers and for the national supermarkets.
35. Phoenix and EAP have provided detailed spreadsheets setting out the distances between and cut-off times for independent sector customers supplied by all full-liners operating in the region. The spreadsheets suggest that the service levels of all suppliers (including AAH, UniChem and Mawdsley Brookes)<sup>2</sup> do not necessarily deteriorate significantly in response to distance and undermine the suggestion that AAH, UniChem or Mawdsley Brooks cannot effectively compete in parts of East Anglia, since they clearly do provide services for all types of customers in this area.
36. AAH and UniChem are relatively well placed to compete for business throughout East Anglia by virtue of their full size depots and the network benefits they gain from existing customer density, and from customer clusters over longer distances. It therefore seems that any customer of the merged entity could switch to AAH or UniChem (or in the West of the region, Mawdsley Brookes). Furthermore, a number of third parties have indicated that they would

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<sup>2</sup> It appears, from the spreadsheets submitted to the Tribunal, that the references to "Mawdsley Brookes" in this paragraph may be an error and that the reference should have been to "Maltbys".

switch in the event of poor service from EAP, and none has identified any significant barriers to switching to an alternative supplier.

37. Customer responses in relation to this case indicate that cut-off and delivery times are one of a number of aspects to service quality which customers value highly. Other important factors cited by customers, that do not vary with geography include: customer service levels, order accuracy, flexibility, discounts and friendliness of staff.
38. In terms of the supply of Ethicals to dispensing doctors, there are no particular barriers on either the demand or supply side between pharmacies and dispensing doctors. A dispensing doctor is essentially another drop on the route, so if AAH and UniChem are supplying pharmacists in the region, there appears to be no reason why they should not be able to add dispensing doctors to their existing route network. Furthermore, responses from dispensing doctors indicate that they are less demanding in their requirements, many preferring only one daily drop. Third parties have indicated that dispensing doctors are reluctant to switch unless service levels fall, and are relatively insensitive to price as they are reimbursed at cost for the Ethicals that they prescribe to patients. This implies that they have less incentive to shop around in search of cheaper drugs. For them, service quality is a key consideration in choosing their full-liner. However the dispensing doctors contacted by the OFT indicated that there were no barriers to switching supplier and a number stated that in principle there is no reason not to use AAH or UniChem. They are reluctant to switch because they are happy with their current supplier and because there is little difference in the offers from full-line competitors.
39. On the basis of the above, the OFT does not expect that there will be an adverse impact from the reduction of choice among full-liners in East Anglia. In the OFT's view there will not be an appreciable impact on discounts or on service levels.

...

### **Barriers to entry and expansion**

42. Barriers to entry in full-line wholesaling are considered to be high. This is because of the high cost of establishing and stocking a depot, the low returns that would be expected and the difficulty in achieving a critical mass of customers to make a depot viable. As a result all of the new entry observed in the past five years has been by acquisition rather than organic growth.
43. Further barriers exist at the route level, where the parties estimate that in order to make a new route in a new geographic area viable, the route needs to carry a turnover of approximately £150k per month (equivalent to 5-6 customers) in order to break even. However, the parties maintain that all full-liners use sophisticated routeing software to optimize their networks. As a result, the addition of a new customer to the network will typically be followed by a re-organization of the entire route network. The marginal cost of supplying a new customer, where existing customer drops are nearby, should therefore be very low. However opening a route in an area where the full-liner has no pre-existing

drops (even within the 2-hour drive time radius) is likely to carry a higher incremental cost.

### **Buyer power**

44. Whilst there are a number of large national buyers of Ethicals in the UK (for example supermarkets and large chains like the Co-op) their choice of supplier is extremely limited since only AAH and UniChem are able to supply on a national basis.
45. For smaller customers in the East Anglia area the choice is more varied as they can source from AAH, UniChem and Phoenix and regional full-liners. However due to their small size their buying power is not significant. The parties submit that buying groups confer buyer power upon smaller customers. However buying groups tend to supply generics under the group brand, for which short-line alternatives are already available. Buying groups do not therefore have a significant impact on the competitive assessment. There is therefore little prospect of customers being able to exercise any buyer power.

...

### **Third Party Views**

47. Competitors to the parties raised concerns about the acquisition, suggesting that for certain customers in certain areas, the merger would severely reduce customer choice. A number of customers who were contacted currently use EAP and Phoenix as main and back up full-liners. While a number of these customers were concerned over their potential reduction in choice, many were not and expressed the view that adequate competition would remain in the area post-merger.

### **Assessment**

48. In the East Anglia region, the merged entity will be the second largest full-line wholesale supplier of Ethicals pharmaceuticals. At this regional level, the merger will effectively reduce the number of competing full liners from four to three. In addition, in terms of their geographic coverage and respective customer bases (namely, a focus on dispensing doctors) the parties could be considered close alternatives.
49. It might be the case that, in certain circumstances, short-liners will be able to provide some constraint on the parties. However, competition to the parties is expected to come from other full-liners operating in the region, namely AAH and UniChem. In assessing the extent of this constraint, the OFT notes that both AAH and UniChem currently offer a service to tied chains and supermarkets (and independent customers) throughout the East Anglia region and can be considered well placed to compete for additional custom in the region. The OFT also considers there is nothing specific about dispensing doctors as customers, which would prevent these competitors from servicing their needs. Added to this is the fact that overall Phoenix currently offers a limited constraint on the activities of EAP.

50. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.”

## **V THE PROCEEDINGS BEFORE THE TRIBUNAL**

### *The notice of application*

82. In its notice of application dated 19 January 2005 Unichem relies on four grounds of review:

Ground 1: The OFT’s decision that it was not under a duty to refer the proposed merger to the CC was irrational and unjustified and/or a misconstruction or mis-application of its duty under section 33.

Ground 2: The OFT’s reasons for not referring the merger to the CC were insufficient to justify the Decision, and did not dispel the serious likelihood of a substantial lessening of competition.

Ground 3: There are a number of unresolved issues of material fact outstanding. In those circumstances the OFT erred in deciding not to refer to the CC. Further, the OFT acted irrationally or unreasonably in purporting to resolve those issues in the way it did.

Ground 4: The OFT failed to take adequate account of its previous decisions, and in doing so breached its duties to act consistently, to take into account relevant considerations, to uphold legitimate expectations, and to give adequate reasons for its decisions.

83. The notice of application was prepared without UniChem having seen the evidence submitted by Phoenix/EAP to the OFT, nor the OFT’s confidential guidance and Issues Letters.
84. Following a case management conference before the Tribunal on 31 January 2005, on 8 February 2005 the OFT submitted the witness statement of Mr Priddis already referred to, with extensive annexes, together with a skeleton argument. At that stage UniChem saw for the first time the evidence given to the OFT by Phoenix/EAP, together with the confidential guidance and Issues Letters. Mr Priddis’ evidence is summarised below.
85. On 7 February 2005 Phoenix submitted its skeleton argument, supported by the witness statements of Mr Cole and Mr Briggs of 7 February 2005, also summarised below.

86. On 11 February 2005 UniChem submitted witness statements by Mario Patrick Johnson, UniChem's Business Development Manager, and Simon Baker, of RBB Economics.
87. The first day of the hearing was on 14 February 2005. Subsequently Phoenix served a second witness statement of Mr Cole dated 17 February 2005 which among other things replies to Mr Johnson's statement of 11 February 2005. On 17 February 2005 Mr Johnson also filed a further statement dealing notably with win/loss data given by Phoenix to the OFT which had not previously been disclosed to UniChem. The second day's hearing was on 18 February 2005.

## **VI THE EVIDENCE**

### **A. THE OFT'S EVIDENCE**

88. The main part of Mr Priddis' witness statement (paragraphs 30 to 124) is concerned with supplementing the OFT's reasons for taking the Decision. Although UniChem alleges that the OFT failed to take particular evidence, facts and/or arguments into account, Mr Priddis states that the OFT did consider the factors relied on by UniChem and either did not find them to be persuasive or did not believe them to reflect accurately the likely future competitive position (Priddis, paragraphs 30 to 32). Mr. Priddis also denies that the OFT has ignored the guidance given in its publication *Mergers – substantive assessment guidance*, OFT 516, May 2003 (the "*Substantive Guidance*") (Priddis, paragraph 33).

#### *Market definition*

89. Mr Priddis states that the OFT considered that it was not certain that full-line wholesalers are constrained by short-liners; that tied pharmacies should be considered alongside independent pharmacies and dispensing doctors when considering the way in which the competitive dynamic works in East Anglia; and that when considering the competitive effect of the transaction independent pharmacies and dispensing doctors should be considered together (Priddis, paragraphs 41 to 51).

*Geographic market*

90. The OFT considered that since the merging parties' activities overlapped in East Anglia. It was however difficult to establish a more precise market definition (Priddis, paragraphs 54 to 60).

*Concentration data*

91. According to Mr Priddis, market concentration data do not, by themselves, give rise to any presumption that a merger may be expected to lessen competition substantially. Further investigation is always required to determine whether it is or may be the case that a merger may be expected to lessen competition substantially (Priddis, paragraph 63). Moreover, Mr Priddis explains that the OFT had in mind a number of specific factors relevant to this case when considering the market concentration data available to it:

- (a) the difficulties of arriving at a precise definition of the relevant product market and the relevant geographic market;
- (b) since it was certainly not the case that each wholesaler could provide a consistent service across the whole of East Anglia, given the geographic spread of their depots, concentration data would not provide the OFT with a good guide to the "dynamics of competition" among pharmaceutical wholesalers in the East Anglia region;
- (c) there were evidential disputes between the relevant wholesalers as to their respective sales in East Anglia and the OFT considered that it should be circumspect in relying on such information; and
- (d) although the OFT had calculated the "relevant" HHIs and concentration ratios they were not included in the Decision as the OFT did not consider that such information added anything to its analysis, given that it had already concluded that market shares provided only a limited guide to current competitive conditions in this market.

(Priddis, paragraph 64)

92. However, the OFT used “share of supply data” as a “check” to ensure that if, on some calculation basis, a high share might be identified, that could be double-checked to ensure that the “story” of competitive effects stood up to scrutiny. The data eventually cited by the OFT in the contested Decision were the data provided to the OFT by Phoenix and EAP (Priddis, paragraph 66).
93. At the request of the Tribunal, Mr Priddis also supplied information calculated on the basis of wholesale supply to independent pharmacies and dispensing doctors combined in East Anglia. This shows the merged EAP/Phoenix with a combined share of 47.2% (EAP with 33.1% and Phoenix with 14.1%), AAH with 36.6% and UniChem with 13.9%. Mr Priddis explains that the OFT had not included these figures in the Decision because the OFT “does not consider that they shed any additional light on the competitive impact of Phoenix’s proposed acquisition of EAP” (Priddis, paragraphs 73 to 74).
94. According to Mr Priddis, the OFT placed “little evidential weight” on the market shares set out in paragraphs 26 and 28 of the Contested Decision. These showed only that Phoenix’s acquisition of EAP called for “careful and thorough scrutiny”. As in the AAH Decision (at paragraph 25) the OFT did not consider the market to be one in which market share data is an accurate indicator of actual or potential competition (Priddis, paragraph 75).

*Non – coordinated effects*

95. Mr Priddis notes that the OFT’s *Substantive Guidance* identifies a number of characteristics of a market where there might be a risk of “non-coordinated effects” arising as a result of a merger. These characteristics include: (i) there are few firms in the affected market(s); (ii) the merging parties are close competitors; (iii) customers have little choice of alternative suppliers; (iv) rivals find it difficult to react quickly to changes in price, output or quality; (v) there is no strong competitive fringe; and (vi) one of the merging firms is a maverick or new entrant. However, Mr Priddis states that the fact that these features are all present “does not automatically mean that a substantial lessening of competition is a realistic prospect.” Therefore, although UniChem states that many of the factors quoted by the OFT’s *Substantive Guidance* are

present, the OFT's own approach is not to apply those characteristics in a "rigid fashion". The OFT considers that "these characteristics should only be applied in the context of a proper understanding of the competitive dynamics of the sector in question and in light of a proper appreciation of the evidence" (Priddis, paragraph 78).

*The level of constraint imposed by the merging parties on each other before the merger*

96. As regards Ethicals, Mr Priddis notes that the principal parameter of competition between full-line pharmaceutical wholesalers is service quality (Priddis, paragraphs 79 and 80).
97. According to Mr Priddis, the OFT was able to conclude that, before the merger, Phoenix and EAP did not in fact exercise a significant competitive constraint on each other, for two reasons:
  - (a) Phoenix offers only a limited service from its depot in East Anglia, more akin to a short-line wholesaler than a full-line wholesaler. The Phoenix depot in Cambridge is a "link" depot rather than a full-line depot and carries only a limited range of 3,000 lines which can be dispatched on the same day. The remaining 7,000 to 10,000 product lines must be ordered from a "feeder depot" in Birmingham and can only be delivered on a "next day" basis.
  - (b) Despite the apparent competitive advantage arising from the geographic location of its depot, Phoenix faces disadvantages in competing with UniChem, AAH and EAP because of its low customer density in East Anglia and consequent lack of network efficiencies.  
  
(Priddis, paragraphs 85-88)
98. Accordingly, the OFT reached the view that the scope of pre-merger competition between Phoenix and EAP was not as significant as it first appeared, and the evidence tended to suggest that in the outlying areas of East Anglia "the most vibrant competition" to EAP came from UniChem and AAH (Priddis, paragraph 89).

*Whether, following the merger, AAH and UniChem would offer effective competition in the outlying North and Eastern areas of East Anglia*

99. The next question posed by the OFT was: “would there, post-merger, be sufficient alternative full-line wholesalers of ethical pharmaceuticals to maintain competitive pressure on the merged Phoenix –EAP?” (Priddis, paragraph 90).
100. Mr Priddis states that, although at first sight the isochrone study submitted by UniChem would seem a useful indicator of the areas in which a pharmaceutical wholesaler could deliver its products and compete for business, when considered in the context of all the information and evidence gathered by the OFT it became clear that the picture painted by UniChem was not accurate. Accordingly the OFT concluded that little probative value could be assigned to UniChem’s representations as the model of competition they proposed did not fit with the majority of the other evidence available to the OFT and did not accurately predict the existing state of competition (Priddis, paragraph 93 ).
101. When explaining the OFT’s belief that Phoenix and EAP will continue to face competitive constraints in the northern and eastern areas of East Anglia, the Decision sets out four relevant factors: (i) both AAH and UniChem already supply to all types of customer in the outlying areas where UniChem say that they cannot compete, including to independent pharmacies and dispensing doctors; (ii) service levels do not necessarily fall significantly as the distance from depot to customer increases; (iii) customers have said that AAH and UniChem are alternative suppliers for them; and (iv) it would be incorrect to focus only on the cut-off time for placing an order as the key element of “service levels” to customers (Priddis, paragraph 94).
102. Mr Priddis notes that both UniChem and AAH already deliver to tied pharmacies, national supermarket accounts and regional pharmacy chains in the area north of the A14. The maps provided by Phoenix and EAP demonstrated to the OFT that both UniChem and AAH are well represented in even the outlying areas of East Anglia. Furthermore, both UniChem and AAH already deliver to independent pharmacies in the relevant parts of East Anglia. UniChem has 18 independent pharmacy accounts in East Anglia including in Kings Lynn, Great Yarmouth and Lowestoft, plus 21 Boots accounts. These pharmacies lie as far outside of the relevant RBB isochrone as it is possible to be. Mr Priddis also noted that UniChem appeared to have 2 dispensing

doctor accounts in East Anglia north of the A14, which the OFT concluded were apparently gained by UniChem between 2003 and 2004 because they were not mentioned in the 2003 briefing paper. The OFT believes that AAH supplies several dispensing doctor accounts in East Anglia north of the A14 as its share of dispensing doctor sales is higher than UniChem's. The OFT also had some evidence from customer interviews that both UniChem and AAH are attempting to expand their businesses in East Anglia, including in the most distant parts of East Anglia, from their respective depots. Win/loss data supplied by Phoenix suggested that both AAH and UniChem had won business from both Phoenix and EAP (Priddis, paragraph 95(a) to (e)).

103. According to Mr Priddis, the marginal cost of adding one drop to an existing van round is low. Accordingly, it would be easy for AAH or UniChem to expand one of their existing routes across East Anglia to serve an additional customer account (paragraph 95(g)). Mr Priddis states that of particular importance to the OFT in this context was the following:

- “...confirmation that planning of delivery routes by wholesalers changes often to take account of new accounts. For example, EAP said that even the gain or loss of one customer may result in the re-mapping of the entire delivery network.
- It was not therefore the case that the economics of the delivery routes were such that routes were fixed and could not readily be altered to include or exclude customer drops.
- The costs of running a van route are largely fixed, until the point that the allocated van becomes full so if the van is driving nearby, the only additional costs that would be incurred in making a small detour for an additional customer drop would be fuel, invoicing costs etc
- UniChem's website claims that it offers the most efficient and lowest cost pharmaceutical wholesale logistics system
- UniChem and AAH have, in the past, expanded their vehicle routes to add additional customer drops. There is no reason why they would not be able to do so in the future.
- There do not appear to be any areas where AAH and UniChem do not have existing routes which can be used as the basis for expansion
- The OFT received no evidence to suggest that the marginal costs of serving an additional customer would be high.”  
(Priddis, paragraph 95(g))

104. Mr Priddis explains (at paragraph 96) that in the light of the matters listed above the OFT concluded that there was good evidence to demonstrate that UniChem and AAH were active and viable competitors to Phoenix and EAP, even in those outlying areas of East Anglia. To the extent that AAH or UniChem might have only a small number of existing customers in a particular area, there is “nothing to stop them expanding by adding to their extensive network of deliveries”.
105. As to the relationship between service levels and distance from the depot, the OFT wished to investigate whether service quality did indeed deteriorate sharply according to distance from the depot. The OFT had noted in the AAH Decision that competitors were unanimously of the view that service levels deteriorated as they travelled further from the depot. UniChem had also provided an isochrone analysis in the context of the AAH/EAP investigation. In that investigation the OFT had asked the parties to provide details of actual cut-off and delivery times to test the arguments being advanced by UniChem. In the time available AAH and EAP had been unable to respond sufficiently fully (Priddis, paragraphs 97 to 101).
106. However, in the present case, Phoenix and EAP, who were aware of the importance of this point for the OFT from their confidential guidance application, had provided the OFT with the requested data and information (Priddis, paragraph 101).
107. Mr Priddis states that, in the public phase of the investigation, the OFT was able to “target its questions to customers more effectively to understand the precise impact of order cut-off times on their ability to change pharmaceutical wholesaler.” In addition, the OFT had available to it details of the pharmacies and dispensing doctors supplied by the various wholesalers. Therefore, the sort of isochrone analysis carried out by RBB on behalf of UniChem was of less probative value than in the AAH Decision. The OFT did not need to rely on an isochrone “model” to predict where deliveries could be made as it knew precisely where UniChem and the other wholesalers were already delivering, as a result of the information supplied by Phoenix, EAP, UniChem and AAH (Priddis, paragraph 102)
108. The OFT’s conclusions in paragraph 35 of the Decision were based on the following factors which were set out at paragraph 103 of Mr Priddis’ statement:

- (a) UniChem's submission concerning cut-off and delivery times did not apply to overnight orders for delivery the following morning which account for 70% of product deliveries to pharmacies.
- (b) If UniChem's submissions concerning a 90 minute drive-time were correct then UniChem would, by definition, have had little commercial success in the area north and east of the A14. However, information before the OFT demonstrated that UniChem had won a number of independent pharmacy and dispensing doctor accounts in that area.
- (c) UniChem's information also showed that UniChem provided twice-daily deliveries to customers north of the A14. The cut-off times provided by UniChem to these customers was not indicative of a poor service level. The OFT considered that, for many customers, UniChem's "cut-off times were within the margin of comfort that pharmacy customers told us was acceptable to them".
- (d) The detailed spreadsheets provided to the OFT by Phoenix and EAP showed that there was not necessarily any significant deterioration in order cut-off times as the distance of the customer from the depot increases. The evidence of Phoenix and EAP showed that many independent pharmacies or doctors north of the A14 had later cut-off times than pharmacies or doctors closer to the depot. Even where the cut-off time was later in the day, customer evidence suggested to the OFT that AAH and UniChem still provided an adequate service.
- (e) The spreadsheets provided by Phoenix and EAP showed that AAH and UniChem served customers in the outlying areas of East Anglia with a twice-daily service that was competitive with the service provided by EAP. While the afternoon delivery service provided by UniChem and AAH was generally later in the day than that provided by EAP, the deliveries arrived in sufficient time to allow for delivery acceptance and prescription dispensing on the same day. Therefore, the OFT took the view that the spreadsheets supported the notion that service levels did not deteriorate significantly as distance from the depot increases.

(f) The detailed maps and customer lists received by the OFT confirmed that UniChem's customer spread is considerably wider than that suggested by the RBB isochrone analysis. Furthermore, the evidence showed that the customer spreads of each wholesaler were quite different. AAH's customer spread did not fit a 90-minute delivery drive time. Phoenix, on the other hand, had a very limited customer spread narrowly focused around Cambridge.

109. Mr Priddis further states that "customers noted that [UniChem] had persuaded a number of independent pharmacies and dispensing doctors in [the outlying areas of East Anglia] to switch to UniChem". A "number of customers" had told the OFT that, in the event of poor service from the merged Phoenix/EAP business they would switch to another pharmaceutical wholesaler such as AAH or UniChem. Although a number of customers identified Phoenix and/or EAP as their most likely suppliers, this did not detract from the fact that UniChem and AAH are known as being active in outlying parts of East Anglia. Furthermore, no customer identified any significant barrier to switching that might lead one to question whether switching would, in fact, occur (Priddis, paragraph 105).
110. Finally, the view that reliance might be placed on cut-off times as a key parameter of competition was seriously undermined by the views of customers in the outlying north and eastern areas of East Anglia. These customers emphasised that order cut-off and delivery times are only one aspect of service quality that they valued highly and additionally customer service, order accuracy, flexibility, discounts, and friendliness of staff are also important. In addition, the OFT also notes that "the majority of customers indicated that a difference in cut-off times of up to one hour would have little or no impact on their business." The spreadsheets provided by Phoenix and EAP showed that overall, UniChem's service was competitive with EAP and was accepted by a material number of independent pharmacies in outlying areas. In addition, dispensing doctors in particular regarded delivery times as more important than cut-off times. The OFT therefore reached the conclusion that it would not be sensible to rely on cut-off times as the key parameter of competition that dictated whether or not a particular wholesaler could supply a given pharmacy or doctor (Priddis, paragraphs 106 to 108).

111. The OFT's conclusion that the merged Phoenix/EAP would continue to face effective post-merger competitive constraint from AAH and UniChem in the outlying northern and eastern parts of East Anglia was based particularly on AAH's and UniChem's "existing patterns of success in these parts of the region, and on the ease with which AAH and UniChem could expand their existing customer base." (Priddis, paragraph 109).

*Whether AAH and UniChem are effective competitors in the supply of Ethicals to dispensing doctors*

112. The OFT considered whether there was anything special about wholesale supply of ethical pharmaceuticals to dispensing doctors that meant that AAH or UniChem might be less effective competitors for doctors than for pharmacies. In particular, the OFT noted that Phoenix and EAP had a higher share of supply in this sector. UniChem was believed by the OFT to have two dispensing doctor customers north of the A14 and AAH several more (Priddis, paragraphs 110 to 111).

113. Mr Priddis stated that the evidence before the OFT clearly showed that, at present, dispensing doctors are reluctant to switch because they are happy with their current supplier and because there is no material difference in the discounts offered by other full-liners. However, the dispensing doctors contacted by the OFT were clear that in the event of a post-merger price increase or deterioration of service they could and would wish to switch supplier. There are no particular demand-side or supply-side barriers between wholesale supply to pharmacies and dispensing doctors. Dispensing doctors have slightly different demand characteristics to independent pharmacies and are less concerned about price, less concerned about a twice-daily delivery and more concerned about other aspects of service levels, such as order accuracy and product availability. UniChem's submissions concerning order cut-off times are therefore of even less relevance, in the OFT's view, in the context of dispensing doctors (Priddis, paragraphs 112 to 114).

114. The doctors interviewed by the OFT indicated that there were no barriers to switching supplier. In the OFT's view the fact that the incumbent supplier is able to meet customers' service requirements such that dispensing doctors rarely need to switch

supplier does not appear to be a valid reason for examining doctors as a separate “market”. The OFT considers that the relevant questions are, could doctors switch supplier “if prices increased or service quality fell” and, if so, is this likely to be an effective constraint on the merged parties? (Priddis, paragraph 115)

*The OFT’s assessment of the scope of competitive constraint from new entrants*

115. The Decision sets out the OFT’s view that barriers to entry in full-line wholesaling are high. (Priddis, paragraph 120).
116. A new route in a new geographic area needs to carry a turnover of approximately £150,000 per month (equivalent to 5 or 6 customers) to break even. Opening a route where a wholesaler has no pre-existing drops is likely to carry a higher incremental cost. However, the merging parties maintained that all full-line wholesalers use sophisticated routing techniques to optimise their networks and, as a result, the addition of a new customer will typically be followed by a re-organisation of the entire route network (Priddis, paragraph 121).
117. As regards the prospect of an existing wholesaler in the East Anglia region expanding to cater for new customers (where existing customer drops are nearby) the OFT believes that the marginal cost of supplying a new customer “should be very low” (Priddis, paragraph 122)

**B. PHOENIX/EAP’S EVIDENCE**

118. In its intervention statement Phoenix annexed the evidence supplied to the OFT already summarised above. Mr Cole and Mr Briggs make the following additional points, among others, in their witness statements of 7 February 2005:
  - (a) Since the merger was announced, UniChem has been approaching Phoenix and EAP customers in all parts of East Anglia offering them advantageous commercial terms, which negates any suggestion that UniChem cannot compete in East Anglia (Cole at paragraphs 36 to 39; Briggs at paragraphs 7 to 13).
  - (b) The spreadsheets submitted by Phoenix/EAP show:

- (i) that in the area to the north of the A14, Phoenix's "first-line customers" lie an average of 3.7 miles, and EAP's "first-line customers" lie an average of 5.2 miles from an independent sector customer of UniChem, AAH or Maltbys. Within the Norwich (NR) postcode region the average distances fall still further to 4.6 miles for EAP and 1.2 miles for Phoenix.
  - (ii) that the service levels of AAH, UniChem and Maltbys largely do not deteriorate the further the supplier travels from the depot to make a delivery.
  - (iii) that in the majority of East Anglia, apart from the Norwich (NR) postcode, the average cut-off times offered by a credible alternative wholesaler are very similar to, and in many cases actually later than, those offered by Phoenix and EAP. In the Norwich (NR) postcode, Phoenix and EAP offer later average cut-off times than UniChem or AAH. However, Phoenix's general market penetration in this area is smaller than that of either UniChem or AAH. It is therefore clear that cut-off times are in fact only one of the aspects of service about which customers are concerned (Cole at paragraphs 8 to 12).
- (c) UniChem's briefing paper of 10 November 2004 was incomplete and erroneous, not only because it is contradicted by the evidence in the spreadsheets, and the evidence of UniChem's approaches to Phoenix/EAP customers, but also because UniChem and AAH have numerous customers in "Zone A" shown on UniChem's isochrone where, according to UniChem, EAP/Phoenix would have a monopoly because UniChem and AAH could not supply customers in that zone. In addition, UniChem has customers even *beyond* Zone A (Cole at paragraphs 34 to 35, Briggs at paragraph 16).
- (d) UniChem failed to disclose to the OFT that it operated a system of trunking from Letchworth to Thetford, and thus gave a misleading account of its delivery capability (Briggs, paragraph 14).
- (e) It is not necessarily the case that customers furthest from the depot have later cut-off or delivery times, since the van may go to the furthest customer first, and then work back (Briggs, paragraphs 17-18).

(f) UniChem delivers to a number of customers at a greater distance from Letchworth than North Walsham which UniChem stated to the OFT was its furthest customer (Briggs, paragraphs 20 to 21).

(g) UniChem has continued to buy pharmacies in the area, including in “Zone A” shown on the RBB isochrone analysis.

119. The second witness statement of Mr Cole of 17 February 2005 states that, in an existing delivery area, a wholesaler can normally accommodate a new customer by re-configuring its network. UniChem’s suggestion that it is capacity-constrained such that it cannot add a new customer to its network in East Anglia – apparently because of time constraints – is “patently absurd”. UniChem operates nationally and adds new customers nationwide on a regular basis. UniChem has not only won new pharmacies in East Anglia, but has acquired pharmacies, as information on customer movements provided at annexes 4 and 5 of the Phoenix intervention statement show. That flatly contradicts UniChem’s evidence that it is capacity-constrained. As regards dispensing doctors, the manufacturer’s discount schemes mentioned by UniChem are insignificant in the present context.

### C. UNICHEM’S EVIDENCE

120. On 11 February 2005 UniChem filed evidence in response to the evidence of Phoenix filed on 7 February and of the OFT filed on 8 February 2005. UniChem relies first on a witness statement by Mario Patrick Johnson, Business Development Manager of UniChem since June 2004, and previously with DHL, the international logistics company.

121. Mr Johnson’s evidence challenges the OFT’s conclusion, in paragraphs 34 to 38 of the Decision, that UniChem would be able to exert an effective competitive constraint on the merged Phoenix/EAP. The points made by Mr Johnson are, in summary:

(a) UniChem finds it very difficult to compete for the business of independent pharmacies in the area north of the A14 (paragraph 5);

- (b) UniChem's independent pharmacy customers in those areas are, in many instances, a legacy from the days prior to 1990 when UniChem was a pharmacists' co-operative. Such customers accept early cut-off times for reasons of historical loyalty (paragraph 6);
- (c) UniChem has 13 such outlets (9 customers), north of the A14, excluding pharmacies that are parts of chains of 5 or more outlets. 6 of those customers have been with UniChem since at least 1988 (paragraphs 6 and 22);
- (d) in the last five years UniChem has won only 3 independent pharmacy customers in that area, and since 1990 only 7 independent pharmacies, 3 of which belong to the same chain (paragraph 7);
- (e) UniChem faces substantial practical and logistical difficulties in adding drops to existing routes, since UniChem is capacity constrained. It would be extremely difficult to reorganise the system to accommodate more than a handful of Phoenix/EAP customers (paragraph 8);
- (f) UniChem has 9 routes covering the relevant parts of Norfolk and Suffolk, based on a system of trunking to Thetford, from which vans deliver along the routes in question. In the morning the vans leave Thetford at 8.00am and return by 12.45pm. The afternoon delivery commences at 2.30pm and must be completed by 5.30pm. There is very little time for unforeseen delays. In addition, there is very little capacity to add an extra drop while ensuring that the last customer receives the order by 5.30pm (paragraphs 12 and 38).
- (g) The OFT never checked with UniChem whether it had spare capacity on the routes, which is the underlying assumption in paragraph 34 of the Decision and paragraph 95(g) of Priddis (paragraphs 13 to 15).
- (h) If UniChem were to succeed in winning more than a handful of new customers it would need to set up a new route, which would, according to paragraph 42 of the Decision, require a turnover of around £150,000 per month (paragraph 15).

- (i) The OFT did not check with UniChem the inferences to be drawn from the Phoenix spreadsheets. Average distances do not tell one whether a new customer could be accommodated within an existing route, which is the crucial question (paragraph 16).
- (j) The average distances between EAP customers and UniChem's independent customers are in any event 16.54 miles in the NR postcode area and 25.26 miles in the IP postcode area. For Phoenix customers the distances are 17.71 miles in the NR postcode area and 20.29 miles in the IP postcode area (paragraph 16).
- (k) UniChem's lack of success, despite having a full time salesman prospecting in the region, is due to the poor cut-off time (11.10 am) that UniChem is able to offer in these areas. Local cut-off time is less crucial for national or regional chains, who negotiate centrally, or for tied outlets. The tied pharmacies are less demanding in their cut-off times, having no choice in the matter (paragraphs 17 to 19).
- (l) Contrary to paragraph 103(b) of Priddis, UniChem has been able to win very few new customers on the far Norfolk coast (paragraph 20).
- (m) Recent contacts by UniChem with EAP and Phoenix customers were "to gauge their reaction" to the Phoenix/ EAP merger and to see if customers would support UniChem's case to the OFT (paragraphs 24 to 26).
- (n) UniChem is not an effective competitor in supplies to dispensing doctors, and in fact has no such customers north of the A14. Sales to dispensing doctors in East Anglia account for £107 million, about 40 per cent of the "contestable" market (paragraphs 27 to 31).
- (o) One obstacle to supplying dispensing doctors is manufacturers' discount schemes administered by Phoenix, 21 of which are exclusive to Phoenix (paragraphs 32 – 34).
- (p) The OFT's arguments that Phoenix is not a significant constraint on EAP are not soundly based (paragraphs 35 to 38).

(q) At no stage did the OFT express any doubts about UniChem's evidence or put back to UniChem the points about UniChem's capabilities which were put to the OFT by Phoenix (paragraph 39 to 40).

122. UniChem's evidence is further supported by a statement dated 11 February 2005 by Simon Richard Baker of RBB Economics. According to Mr. Baker:

- “• the parties' calculation of average distances between EAP/Phoenix independent customers and the independent customers of their competitors relies on the use of the minimum of the distances identified for each EAP/Phoenix customer (i.e. one for each of UniChem, AAH, Maltby and the closest dispensing doctor);
- the average distances between EAP/Phoenix independent customers and the independent customers of their competitors conceals a wide distribution of distances, such that many outlets are substantially further from a competitor's customer than is suggested by the average;
- although 114 EAP customers and 33 Phoenix customers are analysed in the spreadsheets, just 12 UniChem customers appear on it, indicating that any one UniChem customer is the closest UniChem customer to several EAP and Phoenix customers (one UniChem customer is treated as the nearest outlet 44 times);
- the data in the spreadsheets, as it relates to the UniChem customers, contains a number of errors when compared to UniChem's own customer list;
- the spreadsheets indicate that, of the three named competitors (UniChem, AAH and Maltby) AAH and, in particular, wholesalers to dispensing doctors, are the closest competitors to EAP and Phoenix far more of the time than UniChem and that the presence of UniChem only minimally impacts the outcome of this analysis; and
- the last drop on the delivery routes on which several of the relevant UniChem outlets are located is already close to the close of the business day and therefore extending the route to cover even one more drop may prejudice the ability of that van to reach its last customer before it closes.”

123. In his second witness statement dated 17 February 2005, Mr Johnson comments on annexes 4 and 5 of Phoenix's intervention, which had recently been disclosed to UniChem, showing the gains/losses of customers from Phoenix and EAP. According to Mr Johnson: (a) this data was not checked with UniChem; (b) the data are internally inconsistent: (c) in so far as any conclusions can be drawn from the data, the switching

is mainly between EAP and Phoenix, showing that they are each other's closest competitors; (d) there is no switching from EAP to UniChem, and very little from Phoenix to UniChem; and (e) many of the "switches" to UniChem are in fact acquisitions by UniChem for Moss chemists, acquisition being the only means by which UniChem can compete with EAP/Phoenix in this part of East Anglia.

124. Mr Johnson takes issue with Mr Cole's suggestion that UniChem's position on capacity constraints is "patently absurd." Because UniChem may have had capacity in the past, it does not follow that UniChem has such capacity now.

## **VII THE PARTIES' SUBMISSIONS**

### **A. ORIGINAL GROUND (4)**

125. Before summarising the parties' principal submissions, it is convenient to deal at the outset with Ground (4) in the original notice of application, which was that the OFT failed to take adequate account of its own previous decisions. That ground was based on legitimate expectation, duty to act consistently, and lack of reasoning, and was not developed by UniChem in any detail. In our view this ground, as a separate self standing ground, does not succeed.
126. First, UniChem's request for confidential guidance, made 5 years ago, never proceeded to the stage of a public investigation, unlike the present case. Secondly, the OFT, at that time, was bound to have regard to the comment in the 1996 MMC Report (at 2.270) that the OFT should consider referring to the MMC any acquisition of a regional full-line wholesaler by either Unichem or AAH. Thirdly, in our view it is impossible to argue that the fact that 5 years ago Unichem received negative confidential guidance, as indeed did Phoenix/EAP in the present case, makes any difference to the OFT's legal duties to decide the present case on its own facts in accordance with the Act, or that UniChem had any "legitimate expectation" of a reference being made in this case.
127. With regard to the more recent AAH/EAP decision in October 2003, AAH is the largest national wholesaler, and was also subject to the MMC's comments in 1996. In any event it is apparent that: (a) the OFT felt, in that case, that it had insufficient

information on which to make a judgment about the issue of competitive constraints (paragraph 34 of the AAH Decision), unlike the position that prevails in the present case; and (b) there was an issue as regards hospitals, which does not arise in this case (paragraph 35 of the AAH Decision). In those circumstances it does not seem to us that the fact that the OFT, in 2003, decided to refer the proposed AAH/EAP merger, on the facts of that case, takes UniChem very far for the purposes of the present case. Ground (4) therefore fails, in our judgment.

128. However, it is true that in both 2000 and 2003 the relevant authorities considered that a merger between EAP and either UniChem or AAH would raise serious competition issues. That is a background matter which we bear in mind when we consider, later in this judgment, the legality of the OFT's Decision that similar issues did not, or would not, arise in the case of a merger between EAP and Phoenix, the third national full-line wholesaler.

#### B. UNICHEM'S SUBMISSIONS

129. As the case has progressed, and the evidence has developed, all parties have refined their arguments. It seems to us that UniChem's remaining arguments may be grouped into three interrelated, submissions which represent a development from the original grounds of the notice of application. Those submissions are essentially as follows:

- (a) On the basis of the two Issues Letters, and the facts and matters set out in the Decision, the OFT had no option but to refer under section 33(1), on the basis that it cannot reasonably be said that the material set out in the Decision is adequate to dispel or remove the possibility that it "may be the case" that the proposed merger would result in a substantial lessening of competition ("SLC"), or give proper reasons for that conclusion, as indicated by the Court of Appeal in *OFT and others v. IBA Healthcare Ltd* [2004] 4 All ER 1103 (hereafter the "*IBA case*") at [57], [71] to [73] (Morritt VC) and [100] (Carnwath LJ).
- (b) The OFT failed adequately to investigate the underlying facts upon which it based its conclusion that there would not be SLC, in particular by not seeking UniChem's views on matters directly concerning UniChem. Alternatively, the OFT omitted

relevant factual considerations which it ought to have taken into account, or made material errors of its assessment of the facts: see notably the *IBA* case at [57], [86], [87], [93], [100], [106] and *Secretary of State for Education and Science v. Metropolitan Borough of Tameside* [1977] AC 1014, at 1047.

(c) The OFT failed to follow a proper procedure and/or exceeded its jurisdiction: (i) in failing to enable UniChem to see or comment on the Second Issues Letter, or on the evidence provided by Phoenix/EAP; (ii) in failing to seek UniChem's views on factual issues concerning UniChem's capability to compete with the merged concern; and (iii) in relying almost entirely on the evidence of the merging parties in seeking to resolve key and disputed issues of fact.

130. No party objected to UniChem advancing submission (c). That submission is closely connected to UniChem's other submissions concerning the adequacy of the OFT's investigation, and was developed following the further disclosure to UniChem of the documents and materials relied on by the OFT in reaching its Decision.

131. Unichem submits that under section 33(1) of the Act, the OFT is "bound to refer" where there is a real issue as to SLC, or where uncertainties resulting from an Issues Letter have not been satisfactorily dispelled: *IBA* at [57] and [100]. Belief in the possibility of SLC is sufficient to trigger a reference: *IBA* at [82]. UniChem emphasises that a decision not to refer, unlike a decision to refer, is a final decision.

132. UniChem relies on the level of concentration in the market, the market shares of the merging parties and the HHI calculation to show that, in accordance with the OFT's own *Substantive Guidance* at paragraphs 4.2 to 4.9, there was a high risk of SLC in this case. In addition, the Decision found that the parties were close alternatives in terms of geographic coverage and customers. Moreover, there were substantial barriers to entry, no buyer power, and insufficient evidence of rivalry enhancing efficiencies. The risk of tacit co-ordinated effects had been identified in the First and Second Issues Letters but is not dealt with in the Decision.

133. Moreover, submits UniChem, there was an issue of material fact directly concerning UniChem, namely UniChem's capability to impose a competitive constraint on the

merged Phoenix/EAP, which was still unresolved 7 days before the Decision (see paragraph 3 of the key concerns set out in the Second Issues Letter). However, the OFT purported to resolve that issue solely on the basis of the Phoenix evidence, without putting the points back to UniChem. There was, therefore, no proper basis on which the OFT could resolve the matters set out in the Issues Letter, and the OFT purported to do so on an incorrect view of the facts.

134. UniChem next submits that the Tribunal can review the fact finding of the OFT: (a) to ensure that the facts identified in the decision exist; (b) to determine whether the OFT has derived a proper inference or conclusion of law from facts found; (c) to determine whether the OFT has ignored relevant facts; (d) to determine whether there was adequate factual material to support the conclusion arrived at and whether the material before the OFT disclosed grounds for the conclusions reached; (e) to determine whether the OFT's beliefs were reasonable and objectively justified by the facts as they should have been found; (f) to examine why the OFT changed its mind rapidly after setting out in an Issues Letter cogent hypotheses which would, if well founded, have required a reference; and (g) to review the reasonableness of a belief formed by the OFT where there are two or more credible views as to the likelihood of SLC.

135. With reference to *E v. Secretary of State for the Home Department*, [2004] QB 1044 UniChem does not accept that "fairness" is a condition of the ability to review facts recognised by the Court of Appeal in *IBA*. However any condition as "fairness" is fulfilled in this case.

136. On the factual issues, the essential point made by UniChem is that UniChem cannot offer an effective constraint on the merged Phoenix/EAP within the contestable market, particularly in the area north of the A14. Hence the findings made in paragraphs 34 to 38 of the Decision are flawed. UniChem relies on Mr Johnson's and Mr Baker's evidence. According to UniChem:

(a) The OFT never examined capacity constraints nor asked UniChem for any evidence on this point. The OFT never asked UniChem for any details of its distribution system, whether it was capacity constrained, or its ability to add new customers. The Decision depends on the idea that the existing network can be easily expanded.

But, to be a credible competitor to Phoenix/EAP, UniChem would have to add many new customers to existing routes, which would not be feasible. It is not logical “to jump from dots on a map” to the conclusion that UniChem can easily expand its existing network structure. UniChem would have to add new routes, the incremental cost of which is high, as the Decision accepts.

- (b) The Decision is based incorrectly on the assumption that, since the marginal cost of adding a new customer to an existing network is small, it is easy to extend networks. That ignores the logistical constraints and time constraints explained by Mr Johnson. UniChem had no idea that this was a key issue until it saw the Decision.
- (c) UniChem has a market share of about 5-7 per cent of contestable sales north of the A14, compared with the merged Phoenix/EAP of between 57 and 61 per cent and AAH with 32 to 34 per cent, according to the map disclosed by Phoenix/EAP, despite the network advantages which the OFT claims that UniChem has.
- (d) That “deplorable result” is because UniChem focuses on the pharmacy chains and tied outlets, and is capacity constrained, as Mr Johnson explains.
- (e) UniChem has won only three new independent pharmacy customers in the relevant area of East Anglia the last three years, and seven since 1990.
- (f) The switching material relied on by Phoenix/EAP (but not previously disclosed to UniChem) shows no customers switching from EAP to UniChem, with 77 per cent of switches being from EAP to Phoenix. UniChem has acquired customers only by the more expensive process of acquiring pharmacies for the Moss chain.
- (g) UniChem has no sales to dispensing doctors in that area, and only 1.5 per cent of sales in East Anglia, in circumstances where dispensing doctors account for 40 per cent of total sales.
- (h) The spreadsheets were never put to UniChem, although it is clear from paragraph 35 of the Decision that the OFT viewed the spreadsheets as pivotal, in particular as

regards distances and cut-off times, and for the proposition that service levels do not necessarily decline in response to distance.

- (i) The spreadsheets are flawed for the reasons given by Mr Baker.
  - (j) If the spreadsheets show anything, they show that UniChem is not an effective competitor North of the A14.
  - (k) Mr Priddis' evidence is that a majority of customers stated that they would not be concerned with an earlier cut-off time of up to one hour. According to UniChem, the spreadsheets show that in the IP post code, UniChem's cut-off time is about one hour earlier than EAP or Phoenix, but in the NR (Norwich) post code the cut-off times for UniChem are in fact two hours, or one and a half hours earlier, than for EAP and Phoenix respectively.
  - (l) The OFT's proposition in the Decision that service levels do not deteriorate in response to distance is based on inadequate evidence and overlooks the fact that the nearer the customer is to the depot the better the service the wholesaler can offer, as was recognised by the MMC in 1996, and in both the First and Second Issues letters.
  - (m) The issue of co-ordinated effects is not dealt with in the Decision.
  - (n) The OFT failed to put any time frame on the period within which, according to the OFT, UniChem would be able to exercise a competitive constraint on Phoenix/EAP.
  - (o) Given the facts of the case, and the Issues Letters, the OFT has not discharged the burden of dispelling the concerns set out in the letter: *IBA* at [57] and [100]. Even assuming that the OFT has correctly assessed the position of AAH, the evidence is that the proposed merger would give rise, at the least, to a duopoly north of the A14, and hence a serious risk of SLC.
137. As to the alleged failure to follow a proper procedure, UniChem submits that the OFT accepted that its Decision in this case would involve obtaining and considering the views of third parties. UniChem submits that the OFT must take account of third

parties' views on key issues that directly concern them, particularly where the OFT has received conflicting views. Otherwise, the OFT has not taken into account all relevant factors. Third parties must have an adequate chance to put their views on those issues. That may involve giving third parties the Issues Letter, and any response thereto: see *IBA* at [72]. UniChem draws parallels with the procedures followed by the Competition Commission and by the European Commission (see e.g. DG Competition "*Best Practices on the conduct of EC merger control proceedings*", paragraphs 29, 34, 38, 39 and 45). However, the OFT never put any of the key points to UniChem for comment on the issue of whether UniChem might exercise a constraint on the merged concern. Nor did the OFT permit UniChem to comment on the spreadsheets, or any other part of the Phoenix/EAP evidence.

138. According to UniChem, the point about competitive constraints had been obvious from the start, and remained open until just before the very end of the OFT's proceedings. The point was not put to UniChem in the OFT's letter of 3 November 2004, and the telephone conversation of 30 November 2004 led UniChem to believe that its other evidence had been accepted.
139. UniChem does not seek a decision that the OFT should always, as a matter of course, consult third parties in detail, but in this case, where the material issue in question specifically concerned the applicant, it considers that it was entitled to know, with reasonable precision, what the OFT's thinking was on the issue and what points Phoenix had made about UniChem which affected the key decision.

### C. THE OFT'S SUBMISSIONS

140. The OFT submits that, in a case such as the present, it has a wide margin of discretion in which to exercise its judgment: *IBA* at [48]. The present case received a very careful and thorough evaluation, and several arguments advanced by Phoenix/EAP (e.g. as to a national market, the importance of short-liners and efficiency gains) were not accepted. There is no basis for saying that the OFT's decision was "*Wednesbury* unreasonable": see Wade & Forsyth, 9<sup>th</sup> Edition, pp. 362 ff, and the principles established by, among other cases, *Tameside*, cited above, *E. v. Secretary of State for the Home Department*, cited above, notably at [66] and *Brind v. Secretary of State for*

*the Home Department* [1991] AC 696, notably at [765]. The OFT accepts, however, that the Tribunal is entitled to inquire as to whether the factual basis on which the Decision proceeded was a proper and adequate basis for the OFT's evaluation of whether there was a substantial lessening of competition (Day 1, p. 76).

141. The OFT submits, essentially, that it was entitled, in the exercise of its discretion, to reach the Decision not to refer on the evidence that it had. The OFT's *Substantive Guidance* does not create a presumption of SLC, and it does not follow that there is SLC even if various matters set out in the *Guidance* are present. As to the significance of the Issues Letter of 30 November 2004, that document is only a hypothesis, which does not necessarily set out the views of the OFT or even the case team. According to the evidence of Mr Priddis, it should not be assumed that either the First Issues Letter or the Second Issues Letter, represented the views (or even the preliminary views) of the OFT at the time they were prepared: the points set out by the OFT in an issues letter are simply hypotheses. Some hypotheses may be included by the OFT in an issues letter as part of the process of "rigorous testing of the evidence" by the OFT, even where the OFT is already leaning towards a view that the particular hypothesis is not tenable on the basis of the available evidence (Priddis, paragraph 24). It should not, therefore, be inferred that the OFT "reversed its position" between 30 November 2004 and 9 December 2004.

142. According to the OFT, the questions for the Tribunal are whether there has been an error as regards established facts within the principles of *E v. Secretary of State*, cited above. Assuming that there was no error of material fact, is the conclusion that the OFT arrived at on the facts within the range of conclusions that the OFT could reasonably arrive at? Do the reasons give a logical foundation for the Decision? Has there been any relevant failure of procedure? Looking at the matter overall, was this a decision which the OFT could reasonably arrive at?

143. The four reasons for the OFT's conclusion that AAH and UniChem would offer effective post-merger competition in the outlying North and Eastern Areas of East Anglia are summarised by Mr Priddis at paragraph 94 of his first witness statement:

"(i) both AAH and UniChem already supply to all types of customer in the outlying areas where they say that they cannot compete, including to independent pharmacies and

dispensing doctors; (ii) service levels do not necessarily fall significantly as the distance from depot to customer increases; (iii) customers have said that AAH and UniChem are alternative suppliers for them; and (iv) it would be incorrect to focus only on the cut-off time for placing an order as the key parameter of “service levels” to customers.

144. The OFT stresses two essential points. First, it is the totality of customers that is relevant, because the same van supplies to all kinds of customers, whether supermarkets, chains, tied outlets, independent pharmacies, or dispensing doctors. UniChem has over 80 van delivery drops in the East Anglia region. Secondly, delivery routes are not fixed. Routes, or the entire route network, can be re-configured to absorb a new customer (paragraph 43 of the Decision). It is important to look at the network, not the route.
145. As regards the evidence submitted by UniChem, the isochrone analysis was incomplete and unreliable, first, because UniChem plainly was delivering to a large number of customers beyond what it said was its effective delivery range; and secondly because, of the 40 pharmacies within Zone A, where UniChem said it could not compete, two were being supplied by UniChem and 20 by AAH. Moreover, customer feedback supported the view that customers would be willing to switch: see Priddis, 51, 105.
146. As to service levels and cut-off times, the OFT relies on Mr Priddis’ witness statement. According to Mr Priddis, the customer evidence was that cut-off time was only one of a number of factors in the customer’s decision. A difference in cut-off time of up to one hour would be acceptable to the majority of customers. Cut-off times would not therefore be a barrier to UniChem competing in the outlying parts of East Anglia. The spreadsheets showed that overall UniChem’s service in that area was competitive with EAP. The evidence provided by EAP/Phoenix showed customer switching and UniChem expanding its routes.
147. As regards the spreadsheets, the OFT accepted during the hearing that “there is force in UniChem’s criticism in the use of average distances and so on” (Day 2, pp. 18, 19), but submitted that the OFT had not accepted the arguments which Phoenix/EAP were advancing on the basis of the spreadsheets. The OFT had used the spreadsheets simply to establish where the relevant outlets were, and what were their cut-off and delivery

times. UniChem's customers were accepting much earlier cut-off times than Phoenix or EAP customers, but were apparently content with the service UniChem was supplying.

148. As to capacity constraints, if UniChem was operating under capacity constraints it would have been the most obvious point to make in their response to the OFT's letter of 3 November 2004, especially since UniChem had engaged RBB Economics to assess the proposed transaction "founded on the actual logistics and practices of pharmaceutical wholesale supply". However, UniChem failed to raise the issue and it was not a point the OFT needed to go back to UniChem on. Even now, before the Tribunal, the map produced by UniChem of its routes is incomplete. UniChem's evidence does, however, confirm the OFT's analysis that UniChem supplies many different kinds of customer on the same route.

149. The OFT finally submitted that, even if there had been a failure to consult amounting to unfairness, it would make no difference. According to the OFT, the fact that UniChem's more distant customers were partly a historical legacy was irrelevant; those customers had remained competitive and had not stayed with UniChem "out of charity". The mistakes made by UniChem in supplying information to the OFT do not give rise to a failure to consult; UniChem cannot complain if the OFT relies on that information. The point that UniChem has made few gains of customers since 1990 is not decisive, since it is UniChem's presence as a potential supplier that is important. The route information supplied by UniChem to the Tribunal was incomplete, but overall confirms the OFT's analysis that tied, non-tied and hospital customers are all served from the same van. UniChem's argument that it would have to open a new route if more than "a handful of customers" wish to switch, does not contradict the OFT's position since a "handful", such as five new customers, would justify the opening of a new route. Phoenix's manufacturer discount schemes were never raised by UniChem before the OFT, although they could have been. On the importance of cut-off times for the afternoon drop, the OFT was entitled to prefer the evidence of customers to the evidence of Mr Johnson. Any relief to which UniChem might otherwise be entitled should therefore be refused, in the Tribunal's discretion.

#### D. PHOENIX'S SUBMISSIONS

150. According to Phoenix, who support all the points made by the OFT, the evidence shows that UniChem can supply tied, independent and multiple pharmacies throughout the East Anglia region. There is no suggestion that any of those customers are not able to compete, whether because of earlier cut-off times, or for any other reason. In any event, cut-off times apply only to the afternoon delivery, and 70 per cent of supplies are made in the morning.
151. As regards the cost of new routes, Phoenix contends that its original estimate provided to the OFT that it would cost about £150,000 to break even, with 5 to 6 new customers, was made in the context of the cost of opening a new depot in a new area. The same did not apply to a new route in an existing area, where the existing routes could be reorganised. Paragraph 43 of the Decision makes this clear.
152. As regards dispensing doctors, Phoenix draws attention to paragraph 5.8 of UniChem's submission of 10 November 2004, where UniChem states that:
- “It is unlikely that UniChem would consider it worthwhile to target supply to dispensing doctors, faced with the significant cost of introducing new, long van routes to sparsely populated rural areas with little likelihood of being able to generate meaningful market share growth.”
153. According to Phoenix, UniChem could have developed this point but did not do so. There is, in fact, no reason why UniChem should not be able to supply dispensing doctors if it wished to do so, especially since UniChem has a sales representative in East Anglia seeking new business.
154. According to Phoenix, the Tribunal should review the evidence that was before the OFT. The issues before the Tribunal are “multi-layered”, the first issue being whether it was reasonable for the OFT to reach the factual conclusions that it did. On that issue, the Tribunal should not substitute its own judgment. UniChem's argument based on procedural failure is, according to Phoenix, only another way of addressing the first issue, namely was the OFT's analysis of the facts such that it was unreasonable to make findings without obtaining further evidence?

155. According to Phoenix, once it is decided that, on the facts, it was reasonable for the OFT to conclude that AAH and UniChem would impose competitive constraints on the merged Phoenix/EAP, there is no real issue as to the second question, whether the OFT was right to infer that there would be no SLC. Everything turns on the reasonableness of the OFT's factual conclusion as to the existence of competitive constraints.
156. According to Phoenix, on the factual issue of competitive constraints, UniChem's isochrone analysis attached to its submission of 10 November 2004 was wholly flawed, particularly since it related only to independent customers. The OFT was fully entitled to prefer the other evidence to the effect that UniChem was in fact delivering all over East Anglia both to tied and independent customers, both of whom had exactly the same cut-off and delivery times. Moreover, UniChem made no mention of its trunking system to Thetford and understated the distance from the depot of its furthest customer. The switching data provided to the OFT by Phoenix show UniChem acquiring pharmacies.
157. According to Phoenix, UniChem is conspicuously unable to suggest that the Decision "falls outside the bounds of reasonable judgment," *Moyna v Secretary of State for Works and Pensions* [2003] 4 All ER 162, at [25], cited with approval by Carnwath LJ in *IBA* at [99].

## **VIII SECTION 120(4) AND THE IBA CASE**

### *The IBA case*

158. Section 120(4) of the 2002 Act requires the Tribunal, in this case, to "apply the same principles as would be applied by a court on an application for judicial review". Guidance as to the proper approach is to be found in the judgment of the Court of Appeal in *IBA*. In that case both Sir Andrew Morritt V-C and Carnwath LJ gave judgments with which Mance LJ agreed.
159. The Vice-Chancellor said that the words in section 33(1) of the 2002 Act should be applied in accordance with their ordinary meaning. As to the construction of that section he said:

“44. First, it is apparent from s 33(1) and the contrast between belief and suspicion demonstrated in ss 42 and 131 that it is necessary for the OFT to form the relevant belief. Thus some form of mental assent is required as opposed to the less positive frame of mind connoted by a suspicion...

45. Second, the belief must be reasonable and objectively justified by relevant facts. In *Secretary of State for Education and Science v Metropolitan Borough of Tameside* [1977] AC 1014 the question was whether the Secretary of State ‘is satisfied’. Lord Wilberforce pointed out [1977] AC 1014 at 1047) that -

*‘This form of section is quite well known, and at first sight might seem to exclude judicial review. Sections in this form may, no doubt, exclude judicial review on what is or has become a matter of pure judgment. But I do not think that they go further than that. If a judgment requires, before it can be made, the existence of some facts, then although the evaluation of those facts is for the Secretary of State alone, the court must enquire whether those facts exist, and have been taken into account, whether the judgment has been made on a proper self direction as to those facts, whether the judgment has not been made on other facts which ought not to have been taken into account.’*

It was not disputed that the belief must be reasonably held as accepted in para 3.2 of the OFT guidance...

46. Third, by themselves, the words ‘may be expected to result’ in para (b) of both ss 33(1) and 36(1) involve a degree of likelihood amounting to an expectation. In para 182 of its judgment the CAT expressed the view that these words connoted more than a possibility and adopted what they described as a crude way of expressing the idea of an expectation as a more than 50% chance. No doubt this is right when applied to the single question which the Commission is required to answer under s 36(1)(b).

47. Fourth, however, the belief that must be held by the OFT under s 33(1) is ‘that it is or may be the case that’ ... The test for the OFT is only whether the anticipated merger ‘may result in a relevant merger situation’ or not. This is consistent with the respective functions of the OFT and the Commission. The former is a first screen, the latter decides the matter. Accordingly, although the word ‘may’ appears in the opening phrase of s 33(1) and in para (b) of both ss 33(1) and 36(1) it is clear that the opening phrase ‘believes that it...may be the case’ imports a lower degree of likelihood than para (b) in ss 33(1) or 36(1) would itself involve. That lower degree of likelihood might, for example, exist in circumstances where the work done by the OFT did not justify any positive view, but left some uncertainty, and where the OFT therefore believed that a substantial lessening of competition might prove likely on further and fuller examination of the position (which could only be undertaken by the Competition Commission).

48. At the other end of the scale it is clear that the words ‘may be the case’ exclude the purely fanciful because the OFT acting reasonably is not going to believe that the fanciful may be the case. In between the fanciful and a degree of likelihood less than 50% there is a wide margin in which the OFT is required to exercise its judgment. I do not consider it possible or appropriate to attempt any more exact

mathematical formulation of the degree of likelihood which the OFT acting reasonably must require.”

160. Referring to certain passages of the Tribunal’s judgment concerning the contrast between the position taken by the OFT in the issues letter in that case and the decision adopted a few days later, the Vice Chancellor said at [57]:

“...Their comments are readily understandable in the light of the OFT’s apparent change of view in the course of a few days. If the hypotheses set out in the issues letter were well founded then the OFT was bound to refer. The CAT was entitled and bound to examine with care why such hypotheses were rejected in so short a time and whether their rejection was justified, particularly in view of the statutory duty to give reasons imposed by s 107.”

161. As concerns the nature of the review to be carried out by the Tribunal, and in particular the question of “*Wednesbury* unreasonableness” derived from the well known case of *Associated Provincial Picture Houses Limited v. Wednesbury Corporation* [1948] KB 223, CA, the Vice-Chancellor said that the correct test was that formulated by Lord Wilberforce in the *Tameside* case, quoted above (see paragraph [66] of the judgment). The Vice-Chancellor held that the Tribunal had rightly considered the question whether the facts had been sufficiently found in the OFT’s decision and upheld the Tribunal’s view that the OFT could not reasonably have come to the decision it did: see [67] to [74]. In particular, the matters relied on by the OFT did not “overcome the anti-competitive features which do exist to such an extent as to remove the requisite likelihood of a significant lessening of competition” [73].

162. Carnwath LJ saw the key to the issue of the construction of section 33 as being the contrast between the respective roles of the OFT under section 33 and the Competition Commission under section 36:

“82. The difference between sections 33 and 36 lies in the nature of the conclusion to be arrived at. The question for the OFT is whether it ‘believes that SLC is or may be the case’; the Commission is required to ‘decide’ whether there will be SLC. Thus for the OFT, unlike the Commission, belief in the possibility of SLC is enough to trigger the next stage.”

163. Carnwath LJ noted at [86] that there were three possible views for the OFT to take under the wording of section 33(1):

“(1) that the OFT believed that there would be SLC; (2) that the OFT believed that there might be SLC; and (3) that the risk of SLC was sufficiently low for the OFT to believe there neither was nor might be a SLC. (1) and (2) follow from the words “is or may.” (3) is their implicit obverse.”

164. Carnwath LJ then stated:

“87. ...The material placed before the Tribunal represented the results of the first-stage investigation. The issue for the Tribunal was whether on that material the OFT could reasonably take the view that the issues (so clearly defined by the ‘issues letter’) had been sufficiently resolved for it to be satisfied that there would not be SLC. If not, it was its duty to refer the matter for ‘in-depth’ investigation by the Commission.”

165. As to the “intensity of review” Carnwath LJ pointed out that the legal concept of “reasonableness” is a flexible one, and that the intensity of review varies with the statutory context. A particular factor is whether the question at issue is properly within the province of the court: see [90] to [92]. Carnwath LJ said at [92]:

“On the other hand where the question is the fairness of a procedure adopted by a decision-maker, the court has been more willing to intervene: ‘such questions are to be answered not by reference to *Wednesbury* unreasonableness, but in accordance with the principles of fair procedure which have been developed over the years, and of which the courts are the author and sole judge’ (see *R v Panel on Take-overs and Mergers, ex p Guinness plc* [1989] 1 All ER 509 at 531, [1990] 1 QB 146 at 184 per Lloyd LJ).”

166. Carnwath LJ said at [93]:

“The present case, as the Tribunal observed (para 223), is not concerned with questions of policy or discretion, which are the normal subject matter of the *Wednesbury* test. Under the present regime (unlike the 1973 Act), the issue for the OFT is one of factual judgment. Although the question is expressed as depending on the subjective belief of the OFT there is no doubt that the court is entitled to enquire whether there was adequate material to support that conclusion.”

167. Carnwath LJ summed up the relevant principles at paragraph [100] in these terms:

“...Those principles, whether applied by a court or a specialised tribunal, are flexible enough to be adapted to the particular statutory context. No doubt the existence of such a special jurisdiction will help to ensure consistency from case to

case; and the expertise of the tribunal will better fit it to deal with such cases expeditiously and with a full understanding of the technical background. However, the essential question was no different from that which would have faced a court dealing with the same subject matter. That question was whether the material relied on by the OFT could reasonably be regarded as dispelling the uncertainties highlighted by the issues letter. That question was wholly suitable for evaluation by a court. It involved no policy or political judgment, such as would be regarded as inappropriate for review by the Administrative Court.”

*Tetra Laval*

168. We also note the recent judgment of the European Court of Justice in Case C-12/03 P *Commission v. Tetra Laval*. That case was an appeal from a judgment of the Court of First Instance by which the Court of First Instance had annulled a decision of the European Commission declaring a merger to be incompatible with the common market pursuant to Council Regulation (EEC) No. 4064/89. As to the scope of review by the Court of First Instance, the Court of Justice held, at paragraph 39:

“Whilst the Court recognises that the Commission has a margin of discretion with regard to economic matters, that does not mean that the Community Courts must refrain from reviewing the Commission’s interpretation of information of an economic nature. Not only must the Community Courts, inter alia, establish whether the evidence relied on is factually accurate, reliable and consistent but also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it. Such a review is all the more necessary in the case of a prospective analysis required when examining a planned merger with conglomerate effect.”

169. We regard that approach as close to that of the Court of Appeal in *IBA*. The *Tetra Laval* case is, in any event, of interest as to the approach to be adopted by a Court exercising a similar jurisdiction to that of the Tribunal. We also note that under Regulation (EEC) No. 4064/89, and now Regulation (EC) No. 139/2004 there is scope for mergers which originally fall for consideration under the Community system to be dealt with by the OFT (and vice versa): see Articles 9 and 22.

*The Tribunal's approach*

170. The OFT contended, with reference to [48] of *IBA*, and the well known principles of administrative law, that it had a wide “discretion” as to the evaluation of the facts and in forming a view about SLC.
171. With respect, we do not consider that the OFT’s submission had quite the right emphasis. First, it is common ground that section 33(1) imposes a duty, not a power. There must therefore be a limit to the extent to which the OFT’s power of evaluation of the facts may undermine its duty. Indeed, it is accepted that the OFT’s ‘belief’ under section 33(1) must be objectively justified. Secondly, as *IBA* points out, section 33(1) is not concerned with policy or political issues, but with a judgment of facts: Carnwath LJ at [100]. The Court of Appeal in *IBA* accepted at [66] that the test is as set out by Lord Wilberforce in *Tameside* at 1047:
- “If a judgment requires, before it can be made, the existence of some facts, then, although the evaluation of those facts is for the Secretary of State alone, the court must enquire whether those facts exist, and have been taken into account, whether the judgment has been made on a proper self direction as to those facts, whether the judgment has not been made on other facts which ought not to have been taken into account.”
172. In those circumstances we would not ourselves use the term “discretion” which has connotations of policy, in the present context. The more correct concept is one of a margin of judgment or evaluation of the facts. We also accept UniChem’s point that when in [48] of *IBA* the Vice Chancellor said “between the fanciful and a degree of likelihood of less than 50% there is a wide margin in which the OFT is required to exercise its judgment”, he was not implying that the OFT had a wide discretion, only that the degree of likelihood of a SLC will vary widely depending on the circumstances.
173. We also accept Phoenix’s submission that the Tribunal’s approach must be “multi-layered”. The first question is whether the OFT has properly evaluated the primary facts of the case. The second question is whether, on those facts, the OFT was entitled to draw the conclusion that there was an insufficient likelihood of SLC. We agree with

Phoenix that the issue in the present case turns on the first question, namely whether the OFT has correctly evaluated the primary facts, and has followed a proper procedure.

174. A succinct expression of the legal test, as the OFT reminds us, is set out in *Brind*, cited above, by Lord Lowry at paragraph 765: “*could a decision maker acting reasonably have reached this decision?*”. However, it is clear from Carnwath LJ’s judgment in *IBA* at [100] that the concept of “reasonableness”, and the accompanying intensity of review, varies with the statutory context. In the present context, the Tribunal’s review may properly be more intense than it would be if issues of policy or politics were involved. Indeed, it appears to be common ground that the Tribunal has jurisdiction, acting in a supervisory rather than appellate capacity, to determine whether the OFT’s conclusions are adequately supported by evidence, that the facts have been properly found, that all material factual considerations have been taken into account, and that material facts have not been omitted. We see nothing in *E v. Secretary of State*, in which Carnwath LJ gave judgment shortly before *IBA*, to contradict the above approach.
175. Similarly, issues of a fair procedure, which are important in the present case, are undoubtedly matters for the Tribunal. The question of a fair and proper procedure arises independently of *Wednesbury* reasonableness: *IBA* at [92].

## **IX THE TRIBUNAL’S ANALYSIS**

### **1. OVERVIEW**

176. In our view there is no doubt that the OFT conducted a full investigation in this case and considered carefully and professionally a large number of relevant issues. On many points the OFT’s conclusions are either undisputed or within the bounds of reasonableness, as we show below. However, the central difficulty that arises in these proceedings is that the OFT purported to make findings of primary fact about the logistics and economics of UniChem’s distribution system, UniChem’s past pattern of success in East Anglia, and UniChem’s service levels, on the basis of information supplied largely by the merging parties, without checking certain facts with UniChem

or discussing with UniChem the inferences about UniChem which the OFT was minded to draw from the material supplied by the merging parties.

177. UniChem now disputes many of the facts relied on by the OFT. In our view, it is impossible to say, in the context of judicial review, that UniChem's points are not material to the OFT's reasoning in the Decision or are without substance. Nor is the Tribunal able, in the context of a review, to resolve disputed issues of fact. To adopt that approach, in our view, would be to substitute ourselves for the decision maker. It follows that we see no alternative but to remit this matter to the OFT to enable a new decision to be adopted.

## 2. THE MARKET CONTEXT

178. The context in which this case arises may be summarised as follows. AAH and UniChem are the two largest pharmaceutical wholesalers in the United Kingdom. They both own major pharmacy chains, Lloyds and Moss respectively, and deal nationally with supermarkets and national chains. The MMC Report found that they deliver all over the country (see 4.45). According to Phoenix, AAH has 35% of the total market, and UniChem 27%, giving a combined market share at national level of over 60%. UniChem's turnover in pharmaceutical wholesaling is apparently some £1.9 billion. AAH's turnover in 2002 was some £2.7 billion.

179. Phoenix is the third largest pharmaceutical wholesaler in the United Kingdom but does not appear to have significant contracts with national chains or supermarkets, nor in the present context, significant business with hospitals.

180. Phoenix claims a national market share of 16% and has a turnover of £682 million in the United Kingdom. EAP operates almost entirely in East Anglia, and has a turnover of some £111 million. The merged concern would thus be substantially smaller than either AAH or UniChem.

181. The proposed merger raises no concerns at national level, nor as regards hospitals, OTC products or generic drugs. The competitive ambit of the merger is limited to the supply of Ethical pharmaceuticals to independent retail pharmacies (i.e. pharmacies with less

than five outlets, according to paragraph 5 of the Decision) and dispensing doctors in the East Anglia region, and in particular in the area north of the A14.

182. EAP's principal depot is in Norwich, and Phoenix serves East Anglia from a depot in Cambridge. Accordingly there is an issue as to the competitive overlap of the two companies, and whether, as a result of the merger, a substantial lessening of competition may occur in the wholesaling of Ethical pharmaceuticals to independent retail pharmacies and dispensing doctors in East Anglia, notwithstanding that faster-moving Ethicals are in fact also supplied by short-liners who are excluded from the OFT's analysis.
183. Market shares in this context can be looked at in various different ways, namely: (a) the "contestable" market, excluding customers such as tied chains for whose business Phoenix/EAP cannot compete; or (b) the "overall" market, looking at shares of supply which include all outlets, including UniChem and AAH's tied outlets, supermarkets and national chains. In the former case it is possible to present figures for retail pharmacies and dispensing doctors either together or separately.
184. Some of the figures produced in this case are not always easy to reconcile. However on the basis of Phoenix/EAP figures, the various market shares by value may be set out as follows in Tables 1 and 2. The information appears to relate to 2004 and to post codes PE, NR, IP, CO, CB and CM. The area north of the A14 is principally post codes NR and IP.

**Table 1 – Market Shares in the contestable sector**

**1.1 Independent pharmacies and dispensing doctors in East Anglia**

<u>Pre-merger</u>		<u>Post-merger</u>	
AAH	36.6%	Phoenix/EAP	47.2%
EAP	33.1%	AAH	36.6%
Phoenix	14.1%	UniChem	13.9%
UniChem	13.9%	Others	<u>2.3%</u>
Others	<u>2.3%</u>		100%
	100%		

**1.2 Independent pharmacies in East Anglia**

<u>Pre-merger</u>		<u>Post-merger</u>	
AAH	52.8%	AAH	52.8%
UniChem	22.9%	UniChem	22.9%
EAP	14.2%	Phoenix/EAP	21.3%
Phoenix	7.1%	Others	<u>3.0%</u>
Others	<u>3.0%</u>		100%
	100%		

**1.3 Dispensing doctors in East Anglia**

<u>Pre-merger</u>		<u>Post-merger</u>	
EAP	59.4%	Phoenix/EAP	83.1%
Phoenix	23.7%	AAH	14.2%
AAH	14.2%	UniChem	1.5%
UniChem	1.5%	Others	<u>1.0%</u>
Others	<u>1.0%</u>		100%
	100%		

**Table 2 – Market Shares: All pharmacies and dispensing doctors in East Anglia**

<u>Pre-merger</u>		<u>Post-merger</u>	
AAH	44.8%	AAH	44.8%
UniChem	25.9%	Phoenix/EAP	28.0%
EAP	19.5%	UniChem	25.9%
Phoenix	8.5%	Others	<u>1.3%</u>
Others	<u>1.3%</u>		100%
	100%		

185. In terms of value, Phoenix gives the following figures for the supply by full-line wholesalers of Ethical pharmaceuticals in East Anglia:

	<b><u>£ million</u></b>
Independent Pharmacy	147
Multiple Pharmacy (Lloyds, Moss, Rowlands, Boots)	151
Dispensing Doctors	105
Supermarkets	<u>26</u>
	<u>451</u>

That gives a total value for the ‘independent’ sector of some £252 million, of which £147 million is independent pharmacies and £105 million dispensing doctors.

186. It has been difficult to ascertain reliable figures expressed in numbers of outlets in East Anglia. That is partly because, although the Decision defines an ‘independent’ pharmacy as one with five or more outlets, no common definition has been used in the investigation. Sometimes the word ‘independent’ simply means “non-tied,” i.e. including supermarkets. However, in its submission of 2 June 2004 Phoenix told the OFT that EAP supplies 38 independent retail pharmacies, and Phoenix supplies 32 independent retail pharmacies. According to that submission, EAP supplies 88 dispensing doctors and Phoenix supplies 26 dispensing doctors. UniChem apparently supplies some 57 Moss chemists, 18 independent retail pharmacies (although less on the definition used in the Decision), and 21 Boots outlets. UniChem states that it supplies very few dispensing doctors, and none north of the A14. AAH apparently supplies 52 Lloyds chemists, and 33 Co-op outlets, in addition to some independent outlets and dispensing doctors, but information before the Tribunal as to AAH is sparse.

187. The maps at Appendix 1 and 2 to this judgment, supplied by Phoenix, show Phoenix/EAP outlets, and UniChem customers, respectively, in the area north of the A14<sup>3</sup>.

188. The central finding made by the OFT in the Decision is that AAH and UniChem already deliver to tied chains, supermarkets and independent customers in the region of East Anglia (paragraph 34). From that, the OFT concludes that AAH and UniChem are

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<sup>3</sup> EAP is referred to as “Hawk” in the key to the map at Appendix 1.

relatively well placed to compete for business throughout East Anglia, as a result of “the network benefits they gain from existing customer density, and from customer clusters over longer distances”.

189. UniChem has not challenged the central fact that it is providing deliveries to outlets of all kinds throughout East Anglia, whether Moss, Boots or other customers, including in the area north of the A14. The number of UniChem ‘drops’ appears to be significant, roughly equivalent, apparently, to Phoenix/EAP’s retail pharmacy customers. The evidence shows, in particular, that UniChem is delivering in the main centres of population in the north and east of East Anglia such as Norwich, Great Yarmouth, Lowestoft and King’s Lynn, as well as other places. Accordingly, the conclusion that UniChem is able to deliver throughout East Anglia does not seem to us to have been an unreasonable conclusion for the OFT to reach on the evidence. Similarly, the conclusion that the existence of that delivery “network” would be an advantage to UniChem does not seem to us to be an unreasonable conclusion either. A similar point was made by the MMC at paragraph 2.40 of the 1996 Report.

190. We also consider that it was not unreasonable for the OFT to place only limited weight on UniChem’s isochrone analysis. Although it is quite true that that analysis was focusing on independent pharmacies, and UniChem never claimed that it could not deliver at all beyond the bounds described, in our view the isochrone analysis understated the extent to which UniChem was in fact delivering in the various zones, notably to the tied Moss outlets. In addition, it does appear that the contention that AAH and UniChem could not deliver within Zone A shown on the isochrone founders on the evidence that they are already delivering to customers in that area. The OFT’s conclusion that the UniChem evidence gave an incomplete view of the competitive picture was not in our view unreasonable.

191. Thirdly, it is not disputed that there are independent and tied pharmacies in East Anglia which are prepared to accept the service levels offered by UniChem.

192. Fourthly, the OFT had evidence from customers that they would be willing to switch suppliers from EAP if necessary, and saw no barrier in doing so (paragraphs 36, 38 of the Decision).

193. These factors, taken together, form in our judgment solid factual findings in support of the Decision which are not disputed. The question then is whether, on the basis of that foundation, the OFT then drew further conclusions unsupported by adequate evidence, or fell into procedural error, and if so whether the Decision is thereby vitiated for those or any other reasons.

### 3. ANALYSIS OF UNICHEM'S SUBMISSIONS

#### A. GENERAL

194. There is no discussion, in the Decision, of what is meant by a "substantial" lessening of competition in the context of the present case. However, the Decision, the confidential guidance and the Issues Letter which preceded the Decision, are predicated on the basis that the lessening of competition resulting from the proposed Phoenix/EAP merger could be "substantial" for the purposes of section 33(1)(b) of the Act.

195. The Decision not to refer is based on the OFT's finding that the merged concern would, after all, face sufficient competitive constraints, notably from AAH and UniChem, such that any lessening of competition arising from the merger would not be "substantial". The Decision is not, for example, based on the proposition that the merged Phoenix/EAP will be in a stronger position to compete with UniChem and AAH so that any loss of competition is not "substantial". Similarly the Decision is not based on the proposition that AAH alone would provide a sufficient competitive constraint, even if UniChem did not do so. As UniChem points out, even if AAH remains as a competitive constraint, but UniChem does not, that is a different factual situation from that on which the Decision is based.

196. In those circumstances, it seems to us, our review under section 120 of the Act is limited to the legality of the Decision within the framework in which it was taken, and that it is not open to us to consider any wider questions.

197. Against that background, UniChem argues, first, that section 33(1) imposes a duty on the OFT, not a discretion. In this case, the merged concern would be the largest full-line wholesaler for Ethical pharmaceuticals in East Anglia with 49% of that market, and

a near monopoly (83%) in respect of supply to dispensing doctors. There are barriers to entry and no buyer power. All the indications set out in the OFT's *Substantive Guidance* such as large market shares, high concentration ratios, and a high HHI are present. In addition, the OFT raised substantial concerns in the First Issues Letter, the confidential guidance, and the Second Issues Letter of 30 November 2004. According to UniChem, only a short time later, by 9 December 2004, the OFT changed its view, but it had no proper basis for doing so. In all those circumstances, says UniChem, the OFT was bound to refer: see *IBA* at [57].

198. The OFT submits, principally, that it was fully entitled to arrive at the decision not to refer on the basis of the evidence. Secondly, although it respected its *Substantive Guidance*, that *Guidance* should not be applied rigidly and every case must be judged on its own facts. Thirdly, undue weight should not be attached to the Issues Letters which may not reflect the views of the case team or the OFT.

199. As to the *Substantive Guidance*, it seems to us that parts of Mr Priddis' witness statement could perhaps be read as tending, no doubt unintentionally, to downplay the importance of the *Guidance* (see Priddis, 63 to 78). However, the OFT is required to publish the *Guidance* (section 106 of the Act), and the *Guidance* is widely relied on by parties and their advisers. It is true that the *Guidance* is no more than that. It is also true that paragraph 4.4 of the *Guidance* states that there is "no presumption" that market shares, concentration ratios, or the HHI calculations identified in paragraph 4.3 may give rise to SLC, and that further investigation is always required, which is correct. However, in other areas of competition law persistently high market shares are regarded as at least *prima facie* indicators of market power. In our view, where a number of the various indicators set out in the *Guidance* (for example at paragraphs 4.2 to 4.9) are present, there will normally need to be good reasons for a finding that there is no SLC: see also *IBA* at [27] and [74].

200. As to the status of an Issues Letter, paragraph 5.17 of the OFT's "*Mergers Procedural Guidance*" states that an Issues Letter is sent "when complex or material competition issues" are raised. Although we accept that the Issues Letter is a hypothesis, which does not necessarily reflect the provisional or final view of the OFT, it is difficult to resist the conclusion that, if an Issues Letter is sent, there is or is likely to be a material

or complex competition issue in the case which has not yet been definitively resolved. In other words, the question whether “it may be case” remains open. In the present case, the Second Issues Letter of 30 November 2004 was in fact followed by a lengthy submission by Phoenix on 3 December 2004, submitted after what appears to have been a relatively detailed discussion at the meeting on 2 December. It seems to us difficult to suggest that the matters at issue in this case had been definitively resolved prior to the sending of the Second Issues Letter or the meeting on 2 December 2004.

201. It appears, therefore, that the situation in the present case has some similarity to the situation that arose in *IBA*. We fully accept that the sending of an Issues Letter does not oblige the OFT to refer. If, however the OFT has sent an Issues Letter and then shortly afterwards decides not to refer, it must be shown that the requisite likelihood of SLC has been removed, and that the material relied on by the OFT can reasonably be regarded as dispelling the uncertainties highlighted by the Issues Letter: *IBA* at [73], [100]. The Tribunal is entitled and bound to inquire whether the rejection of the hypotheses in the Issues Letter was justified: *IBA* at [57].

202. The Second Issues Letter of 30 November 2004 included the following “key competition concerns”:

- “1. The merger will reduce from four to three the number of Full-liners serving the East Anglia Region. This change in market structure may result in a loss of competition between the parties and may also contribute to reduced incentives for the remaining players to compete as strongly as before. There is therefore the risk that the merger may lead to a lessening in competition in which all firms find it profitable individually to offer less favourable terms or lower their level of service.
2. In terms of customer base, both parties tend to mainly supply Independent Pharmacies and Dispensing Doctors and so compete for the same customers. In the East Anglia Region, the parties will have a combined share of supply of 21% to Independent Pharmacies and 83% to Dispensing Doctors. AAH and UniChem by contrast compete more actively in the supply to multiple pharmacies and supermarkets. Therefore for Dispensing Doctors, at least, the parties may represent each other’s next best alternative.
3. The merger may create a monopoly in certain parts of East Anglia where neither AAH nor UniChem can provide an effective service. AAH and UniChem are at a disadvantage geographically and, as noted above, have a different customer focus. They therefore may not provide as strong a competitive constraint on the parties as do the parties on each other. In terms of the level of service offered (particularly

cut-off times for twice daily deliveries) the offering provided by EAP may be likely to be the next best alternative for a Phoenix customer and vice versa.

...

5. The merger may increase the prospect of the remaining three Full-liners in the East Anglia Region tacitly or explicitly coordinating their behaviour. This might occur either through geographic market sharing or through coordination on the level of discounts or service.
6. In summary, concerns arise that the merger may create a substantial lessening of competition in the supply of Ethicals to Customers in the East Anglia Region resulting in the lowering or removal of discounts, lower service levels, and the offering of less favourable terms.”

203. The extent to which EAP/Phoenix exercise a competitive constraint on each other is dealt with at paragraphs 31 to 33 of the Decision, cited above. It is true that the matter is raised in the notice of application and that Mr Johnson makes certain points about that, for example as to gains/losses between these two companies. However, the main thrust of UniChem’s submissions is directed to the issue of UniChem’s ability to be a competitive constraint on the merged concern, rather than on the loss of competition between EAP and Phoenix.

204. In those circumstances we are not persuaded, on the material available to us, that there are sufficient grounds of review for disturbing the OFT’s findings, in paragraphs 31 to 33 of the Decision, regarding the constraint that Phoenix currently offers to EAP.

205. However the Second Issues Letter also suggests:

- (1) That the change in market structure resulting from the merger will not only lead to a loss of competition but may contribute to a reduced incentive for the remaining players to compete as strongly as before. There is a risk that all firms would find it profitable individually to offer less favourable terms or lower their level of supply.
- (2) AAH and UniChem compete almost entirely in the supply to multiple pharmacies and supermarkets, and that the merging parties are each other’s closest competitors for dispensing doctors.

- (3) There may be a monopoly in parts of East Anglia where UniChem and AAH cannot provide an effective service. AAH and UniChem are at a disadvantage geographically and have a different customer focus. In terms of the level of service (particularly cut-off times) EAP and Phoenix are each other's closest alternative.
- (4) There may be a risk of AAH, UniChem and Phoenix/EAP tacitly coordinating their behaviour.

206. In our view paragraphs 34 to 38 of the Decision reply in substance to most of these points, for example in that the OFT finds that AAH and UniChem are supplying throughout East Anglia, that the service levels they offer are acceptable to their customers, including independent customers, that customers would be prepared to switch, and that UniChem could supply dispensing doctors. However, given the concerns set out in the Second Issues Letter, sent at a time when the OFT had virtually completed its investigation, it is in our view particularly important that the facts upon which the OFT based its conclusion in the Decision were adequately found, on the basis of good procedure, and are sufficient to remove or dispel the concerns raised in the Issues Letter.

207. The Second Issues Letter also suggests that the merger might give rise to a reduced incentive to compete, or that the parties might tacitly coordinate. Those concerns are not, as far as we can see, addressed in the Decision. However, UniChem has not suggested that it would have no incentive to compete, only that it would be difficult to do so, nor has UniChem suggested that it would tacitly co-ordinate with the other parties to refrain from competing. Accordingly, we do not pursue those issues in the context of these proceedings.

## **B THE MAIN FACTUAL ISSUES**

208. The factual disputes in the evidence which have arisen in this case, and the related procedural issues, focus on four main areas:

- (a) whether UniChem is or would be capacity-constrained in adding new customers to existing routes, and the difficulties allegedly involved in adding extra drops to existing routes or adding new routes;
- (b) whether UniChem's existing pattern of success shows that UniChem is or is likely to be a credible competitor in the parts of East Anglia north of the A14;
- (c) whether any conclusions can properly be drawn from the spreadsheets supplied by Phoenix/EAP to the OFT, in particular as to cut-off times and whether service levels deteriorate with distance from the depot; and
- (d) the correctness of the OFT's conclusions as regards dispensing doctors.

209. Although similar issues could arise in relation to AAH, the findings in the Decision about AAH, who is not before the Tribunal, have not been challenged.

*(a) The issue of capacity constraints*

210. UniChem's essential argument, based on Mr Johnson's evidence, is that UniChem has little or no spare capacity on its routes and would not easily be able to add extra drops. The principal constraint is the difficulty of making twice-daily deliveries from the depot in Letchworth. On UniChem's schedules it would be difficult to accommodate more than a handful of new customers without opening a new route, but that would be costly, as the Decision acknowledges. None of these difficulties were ever explored with UniChem, nor was the central assumption of the Decision, namely that UniChem had spare capacity, and could service new customers at a very low marginal cost, ever explored with UniChem by the OFT.

211. The OFT and Phoenix submit that the marginal cost of adding an extra drop is, in principle, small. Further, customers can easily be accommodated by re-configuring existing routes, taking advantage of UniChem's existing network. UniChem has acquired new outlets, including acquisitions for Moss, and it has re-configured its routes to accommodate those customers. UniChem has vast experience of re-configuring routes from its position as a national wholesaler. UniChem could have raised the capacity constraint point in its letter of 10 November 2004 but did not do so.

If UniChem did attract more than a handful of new customers from EAP/Phoenix, adding a new route would be profitable.

212. In our judgment it is material to the reasoning in the Decision that UniChem would be able to add new customers at a low marginal cost, either by adding customers to existing routes, or by re-configuring its existing route network, without incurring the incremental cost of opening one or more new routes.

213. That, in our view, emerges from the following passages in the Decision:

“the OFT considers that [AAH and Unichem] should indeed be able to offer a pharmacy near an existing route a service at negligible marginal cost since they already make drops in the area” (paragraph 33)

“in the outlying North and Eastern areas of East Anglia, both competitors deliver to tied chains and supermarkets in these areas already. It should therefore be relatively easy and cost effective to add one or more drops to an existing ‘round’.” (paragraph 34)

“AAH and Unichem are relatively well placed to compete for business throughout East Anglia by virtue of their full size depots and the network benefits they gain from existing customer density, and from customer clusters over longer distances. It therefore seems that any customer of the merged entity could switch to AAH or Unichem (or in the West of the region, Mawdsley Brookes)” (paragraph 36)

“A dispensing doctor is essentially another drop on the route, so if AAH and Unichem are supplying pharmacists in the region, there appears to be no reason why they should not be able to add dispensing doctors to their existing route network.” (paragraph 38)

“Further barriers exist at the route level, where the parties estimate that in order to make a new route in a new geographic area viable, the route needs to carry a turnover of approximately £150k per month (equivalent to 5-6 customers) in order to break even. However, the parties maintain that all full-liners use sophisticated routing software to optimize their networks. As a result, the addition of a new customer to the network will typically be followed by a re-organization of the entire route network. The marginal cost of supplying a new customer, where existing customer drops are nearby, should therefore be very low. However opening a route in an area where the full-liner has no pre-existing drops (even within the 2-hour drive time radius) is likely to carry a higher incremental cost.” (paragraph 43)

214. It is in our judgment explicit in these statements that, in the OFT's view, UniChem could easily accommodate a sufficient number of Phoenix/EAP customers to exercise an effective constraint on the latter, since UniChem would be able to absorb such customers at low marginal cost within its existing route network, if necessary by re-organising the routes, without incurring the incremental cost of adding new routes. Paragraph 43 of the Decision indicates that there is a higher incremental cost in adding a new route, rather than re-configuring an existing network.
215. It is also in our view explicit in those statements that in a sufficient number of cases UniChem's existing drops are, in the OFT's view, sufficiently close to EAP/Phoenix customers to make re-organising the routes without incremental cost a feasible option. Thus, according to the Decision, UniChem should indeed be able to offer a pharmacy *near an existing route* a service at negligible marginal cost since "they already make drops in the area" (33) "it should be relatively easy and cost effective to add one or more drops *to an existing round*" (34), "*any customer* of the merged entity could switch"(36), "a dispensing doctor is essentially *another drop on the route*" (38) "where existing customer drops are *nearby* [the marginal cost of supplying a new customer] should therefore be very low" (43).
216. The OFT reached those conclusions without putting any points to UniChem about its distribution system or the marginal cost of adding new customers. Those conclusions are however, now challenged by Mr Johnson's evidence, notably at paragraphs 8 to 16 of his witness statement of 11 February 2005. Mr Johnson makes the points, among others, that UniChem's delivery schedules are already very tight from the time point of view, that there is little or no spare capacity, and that even relatively short detours can be time consuming on the largely rural roads in question. He also stresses that, according to the spreadsheets, UniChem's existing independent pharmacy customers appear to lie between 16 and 25 miles from the nearest EAP or Phoenix customer in the NR and IP postcodes. Mr Johnson draws the conclusion that it would not be easy or inexpensive to add further drops to existing rounds or to re-configure the routes without opening new ones. Mr Baker, in his evidence, points out that on certain routes the last drop is already close to 5:30pm and that on such routes it would be difficult to accommodate even one EAP/Phoenix customer which could be located more than 10 miles away.

217. The unusual situation in which the Tribunal thus finds itself is that a finding of primary fact central to the Decision is now strongly challenged. We are not in a position to say that the evidence of Mr Johnson and Mr Baker is obviously incredible or irrelevant to the matters on which the Decision is based.
218. We have therefore asked ourselves on what evidence the OFT based its opposite conclusion that UniChem could easily add Phoenix/EAP customers to its network at negligible or low marginal cost.
219. That evidence did not come from UniChem. It appears that the foregoing conclusion of the OFT was based on the matters summarised in Priddis at paragraph 95(g): see paragraph 103 above. We make the following observations on the matters there relied on.
220. Although, theoretically, the marginal cost of another single drop may be low in an individual case, whether an additional drop can be accommodated at negligible cost depends on the proximity of the drop to an existing route, the capacity of that route, or the ease with which the network as a whole may be re-configured to absorb the customer. However, UniChem argues that, on the OFT's argument, the issue here is not limited to a single drop, since whether UniChem could be an effective constraint depends on how far a number of additional drops could be absorbed at low marginal cost. How a far number of additional drops could be so absorbed depends on the logistics and capacity of the network at any given time. In our view UniChem's argument is not obviously incorrect. However, the OFT did not discuss with UniChem "the economics of delivery" or the whereabouts of the existing routes, nor whether there was "nothing to stop them expanding" (see Priddis, paragraph 96).
221. The "confirmation" (presumably by Phoenix/EAP) to which Mr Priddis refers that wholesalers often re-map their routes and that routes are not fixed does not in our view establish whether, in this particular case, UniChem could easily re-map its routes for the purpose of absorbing any significant number of Phoenix/EAP customers at negligible marginal cost. Whether UniChem could do so was not raised with UniChem.

222. It is far from clear, in the light of the evidence about distances now before the Tribunal, that all that would be involved in most cases would be “a small detour” (Priddis at 95(g), third point). Nor is it established to what extent UniChem’s existing drops are “nearby” EAP/Phoenix customers. Mr Johnson suggests distances of between 16 and 25 miles one way between the independent customers of UniChem and Phoenix/EAP.
223. The reliance by the OFT on a generalised claim by UniChem on its website about its wholesale logistics system does not seem to us to be sufficient when considering the practicalities and costs of re-configuring routes in East Anglia.
224. As regards the OFT’s contention that UniChem has in the past expanded its routes to include additional drops, it is not stated in the OFT evidence what examples are being referred to. We gather that this relates mainly to the win/loss data supplied by Phoenix/EAP. That data was not put to UniChem, nor was UniChem asked to what extent it had in the past expanded its routes. UniChem strongly contests the win/loss data referred to, as seen below.
225. Bearing all those matters in mind, and in the view of the matters which UniChem raises, we find it hard to be satisfied that there is, in the Decision or the OFT’s evidence, a sufficient factual basis for the finding in the Decision that UniChem could in practice easily absorb a material number of Phoenix/EAP customers at low or negligible marginal cost. We find it difficult to say that the matters referred to at paragraph 95(g) of Priddis are sufficient, on their face, to negate or rebut the evidence now before the Tribunal that such is not the case. It is, moreover, difficult for the Tribunal to accept as adequate contested facts which pertain to a particular party’s capabilities which were not previously checked or discussed with the party now contesting them.
226. It is however, submitted by the OFT that UniChem itself should have raised the point about capacity constraints in its letter to the OFT of 10 November 2004. We do not accept that submission. Although, no doubt, UniChem could have raised the point, in our view there was nothing to indicate to UniChem that a material plank of the OFT’s reasoning was that UniChem was in a position to supply a significant number of Phoenix/EAP customers at negligible marginal cost by the simple expedient of re-

configuring its routes. In our view a proper factual investigation would have involved putting that point to UniChem if it was to be relied upon, so as to ensure the factual accuracy of the point being made. The point could have been raised by letter, email or in the telephone conversation of 30 November 2004, and a response quickly given.

227. Nor do we consider that the OFT was absolved from putting the point to UniChem by the fact that the OFT may have considered the isochrone analysis to be inaccurate or misleading. The point about the marginal cost of supplying additional customers seems to us to be a quite separate issue from the isochrone analysis and is, in any event, an important plank of the Decision.

228. Moreover, in the telephone conversation of 30 November 2004 the case officer told UniChem that its existing submission was “very helpful and comprehensive”, whereas in fact the OFT now says that it considered the submission to be misleading and incomplete. That was an unfortunate conversation in our view, which did nothing to alert UniChem to the matters of primary fact about UniChem on which the OFT was apparently minded to base its Decision.

229. It was suggested by the OFT, in oral argument, that if UniChem were to acquire more than a handful of Phoenix/EAP customers it would then become profitable for UniChem to incur the incremental cost of developing a new route. That, however, is not the reasoning set out in the Decision, or in the OFT’s evidence, which is based on the proposition that a sufficient number of Phoenix/EAP customers could easily be added to UniChem’s existing network at negligible marginal cost. The likelihood of UniChem incurring the incremental cost of opening new routes to serve the outlying areas of East Anglia given the distances involved is not a matter addressed in the Decision. In our view, it is not open to us to decide whether, or how far UniChem would be likely to incur the cost of investing in new routes, or that the potential threat of UniChem doing so would be sufficient, in itself, to exercise a competitive constraint in Phoenix/EAP. That is a matter for the OFT to assess.

230. Phoenix suggests that, in the past, UniChem has adapted its routes to accommodate acquisitions of Moss Chemists. Mr Johnson denies that that means that UniChem has the capacity to do so now. This example is not mentioned in the Decision and these

acquisitions are not identified in the OFT's evidence. The overall economic transaction involved in acquiring a tied pharmacy is presumably different from that involved in supplying an independent pharmacy. We are not, in the context of a review, in a position to judge whether these are comparable examples, nor whether any costs incurred by UniChem in changing its routes in these cases (assuming it did so) were negligible or not. This is not a matter put to UniChem in the course of the procedure before the OFT.

231. Phoenix also placed before the OFT, and placed before the Tribunal, what it says is evidence of recent attempts by UniChem to persuade many Phoenix/EAP customers to switch to UniChem. Phoenix draws the inference that UniChem considers, in reality, that it could be quite easy to absorb customers of Phoenix/EAP if UniChem wished to do so. Phoenix also emphasises that UniChem has a salesman whose job it is to prospect for customers throughout East Anglia. Mr Johnson however, states that recent UniChem contacts with Phoenix/EAP customers were to "gauge their reaction" to the merger and to persuade them to support UniChem before the OFT. No customer has switched to UniChem. As to the salesman, UniChem says that it has been singularly unsuccessful in obtaining any business.

232. The evidence of Phoenix about UniChem canvassing Phoenix/EAP customers, albeit denied by Mr Johnson, together with the evidence about UniChem's sales representative, could, if true, support the view that UniChem would not find it as difficult as it says to compete for business in East Anglia. We also note that Mr Priddis refers to some evidence from customers about UniChem attempting to expand its business in East Anglia (Priddis, paragraph 95(d)).

233. In our view however, once again it is difficult on a review to take account of these new factual elements, since those are contested factual matters which are not relied on in the Decision or the OFT's evidence. The reference in paragraph 95(d) of Priddis is extremely vague. None of these matters, or the inferences to be drawn from them, were put to UniChem during the course of the procedure.

234. Looking at the matter as a whole we reach the conclusions that: (i) the question of how far UniChem could add additional drops, if necessary by re-configuring its route

network, at negligible marginal cost, was a material issue before the OFT and is material to the reasoning of the Decision; (ii) the OFT's conclusion that UniChem could do so at negligible marginal cost is disputed by UniChem on the basis of the evidence of Mr Johnson and Mr Baker; (iii) the evidence that the OFT relied on for its conclusion is not adequate to maintain that conclusion in the face of the challenge now made; and (iv) this point could and should have been raised with UniChem before the Decision but that was not done.

*(b) UniChem's existing pattern of success*

235. UniChem submits that the OFT drew the wrong conclusion from what it saw as UniChem's "existing pattern of success", and wrongly failed to check the facts with UniChem. In fact, says Mr Johnson, UniChem's independent retail pharmacy customers in the outlying parts of East Anglia are largely a historical legacy from the days when UniChem was a pharmacists' cooperative; UniChem has won very few new accounts; UniChem has no dispensing doctors north of the A14; and the only way in which UniChem has been able to expand in this area is through acquisition of pharmacies by Moss.
236. The OFT submits that it was entitled to rely on the evidence it had about the location of UniChem's outlets to support the proposition that UniChem was capable of delivering to all parts of East Anglia; the historical background is irrelevant, since the customers would not have remained with UniChem had UniChem's service been uncompetitive; the apparent mistake about the two dispensing doctors north of the A14 was due to UniChem's own evidence for which the OFT was not to blame; and the OFT was entitled to rely on Phoenix/EAP and customers to the effect that UniChem had gained outlets in the area.
237. In our judgment, it is apparent from Mr Priddis' evidence that the OFT did rely on what it considered to be UniChem's "existing pattern of success" in the outlying parts of East Anglia: Priddis at paragraph 109. It is also apparent that the OFT had certain information which seems to have coloured the OFT's view. This includes win/loss data supplied by Phoenix/EAP which tentatively showed that "75% of pharmacy/dispensing doctors leaving EAP had switched to AAH or UniChem" (Priddis, 88(f)); that

UniChem had supplied two dispensing doctors north of the A14, apparently won between 2003 and 2004 (Priddis, 95(c)); that “customers had noted” that UniChem had persuaded a number of independent pharmacies and dispensing doctors [in the outlying areas of East Anglia] to switch to them” (Priddis, paragraph 105(a)); and that UniChem had been able to win independent pharmacy accounts on the far Norfolk coast (Priddis, paragraph 103(b)).

238. In relation to these matters, Mr Johnson contests that the win/loss data shows *any* switches from EAP to UniChem, even leaving aside what Mr Johnson says are inconsistencies in the data. Mr Johnson’s evidence is that what are shown as “switches” to UniChem are in fact acquisitions by UniChem for its Moss chain (Johnson, second witness statement, paragraphs 3 to 9). If Mr Johnson is right, then it would appear that the win/loss evidence does not support the proposition relied on, which is that UniChem can compete effectively for the business of independent pharmacies in East Anglia. It is true that that evidence might support a different proposition, for example that EAP’s customer base is under pressure from UniChem’s policy of acquisitions, but it does not, according to Mr Johnson, show customers who remain independent leaving EAP for UniChem.
239. The references in Mr Priddis’ evidence to UniChem having two dispensing doctors north of the A14 turns out to be a mistake, as a result of information supplied by UniChem. A fact relied on, small in itself, turns out not to exist. This highlights one of the difficulties: when companies are asked to put together a great deal of information in a short time, mistakes may happen. If the OFT had wished to draw an inference as regards dispensing doctors on the basis of the apparent difference in the information supplied by UniChem in 2003 and 2004 respectively, it would not have been difficult quickly to check that inference with UniChem. In all probability, at that stage, the error would have been discovered.
240. In relation to the evidence that the OFT apparently received indirectly from customers to the effect that UniChem had won accounts in respect of both independent pharmacies and dispensing doctors in the outlying areas in East Anglia, this seems to have been erroneous as far as dispensing doctors are concerned and, according to Mr Johnson, minimal as far as independent pharmacies are concerned. Again, the facts could have

been checked with UniChem. The same applies to the OFT's observation that UniChem had "won" customers on the far Norfolk coast. That is denied by Mr Johnson (paragraphs 7, 21 to 23) who says that these are long-standing customers who have stayed with UniChem for historical reasons.

241. Although it would not be right to get these matters out of proportion, if the OFT had an incorrect or incomplete understanding of UniChem's success in the relevant areas in the past, it is difficult to say that that is immaterial. UniChem's potential as a competitive force is presumably no greater after the merger than before. The historical pattern does, therefore, throw light on how likely it is that UniChem would be an effective constraint in the future, as the OFT itself accepts. In our view, the inferences that the OFT was minded to draw about UniChem's existing customer base and gains or losses of customers in the relevant area should have been put to UniChem for comment if reliance was to be placed on that data.

*(c) The spreadsheets*

242. The spreadsheets, which UniChem had not seen before these proceedings, purport to set out locations, cut-off and delivery times for UniChem customers, and the distance from UniChem's independent pharmacy customers to the nearest EAP or Phoenix customer. Mr Johnson and Mr Baker give evidence to the effect that the spreadsheets do not support the propositions advanced in paragraph 35 of the Decision, nor the arguments advanced by Phoenix to the OFT, and show in fact that UniChem is at best a marginal player in the relevant parts of East Anglia. UniChem submits that the average distances used distort the picture and conceal wide variations; a single UniChem outlet is used 44 times as the 'nearest' UniChem customer to various EAP and Phoenix outlets; the spreadsheets say nothing about the logistics of supply, but in fact demonstrate how difficult it would be to extend certain routes; and, on average, the 12 UniChem customers shown are between 15 and 25 miles from the nearest EAP and Phoenix customers.

243. The OFT accepts UniChem's criticisms of "distances and so on" but submits that it relied on the spreadsheets only to identify the whereabouts of UniChem's customers, and for a comparison of cut-off times and deliveries. It did not accept Phoenix's

arguments based on distances. The information in the spreadsheets, however, enabled the OFT to conclude that UniChem was broadly competitive with EAP and Phoenix on service levels.

244. Mr Priddis refers in paragraph 103(d) and (e) to the comparison of cut-off times and delivery times that the OFT made on the basis of the spreadsheets. There is no reference in Mr Priddis' evidence, filed before UniChem's evidence became available, to the OFT relying on the spreadsheets for the calculations of distance relied on by Phoenix/EAP.
245. The first sentence of paragraph 35 of the Decision refers to "the distances between", which suggests that the OFT may have had regard to the distance calculations set out in the spreadsheets. However, the conclusion drawn from the spreadsheets in paragraph 35 of the Decision, and in paragraph 103 of Mr Priddis' evidence, is a conclusion in relation to relative service levels, not a conclusion based on the proximity of a UniChem outlet to an EAP or Phoenix outlet.
246. That conclusion was, according to paragraph 35 of the Decision, that "the service levels of all suppliers... do not necessarily deteriorate significantly in response to distance". According to Mr Priddis' evidence, there are two limbs to that:
- (a) the spreadsheets showed that "there was not necessarily any significant deterioration in order cut-off times as the distance of the customer from the depot increases"; and
  - (b) the spreadsheets showed that "UniChem served customers in the outlying areas of East Anglia with a twice-daily service that was competitive with the service provided by EAP" (Priddis, 103(d) and (e)).
247. In terms of delivery times, UniChem has not put in issue the second of those propositions, namely that its delivery times are broadly competitive with those of EAP. However, UniChem challenges the adequacy of the evidence on the basis of which the OFT came to the conclusion that there was not necessarily a significant deterioration in order cut-off times as the distance from the depot increases.

248. On that issue, as far as we can see, the spreadsheets show on their face that in the IP post code area the average cut-off time for UniChem (based in Letchworth) is about one hour earlier than the cut-off times offered by EAP or Phoenix, while in the NR post code area UniChem's cut-off time is an average two hours earlier than EAP (based in Norwich) and one and a half hours earlier than Phoenix (based in Cambridge). At first sight, the inference from the spreadsheets is that UniChem is able to maintain competitive delivery times in those areas, but has to offer earlier cut-off times.

249. It appears that "service levels" include cut-off times, since paragraph 37 of the Decision states that "cut-off and delivery times are one of a number of aspects to service quality which customers value highly". We have great difficulty in seeing how, as regards cut-off times, the spreadsheets on their face sustain the proposition that service levels do not deteriorate with distance when comparing UniChem, EAP and Phoenix. UniChem, with its depot in Letchworth, is able to offer significantly less favourable cut-off times in the IP and NR post code areas than EAP based in Norwich and Phoenix based in Cambridge. The conclusion to the contrary, said to be based on the spreadsheets, was not put to UniChem.

250. However, the OFT argues that cut-off times are less important as a competitive parameter than might be supposed. The principal points made in the OFT evidence are that customers value other factors as well as cut-off times; that 70 per cent of deliveries are made in the morning, where cut-off times do not apply because the order is made up overnight; that a customer with an early cut-off time may get an early delivery; that some dispensing doctors do not require a second delivery and regard delivery times as more important; that UniChem's cut-off times are acceptable to its existing customers; and that "a majority" of customers said that an earlier cut-off time of "up to one hour" would not affect them (Priddis, 103, 106 to 107).

251. We note that these points do not appear in the Decision, which states only:

"37. Customer responses in relation to this case indicate cut-off and delivery times are one of a number of aspects to service quality customers value highly. Other important factors cited by customers, that do not vary with geography include; customer service levels, order accuracy, flexibility, discounts and friendliness of staff."

252. The contention that it would be incorrect to focus only on cut-off times as the key element of service levels (Priddis, paragraph 94) is said to be one of the four relevant factors relied on by the OFT. That is a matter which, in our judgment, ought to have been set out in the Decision. The Decision at paragraph 37 gives the impression that cut-off times are “valued highly” by customers, albeit that they are not the only matter to be considered.
253. However, a difficulty we have over the logic of the evidence now put forward by the OFT is that if the majority of the customers contacted indicated that earlier cut-off times of “up to an hour” would have little or no impact on their business (Priddis, paragraph 106) one inference that could be drawn is that a difference in cut-off times of more than one hour would make a difference to customers. Since the cut-off times offered by EAP (and thus presumably the merged Phoenix/EAP) in the NR post code are some two hours later than UniChem can offer, the further inference is that UniChem would be at a competitive disadvantage in competing for the business of those customers. A similar point could apply in the IP area where the difference is just over one hour.
254. It follows from the foregoing that if the Decision is intended to imply that cut-off times are not earlier depending on the distance from the depot, the spreadsheets appear not to support that conclusion when making a comparison as between UniChem, EAP, and Phoenix. The OFT’s evidence further implies that that could be material for the NR post code, and possibly the IP post code.
255. It is true that the OFT further relies, notably, on the arguments that most deliveries are made in the morning drop; that cut-off times are less important for dispensing doctors; and that UniChem’s existing independent and tied customers accept earlier cut-off times. Notwithstanding those arguments, we think it unsatisfactory that, when considering how effective a constraint UniChem could offer to the merged Phoenix/EAP, the Decision does not discuss at all the apparent problem that UniChem has to offer significantly earlier cut-off times than Phoenix or EAP in the NR and IP areas, especially since this matter figured in the Second Issues Letter, as well as in the First Issues Letter and the AAH/EAP Decision.

256. We also think it unsatisfactory that the OFT did not put back to UniChem any inferences it was minded to draw from the spreadsheets as regards facts about UniChem or the terms offered by UniChem to its customers.

257. In that connection, although it is true that the OFT tells us that it did not rely on the spreadsheets as regards distances, and we accept that evidence, the argument based on distances was an argument that Phoenix put to the OFT and has also put before the Tribunal. In those particular circumstances, from the point of view of a perception of fairness, we can understand UniChem's disquiet about not having had an opportunity to comment on all the inferences about UniChem said to emerge from the spreadsheets, notwithstanding the OFT's assurance that it did not in fact accept what Phoenix was saying about distances.

*(d) Dispensing Doctors*

258. As far as dispensing doctors are concerned, the OFT in paragraph 38 of the Decision relies on five main points: (1) "A dispensing doctor is essentially another drop on the route, so if AAH and UniChem are supplying pharmacists in the region, there appears to be no reason why they should not be able to add dispensing doctors to their existing route network (Decision, paragraph 38);" (2) dispensing doctors have less demanding requirements, many requiring only one daily drop; (3) service levels are more important than price for dispensing doctors; (4) doctors told the OFT that they saw no reason not to switch to AAH or UniChem if necessary; and (5) doctors are currently reluctant to switch because they are content with existing service levels.

259. Given that dispensing doctors have apparently told the OFT that they would be prepared to switch to another supplier if necessary, we assume that to be the case. In the light of that, it is difficult for us to place much weight on the disputed evidence advanced by UniChem about manufacturers' discount schemes. Points (2) to (5) above do not therefore seem to be open to serious challenge.

260. However, as regards point (1), one important question is whether it would be logistically feasible and economically profitable for another wholesaler to supply dispensing doctors. That depends on the logistics of the wholesaler's system and the

cost of supply in what appears to be a low margin business. In other words, the answer to the question that the OFT rightly posed, (“could doctors switch suppliers if prices increased or service quality fell?”) depends on both demand side and supply side considerations. That takes us back to the question whether dispensing doctors are simply “another drop on the route” as stated in paragraph 38 of the Decision.

261. It is correct that a dispensing doctor will be served by a route which makes drops to other outlets. However, the difficulty here is the same as the difficulty already discussed above under the issue of competitive constraints. The underlying assumption of the statement that dispensing doctors are simply “another drop on the route” is that these outlets could easily be supplied by UniChem on the basis of re-configuring its existing routes, at low or negligible marginal cost, without the need to open new routes. As we have already held, that assumption was not put to UniChem and is contradicted by Mr Johnson’s evidence. We have also held that the matters relied on at paragraph 95(g) of Priddis are insufficient to sustain before the Tribunal the assumption the OFT has made, in the light of UniChem’s evidence. None of those matters were put to UniChem as regards dispensing doctors.

262. The issue of competitive constraints would appear to be more acute as regards dispensing doctors since, unlike the case with retail pharmacies, UniChem has only a 1.5% share of this sector in East Anglia, and no dispensing doctors north of the A14. UniChem therefore starts from a very low base. UniChem’s own evidence to the OFT in its submission of 10 November 2004 was that it had encountered difficulty in penetrating the dispensing doctors’ market (footnote 6), and that:

“It is unlikely that UniChem would consider it worthwhile to target supply to dispensing doctors, faced with significant cost of introducing new, long van routes to sparsely populated rural areas with little likelihood of being able to generate meaningful market share growth.” (paragraph 5.8)

263. In all those circumstances we find it difficult to say that the assumption implicitly made in the Decision to the effect that dispensing doctors are just “another drop on the route”, who could and would easily be supplied by UniChem re-configuring its routes at negligible marginal cost, is supported by adequate evidence or sufficient factual investigation, UniChem not having been asked about it.

### C. UNICHEM'S SUBMISSION AS TO A FAILURE OF PROCEDURE

264. As regards the issue of procedure, much of the argument that has arisen in these proceedings would have been avoided if the OFT had gone back to UniChem and briefly sought UniChem's views on the issues identified above, such as the ease with which UniChem could re-configure its route network to serve EAP/Phoenix customers, particularly dispensing doctors, UniChem's gains/losses in recent years, and the inferences to be drawn from the spreadsheets.
265. In our view that could have been done relatively easily, for example in a meeting of the kind the OFT had with UniChem during the AAH/EAP case. Instead, the OFT seems to have relied largely on what it was told by the merging parties about UniChem's capabilities.
266. In the present case the OFT investigated this matter, one way or another, over 7 months. The OFT received a large number of submissions from the merging parties, and held several meetings with them, including relatively extensive discussions during the so-called "pre-notification" stage. For nearly six months the OFT was in contact only with the merging parties. At the "public" stage, UniChem was given a week to submit its comments, although it had begun work slightly earlier. The OFT had no meeting with UniChem although a main issue was the effectiveness of UniChem's network and UniChem's own logistical capability. No questions were asked of UniChem about that. While the merging parties can, in our view, legitimately expect to be heard very fully by the OFT, it is in our view desirable to maintain a balanced procedure.
267. We accept the OFT's submission that in a procedure such as the present it is impossible to "put back" all points to all parties. In some cases, but not apparently the present case, the OFT will be receiving a welter of submissions from all quarters. Nor do we at first sight read the Vice-Chancellor in *IBA* at [72] as saying that as a matter of law third parties should always have the opportunity to comment on an Issues Letter, but we do not need to decide that point now. Our judgment in the present case turns on the particular circumstances of this case.

268. In our view, in a given situation where, as here, on an important issue the arguments advanced by merging party A depend on primary facts and matters that are within the knowledge of, and concern the behaviour of, a third party B (in this case as regards notably B's run/distribution capacity, past pattern of success and service levels), it would normally be appropriate for the OFT to check with B the primary facts and briefly seek B's comments on the points made, if they are to be relied on. However no elaborate procedure is required. In most cases a short meeting or letter should suffice for the points to be put in outline.
269. In our view such an approach is normally necessary a matter of an adequate factual investigation, and as a matter of a balanced and fair procedure. In a case where facts about a third party are central to a decision, a balanced and fair procedure should not rely almost entirely on what the merging parties say about the third party without any cross-check of those facts with the third party concerned. That is particularly important where, as here, the decision is a final decision not to refer. A precaution of that kind should also greatly limit the likelihood of proceedings such as this before the Tribunal in future.
270. The facts referred to above were not cross-checked in this case, notwithstanding that the case was apparently near the borderline, as shown by the First Issues Letter, and the confidential guidance to Phoenix/EAP in July 2004, and the Second Issues Letter of 30 November 2004. There was also UniChem's prior involvement in 2000 and 2003. For the reasons already given, we do not think the OFT's letter to UniChem of 3 November 2004 or UniChem's reply of 10 November 2004 filled that gap. The telephone conversation of 30 November 2004 could have alerted UniChem to the points, but did not do so. In the particular narrow circumstances of this case, we consider that a procedural failure occurred.

#### D. OVERALL ASSESSMENT

271. In our judgment, it is not every error of assessment or procedural failure which will lead to the Tribunal remitting a matter to the OFT under section 120 of the Act. That said, given that these are review, rather than appellate proceedings, there is a limit to the extent to which we can go into the merits and say that a material point would have

made no difference to the outcome, or that the same result could or should be reached by a different route.

272. In this case, on the central issue of competitive constraints both as regards retail pharmacies and dispensing doctors, our findings are that: (1) there are material issues of contested fact concerning UniChem's capability to add drops or re-configure its network at negligible marginal cost, UniChem's past pattern of success, UniChem's service levels, and the inferences to be drawn from the spreadsheets and the win/loss data supplied by Phoenix/EAP to the OFT; (2) the OFT's finding on the marginal cost point is not supported by evidence adequate to sustain what is said in the Decision, in the face of the factual contentions now advanced by UniChem; (3) the inferences to be drawn as regards UniChem's past patterns of success and service levels are contested, and it is difficult to say that the points made by UniChem could not be material to the OFT's judgment of the facts; (4) the issues of UniChem's logistical capacity to adapt its network and the cost of doing so, and the inferences to be drawn as regards UniChem's past pattern of successes, and the spreadsheets, are matters which in our judgment should have been put to or discussed with UniChem.

273. We bear in mind, on the other hand, the factual findings, to which we have already referred, which support the Decision, including UniChem's existing network, the fact that UniChem's existing customers in East Anglia apparently accept UniChem's earlier cut-off times, and that customers have expressed the willingness to switch if necessary. In addition, the finding that Phoenix constrains EAP only to a limited extent stands. We also bear in mind the care with which the OFT considered a large number of other matters, for example, relating to the relevant geographic market, short-liners and rivalry enhancing efficiencies. The detail with which Mr Priddis was able to explain the OFT's approach was impressive.

274. In addition, according to Table 1 above, as regards independent retail pharmacies, the market share of the merged EAP/Phoenix would still be less than that of UniChem (and AAH).

275. As regards dispensing doctors, although it is not shown whether UniChem could absorb those outlets at negligible marginal cost, there is no real challenge to the other evidence

that it is delivery times, rather than cut-off times, which are important to dispensing doctors, that price is less important than service, and that doctors would be prepared to switch if service levels declined.

276. We note too that in the 1996 report the MMC found that UniChem had the capacity to deliver throughout the United Kingdom (e.g. 4.45). UniChem also submitted, in both the AAH/EAP investigation, and in the current investigation, that it “has the expertise and resources to be a credible competitor across the UK as well as in East Anglia” (see 4.4 of the 2003 briefing paper, footnote 6 of the 2004 briefing paper).
277. In all those circumstances, in our view the considerations before us are finely balanced indeed. The situation in which the Tribunal finds itself is that while much of the Decision is in our view soundly based, we are constrained to hold: (1) that certain material matters relied on in the Decision are insufficiently supported by the evidence; (2) as a result, we are not in a position to be satisfied that all material considerations have been taken into account; and (3) that there in any event has been a material failure of procedure.
278. While it is strongly arguable that the uncontested matters to which we have referred above support the conclusion that the OFT’s Decision remained within the bounds of reasonableness, in our view it is difficult to overlook the contested matters of fact raised by UniChem which are material to the OFT’s reasoning. In our judgment, in the final analysis, the OFT did not know enough about the reach and logistics of UniChem’s network and the economics of delivery routeing to have an adequate factual basis for its Decision. In addition, we regard the OFT’s omission to seek comments from UniChem on those matters, and on the other matters we have mentioned above, as being of decisive importance.
279. In those circumstances we are unanimously of the view that we have no alternative but to quash the Decision and remit the matter to the OFT for re-consideration, in order for the OFT to take into account what UniChem has said in these proceedings. That reconsideration is not at large but is limited to paragraphs 34 to 38 of the Decision, insofar as those paragraphs concern the points made by UniChem, namely the matters raised in the evidence of Mr Johnson and Mr Baker. It is for the OFT to decide whether

it accepts or rejects that evidence, the weight to be given to it, whether that evidence is or is not outweighed by other factors, and the reasoning to be adopted in a new decision. We see no reason why a new decision should not be taken rapidly. This judgment does not in any way prejudge or decide the question of whether it is or may be the case that the proposed merger may be expected to result in a substantial lessening of competition within the meaning of the Act.

Christopher Bellamy

Graham Mather

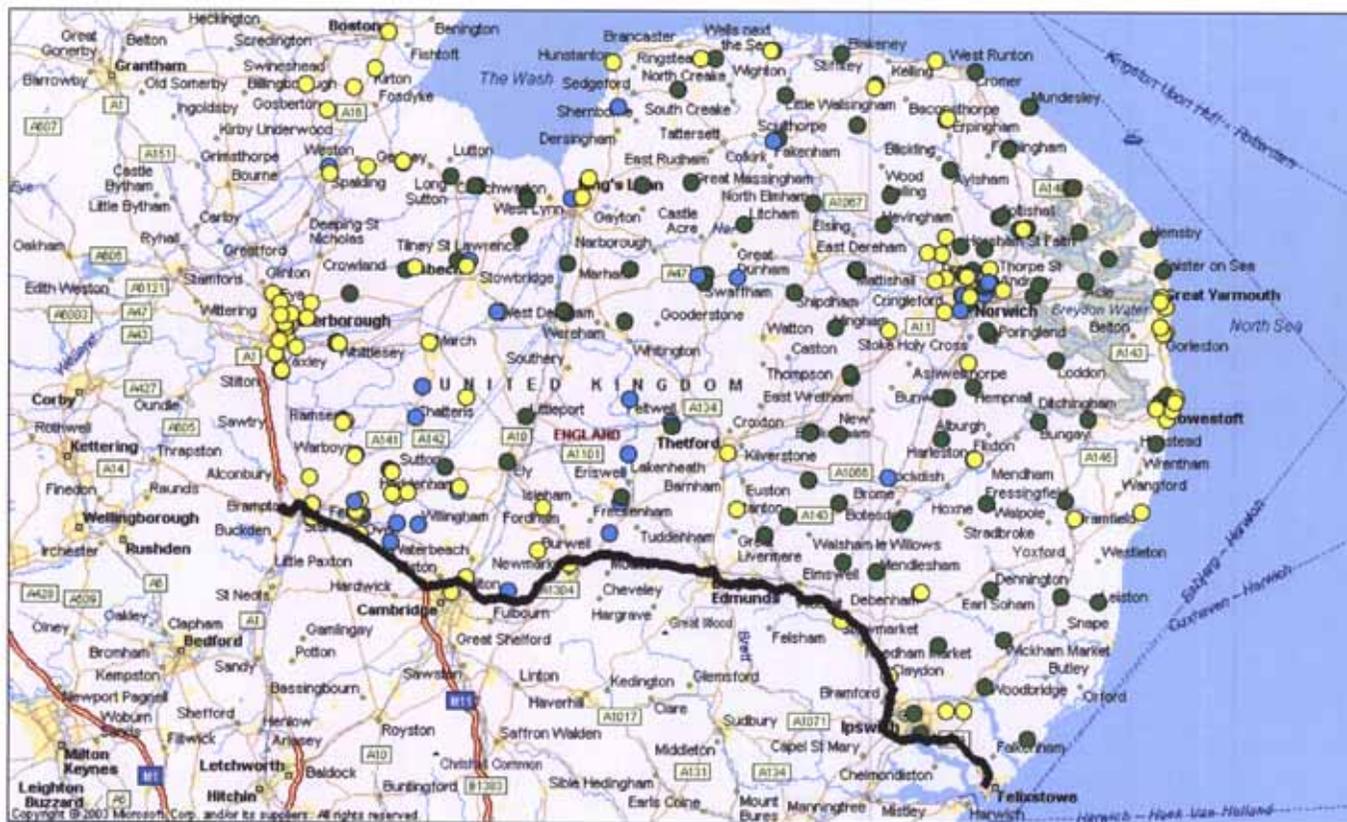
Paul Stoneman

1 April 2005

Registrar

APPENDIX 1

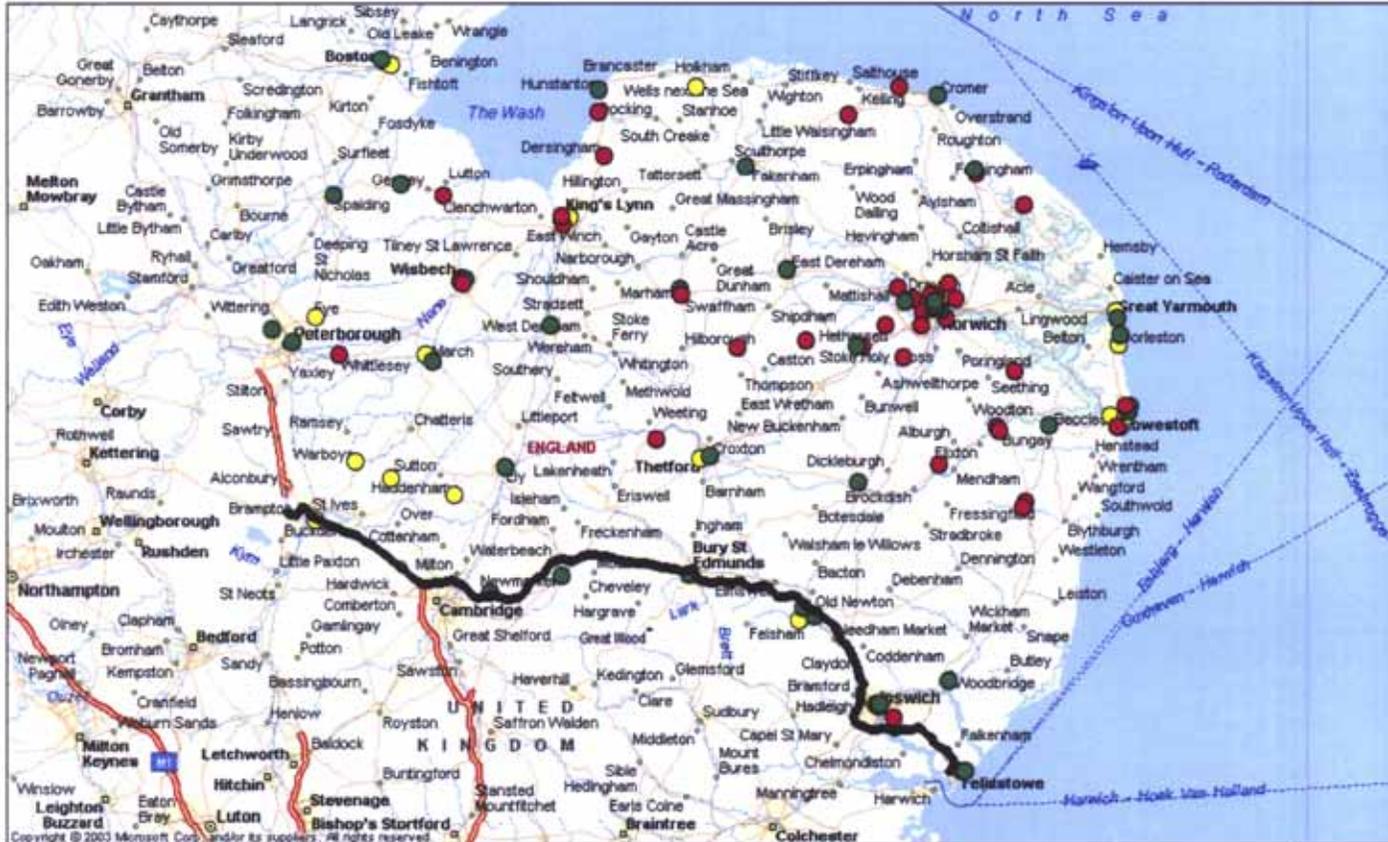
Independent Sector Customers Excluding Co-Op



- KEY:**
- Independent Sector Customers – Not Hawk or Phoenix First Line
  - Phoenix – Independent Sector Customers
  - Hawk – Independent Sector Customers

## APPENDIX 2

### Analysis of Unichem Distribution Network



KEY:

Moss Pharmacy

Unichem Independent Customer

Boots The Chemist supplied by Unichem as its first choice external wholesaler when required

