

# 8 Conclusions

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## Background

8.2. Our terms of reference (see Appendix 1.1) require us to investigate and report whether a monopoly situation exists in relation to the supply within the UK of contact lens solutions (CLS). If we find that such a monopoly situation does exist, various other questions then follow.

8.3. In his press release announcing the setting up of the inquiry the Director General of Fair Trading said that the reference had been 'prompted primarily by concerns that suppliers of CLS may be enjoying high rates of return, suggesting that price competition in this market is not as effective as it might be'. The reference, however, covers all levels of supply: manufacturers and importers (whom we refer to as 'suppliers'), wholesalers and retailers.

## The products

8.4. Contact lenses need to be kept in good condition in order to maintain quality of vision and comfort and avoid the risk of ocular infection. CLS achieve these aims by cleaning the lens, preventing the accumulation of deposits on its surface and keeping it free from contamination. Depending on lens type (see paragraphs 2.1 to 2.8), solutions are needed for the following functions:

- surfactant cleaning, which involves physical rubbing of the lens to remove surface deposits;
- disinfecting, by means of immersing the lens in solution for a specified period;
- neutralizing: some disinfectants require neutralizing as a separate step before the lens can be used again;
- rinsing: typically a saline solution is used to rinse off the lens after surfactant cleaning;

- soaking/storage: lenses are kept immersed while not in use in order to keep them disinfected and, in the case of soft lenses, to prevent dehydration (in most cases the disinfecting or neutralizing solution is also used as the storage medium);
- wetting and comfort: solutions used mainly with hard lenses to aid insertion and lubricate the lens during wear; and
- the periodic removal of protein deposits, particularly from soft lenses, by means of specialist cleaners, also known as protein removers.

8.5. Among disinfectants, the largest category by value, there are three distinct types:

- traditional cold chemical disinfectants, consisting of a single disinfecting/soaking solution which contains preservatives in order to perform the disinfection function and to keep the solution itself free from contamination;
- hydrogen peroxide products, used mostly for soft lenses, consisting of a disinfecting solution and a neutralizing solution; and
- chlorine disinfectants, which require a chlorine disinfectant tablet to be dissolved in saline solution.

Peroxide and chlorine systems, which are also referred to collectively as oxidatives, are preservative-free.

8.6. Solutions are generally marketed as parts of lens care systems, consisting of a range of products required to perform the various functions described above. Particular systems are intended primarily for use with either hard or soft lenses but this separation is not total: some products can be used for both hard and soft lenses while others cannot. Moreover even among products designed for, say, soft lenses, some products from one system can be interchanged with products from another system but some cannot. These and other factors limit the extent to which consumers can switch between products and create a need for information, sometimes involving professional advice, on the opportunities for and implications of doing so.

## **The regulatory framework**

8.7. The incidence of eye infections among contact lens wearers in the UK prompted the Government to commission a study in the mid-1970s into the effectiveness of the CLS then on the market. A high proportion were found to be unsatisfactory and the Government decided to bring CLS within regulatory control under the Medicines Act 1968. With effect from 1983, suppliers were required to hold a product licence before a CLS product could be marketed in the UK. Licensing is also applied to the importation, manufacture and wholesaling of solutions. In addition, product licences for CLS are not granted unless the applicant specifies that the retail distribution of the product will be restricted to opticians and/or pharmacists so that professional advice can be available at the point of sale. The Medicines Control Agency (MCA) of the Department of Health is responsible for administering the regulations with the advice of the Committee on Dental and Surgical Materials (CDSM) consisting of independent experts. The MCA is required by the Medicines Act to determine applications for product licences on the basis of the quality, safety and efficacy of the products in relation to their intended purpose.

8.8. Health Ministers have also issued specific regulations governing the labelling of solutions and the information which must be given to opticians and pharmacists on such matters as the product's active ingredients and its compatibility with different types of lenses. Among other provisions these regulations require that labels should state the recommended period within which the solution should be used once the container has been opened. The MCA's guidelines for applicants state that 'the container of a product intended for use on more than one occasion shall normally be sufficient for not more than 28 days' use' (see paragraph 2.35). Labels must also carry a warning in capital letters: 'Do not mix with other fluids except as directed'.

8.9. Near the end of our inquiry the Council of Ministers of the EC adopted a Directive on Medical Devices which will govern the regulation of the vast majority of CLS (among many other products) in the

future: see paragraphs 2.36 to 2.42. The UK authorities will have to decide the precise means of implementing the Directive with respect to CLS within the framework which the Directive has established. There will be a choice of routes for suppliers to satisfy a 'notified body'—which each member state will be entitled to nominate—that they conform to the essential requirements laid down in the Directive. This system will replace the present MCA product licensing requirements. Specific standards for CLS have yet to be agreed among the EC member states but the end result will be that once a product has gained the approval of a notified body it can be sold anywhere in the EC. The Directive's provisions take effect in January 1995 but may be implemented by member states at any time between then and 1998. Assuming standards for CLS are agreed by January 1995, companies wishing to market solutions in the UK may then choose whether to follow the existing Medicines Act procedures or—as soon as notified bodies are set up in any member state—to opt for one of the routes laid down under the Directive. Meanwhile, however, we have to address the situation as it exists under present UK regulations.

## **The role of opticians and pharmacists**

8.10. Opticians crucially affect the CLS market because of their role in promoting, prescribing and fitting contact lenses and in recommending lens care systems to consumers. At the first lens fitting opticians normally demonstrate the use of solutions and give customers a free pack consisting of small quantities of the care system they recommend (the 'starter pack'), sufficient for perhaps two weeks' use. The customer returns for a further consultation at the end of that period. If all is well the optician confirms the recommendation of a care system and the customer thereafter purchases the necessary solutions. Allergan Limited (Allergan), the leading supplier of CLS in the UK, told us that typically the optician's recommendation as to which solutions should be used was followed by the wearer throughout the life of the lenses (though our survey of consumers showed a significant degree of switching). Because of the importance of this role in recommending CLS, the suppliers concentrate their marketing efforts on opticians.

8.11. In considering how products are sold it is instructive to compare solutions with prescription drugs. In both cases the person who chooses the product is generally not the user but the professional adviser, although in the case of solutions it is the user who pays. But whereas doctors prescribe but do not (with minor exceptions) sell drugs, opticians both recommend and sell solutions and therefore have both a professional and a commercial interest in the products.

8.12. Solutions are also sold through pharmacies. The MCA, on the advice of the CDSM, permits this on the grounds that pharmacists are expected to be able to advise customers as necessary about the solutions they may wish to buy, or at least recommend that customers seek the advice of their optician. Pharmacists should also be able to answer questions, for example, about the compatibility of solutions with any medicines which the customer might be taking.

8.13. Both opticians and pharmacists are subject to specific systems of regulation as described in Chapter 2. In particular the British College of Optometrists has issued guidelines on contact lens practice (see paragraphs 2.50 to 2.53).

## **Users**

8.14. It is estimated that there are currently over 2 million contact lens wearers in the UK, about 4 per cent of the population. The proportion of lens wearers is greater among women than men and much greater among people under the age of 45. Lens wearers also tend to come from the higher socio-economic groups.

8.15. The annual costs of CLS to wearers vary considerably depending on the type of lens and the particular care system adopted. A comparison of systems for soft lenses—comprising surfactant cleaner, saline and disinfectant—shows that a system based on a cold chemical disinfectant costs around £120 a year, a system based on chlorine tablets around £140 a year, and one based on a peroxide disinfectant around £170 a year (assuming the purchase of monthly pack sizes and full compliance with the instructions). Protein removal would add some £35 to the annual costs in each case. On the same basis a cold

chemical system for hard lenses costs around £110. Protein removal is less likely to be necessary for hard lens wearers.

8.16. There is evidence indicating that a sizeable proportion of lens wearers fail to comply properly with lens care regimes. Many wearers use solutions after the date by which they should be discarded, do not clean their lenses every time they use them, or do not always use fresh solution. These failings in compliance appear to be due to a variety of reasons, notably inertia, lack of time, lack of understanding and unwillingness to bear the full costs of proper lens care. Some wearers seem not to experience any ill effects as a result of their non-compliance but others suffer adverse consequences ranging from irritation and discomfort to serious eye infections in a small proportion of cases, even loss of sight at the extreme.

## The market and its definition

8.17. The main suppliers of CLS in the UK are as follows:

- (a) Allergan, which is owned by a US company Allergan Inc and obtains most of its solutions from a sister company, Allergan Pharmaceuticals (Ireland) Limited Inc (API) which manufactures in Ireland;
- (b) CIBA Vision (UK) Ltd (CV-UK), which is part of the CIBA Vision division (CIBA Vision) of the Swiss company CIBA-GEIGY AG (CIBA-GEIGY) and sources most of its solutions from a fellow UK subsidiary CIBA Vision Lens Care Production Ltd (CVLCP) which has a new factory at Macclesfield; we use the name 'CIBA Vision' to refer to CV-UK and CVLCP together, or to the CIBA Vision division as a whole, according to the context;
- (c) Alcon Laboratories (UK) Ltd (Alcon), part of the US-based Alcon group but ultimately owned by Nestlé SA of Switzerland;
- (d) Bausch & Lomb UK Limited (B&L) together with its subsidiary Madden & Layman Ltd (M&L), both owned by a US company Bausch & Lomb Inc;
- (e) Sauflon Pharmaceuticals Ltd (Sauflon), a small independent UK company;
- (f) Smith & Nephew Pharmaceuticals Ltd (S&NP), a subsidiary of the UK company Smith & Nephew plc; and
- (g) Pilkington Barnes-Hind Limited (PBH), a subsidiary of the UK company Pilkington plc.

8.18. The estimated total value of CLS sales by suppliers in 1992 was £50 million, of which disinfectants represented about 61 per cent, salines 13 per cent, surfactant cleaners 12 per cent, protein removers 8 per cent and other products 6 per cent (see Table 3.2). Suppliers' estimated shares of this overall CLS market were as follows:

TABLE 8.1 Suppliers' shares of the total CLS market, 1992

	%
Allergan	38
CV-UK	34
Alcon	9
B&L/M&L	8
Sauflon	6
S&NP	2
PBH	1
Others	2

Source: MMC, based on data provided by the suppliers.

8.19. As explained in Chapter 3 (paragraphs 3.40 to 3.50), there are differences of view about the definition of the market for the purposes of economic analysis. CIBA Vision argued that CLS were part of a wider market in sterile ophthalmic solutions. Allergan said that it saw CLS as part of a market for vision products, which included spectacles, and that there were close associations on the supply side between CLS and ophthalmic pharmaceuticals.

8.20. In our view there are barriers to entry, resulting in particular from the operation of the regulatory controls (see paragraphs 8.115 to 8.126), which prevent companies which do not currently supply CLS, albeit they may have expertise in other ophthalmic products, from posing a credible threat to the existing suppliers. As to 'vision products', there may be some consumers who choose between wearing spectacles and contact lenses because of the cost of solutions, but the weight of evidence we received was that any such trade-off was marginal. A further possibility is to see lenses and solutions together as a single market since there is a range of lenses available varying in their requirements for solutions and including, in particular, disposable lenses which may occasion little use of solutions. However, the use of disposable lenses is very limited at present (though we consider in paragraph 8.100 their likely impact on the CLS market in future), and most recommendations made by opticians involve a combination of lenses with a range of solutions. We do not therefore consider that the market should be defined more widely than solutions alone.

8.21. Indeed, there is a case for considering solutions as divisible into four product markets, namely surfactant cleaners, disinfectants, salines, and protein removers. Most solutions can be allocated to one of those four categories, and for the majority of wearers the uses of the solutions in these categories are distinct. In other words, the extent to which the consumer can substitute a product from one of these categories by a product from another category is for the most part severely limited. Moreover, although the production facilities required may often be similar, the absence of appropriate product licences may well impede 'supply side substitution'. The argument for looking at different product markets is clearest in the case of protein removers, where a consumer needing to remove protein deposits has a choice only among the products made specifically for that purpose.

8.22. At the same time, there is a case also for thinking of CLS as representing a single market. Some products can be used for more than one function; in particular, some products are designed to serve as both disinfectants and cleaners, and salines are not only used for rinsing, but are also necessary for dissolving chlorine tablets (ie in the disinfection process) and protein removal tablets. Furthermore, a consumer will require products for the various stages of the treatment of lenses—which in turn results in solutions being sold as part of systems.

8.23. We have adopted both the approaches described in paragraphs 8.21 and 8.22 although for the most part we take solutions as a single market.

8.24. We consider that the UK is, at present, a separate market for solutions because the regulatory system causes the range of products which are on offer in this country to be significantly different from that in most other markets and presents a barrier to entry both for new suppliers and new products.

8.25. The suppliers' shares of the four product markets identified in paragraph 8.21 and the two sectors of the disinfectant market (oxidatives and cold chemical) are shown in Tables 3.3 to 3.8. Among the main features are the all-round strength of Allergan, its very high share in protein removers, and the dominance of the oxidative sector by CV-UK and Allergan.

8.26. Table 3.11 shows the breakdown of suppliers' sales to wholesalers and retailers. In 1992 34 per cent of suppliers' sales in aggregate went direct to opticians other than the Dollond & Aitchison Group plc (D&A) and Boots Opticians Ltd (BOL), the two biggest optician chains; 28 per cent to Boots, including supplies both for BOL and Boots' pharmacies which are operated by Boots The Chemists Ltd (BTC); 13 per cent to optical wholesalers; 11 per cent to D&A; 10 per cent to pharmaceutical wholesalers; and 4 per cent to others such as individual pharmacists and buying groups. At retail level we estimate that just under 60 per cent of CLS are sold by opticians and just over 40 per cent by pharmacists, measured by value at retail prices. Boots alone has about 36 per cent of the total, made up of 31 per cent through BTC and 5 per

cent through BOL.<sup>1</sup> (We use the name 'Boots' to refer to the Boots group as a whole or to BTC and BOL together, according to the context.)

8.27. Some of the leading retailers, notably Boots, D&A and Specsavers Optical Group Ltd (Specsavers, a group of franchised opticians outlets), sell CLS under their own labels, most of them sourced from the leading suppliers listed in paragraph 8.17. In 1992 own-label sales (which are included in the figures given in Table 8.1 and in paragraph 8.26) accounted for around 17 per cent of suppliers' sales and between 20 and 25 per cent of total sales at retail prices.

## **The monopoly situations**

8.28. Our terms of reference (Appendix 1.1) require us to investigate and report on whether a monopoly situation exists in relation to the supply within the UK of CLS, and if so by virtue of which provisions of sections 6 to 8 of the Fair Trading Act 1973 (the Act) the monopoly situation may be taken to exist, and in whose favour the situation exists. As noted in paragraph 8.3, the terms of reference do not specify any particular level of supply (manufacture/import, wholesale, retail): we have therefore investigated the possible existence of monopoly situations at each level.

8.29. Section 6 of the Act deals with monopoly situations in the supply of goods and is therefore the relevant section for our inquiry (section 7 deals with services and section 8 with exports). It envisages two different kinds of monopoly situation, usually referred to as 'scale' and 'complex'.

## **Findings on scale monopoly situations**

### ***Suppliers***

8.30. A scale monopoly situation under section 6(1)(a) or (b) is taken to exist when at least one-quarter of all the goods of a particular description which are supplied in the UK are supplied by or to the same person, or by or to members of the same group of interconnected bodies corporate. Table 3.9 shows that in 1992 Allergan accounted for 38 per cent and CV-UK for 34 per cent of the CLS sold by suppliers, measured by value at suppliers' realized prices, to wholesalers and retailers in the UK. The supply data for 1992 are estimates but the position was not substantially different in 1991, when Allergan's share was 39 per cent and CV-UK's was 32 per cent. In October 1992 we informed Allergan and CV-UK, separately, of our provisional findings that scale monopoly situations existed in that they each supplied at least one-quarter of the reference goods supplied in the UK. Each company told us it agreed, or had no reason to doubt, that the provisional finding made in respect of it was correct.

8.31. We conclude:

- (a) that a monopoly situation exists by virtue of section 6(1)(a) of the Act (a scale monopoly) in that Allergan supplies at least one-quarter of the CLS which are supplied in the UK; and
- (b) that a monopoly situation exists by virtue of section 6(1)(a) of the Act (a scale monopoly) in that CV-UK supplies at least one-quarter of the CLS which are supplied in the UK.

8.32. Our terms of reference also require us to report in whose favour the monopoly situations exist. We informed Allergan of our provisional conclusion that the monopoly situation existing by virtue of its supplies of CLS existed in favour of Allergan itself and of API and Allergan Inc (see paragraph 8.17(a)).

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<sup>1</sup>For comments on the difference between Boots' share of suppliers' sales and its share of retail sales see paragraph 8.168.

8.33. Allergan advanced a number of arguments against this finding in relation to API and Allergan Inc. It pointed out, as we accept, that Allergan was conducting its own business and that neither API nor Allergan Inc supplied CLS in the UK or carried on business there at all. Allergan submitted that the person in whose favour a scale monopoly situation existed would normally be the supplier itself, and that other persons would be involved only in exceptional circumstances, such as where a quarter or more of the reference goods were supplied by an agent on behalf of a principal.

8.34. Allergan further argued that it was not open to the MMC to find that a scale monopoly existed in favour of foreign companies whenever they supplied goods to an interconnected body corporate which had a scale monopoly. Nor, it suggested, would a finding that foreign companies were persons in whose favour a monopoly situation existed seem to serve any useful purpose, bearing in mind the limitation placed, by section 90(3) of the Act, on the order-making powers provided for in section 56. Neither API nor Allergan Inc was a person such as was described in section 90(3) and no action or omission of either of them within the UK had been called in issue in the present inquiry. The finding was therefore of theoretical and not practical interest.

8.35. Moreover, Allergan observed that it was possible that in the MMC's eventual report recommendations might be made in relation to conduct outside the UK; while, by reason of section 90(3) of the Act, these could not be directly implemented by order, they might form the basis for the placing of indirect pressure on a foreign company.

8.36. Allergan accepted that some previous MMC reports had found a monopoly situation in favour of shareholders in, and suppliers to, the monopoly supplier itself. Allergan did not find this consideration convincing since none of those cases had been challenged by way of judicial review and hence tested in the courts, and it could discern no consistency in the MMC's treatment of the point. Some of the cases could in any event be distinguished from the present one on their facts.

8.37. Allergan further argued that many companies could be said to benefit from a given scale monopoly situation. There was no satisfactory way to distinguish between them, for example by reference to the scale of their shareholding in, or their volume of trade with, the monopoly supplier.

8.38. We have taken careful account of these arguments and have had regard to recent cases in which questions relating to 'persons in whose favour' have been judicially considered, albeit in relation to complex monopoly situations. While it is likely that the supplier will normally be a person in whose favour a scale monopoly situation exists, the Act appears to us to provide no impediment to a finding that there are other such persons too. The question necessarily involves a factual element and section 48(b) of the Act, which relates to this question, contains neither an express nor an implied limitation.

8.39. It appears to us implicit in the outcome of the Visa case<sup>2</sup> that a finding may properly be made that a foreign company is a person in whose favour a monopoly situation (scale or complex) exists. We consider that it is open to us to find that a foreign company is such a person whether or not it is carrying on business in the UK within the meaning of section 90(3)(c) of the Act. As regards the argument advanced by Allergan that foreign companies might be exposed to indirect pressure by reason of possible MMC recommendations, and presumably by reason of their ability to give undertakings, we find it impossible to speculate on what might be the result of hypothetical recommendations which, it must be assumed, would be properly made. The point, however, does not seem to us to bear on the interpretation of the expression 'persons in whose favour' in section 48(b).

8.40. We do not consider that it would be consistent with our statutory duties to attempt to define all the circumstances in which persons, not themselves suppliers of the goods or services concerned, would be persons in whose favour a monopoly situation existed. The facts of a particular case are necessarily of particular relevance and we see no reason to accept any limitation such as that in Allergan's example of principal and agent. As Allergan has recognized, in a number of previous reports which concerned a variety of circumstances, the MMC have found that the persons in whose favour a scale monopoly situation existed were not confined to the monopoly supplier itself. These conclusions were not challenged and we have no reason to doubt their correctness.

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<sup>2</sup>*R v Monopolies and Mergers Commission and others ex parte Visa International Service Association*: judgments of Mr Justice Hodgson given on 15 June 1990 and of the Court of Appeal given on 4 October 1990.

8.41. As noted in paragraph 8.34, Allergan has suggested that no action or omission on the part of API and Allergan Inc has been called into question. In the result this is correct. However, we do not believe that this result means that they cannot be persons in whose favour the monopoly situation exists, which is a separate question.

8.42. In the present case API is the source of some 90 per cent of Allergan's supplies of CLS. Because of the system used to determine the transfer prices which Allergan pays to API, API's income from these sales depends on the selling prices and costs of Allergan's operations in the UK (see paragraph 4.15). Therefore the more profitable Allergan becomes, the more profit will accrue to API. Allergan Inc is the parent company, holding indirectly 100 per cent of the shares in both Allergan and API, and is therefore the ultimate beneficiary of the results of both companies. While, therefore, we take Allergan's point that many persons could be said to benefit in one way or another from the scale monopoly situation, we believe there are sufficient grounds for regarding these two companies as persons in whose favour the scale monopoly situation exists.

8.43. We therefore conclude that the scale monopoly situation which we have identified exists in favour of the supplier, Allergan—and, for the reasons which we have set out above, in favour also of API and Allergan Inc.

8.44. In the case of CV-UK we informed the company of our provisional conclusion that the monopoly situation existed in favour of CV-UK, and also CVLCP and CIBA-GEIGY.

8.45. CIBA Vision did not question our provisional finding on this point. Its response to our issues letter was made expressly on behalf of both CV-UK and CVLCP. Moreover, CIBA Vision argued that the profitability of its UK CLS business should be judged by reference to the consolidated figures for CV-UK and CVLCP, which were both controlled by the same UK holding company, CIBA-GEIGY PLC.

8.46. CV-UK now sources the great majority of the CLS which it sells in the UK from CVLCP, which benefits directly from CV-UK's performance through the transfer prices paid for those goods. CIBA-GEIGY, as the parent company owning 100 per cent of the shares in both the UK companies concerned, is the ultimate beneficiary of their results from CLS business in the UK. We therefore confirm our provisional finding that the monopoly situation exists in favour of the supplier, CV-UK, and also CVLCP and CIBA-GEIGY.

### ***Wholesalers***

8.47. In both 1991 and 1992 23 per cent of suppliers' total sales of CLS were made to wholesalers and the rest direct to retailers (see Table 3.11). We have already dealt with the question of scale monopoly situations among suppliers. Leaving them aside it is clear that no wholesaler or group of wholesalers supplies, or buys, as much as one-quarter of the CLS supplied in the UK. We therefore conclude that no monopoly situation exists at the wholesale level separate from those which we have found at the supplier level.

### ***Retailers***

8.48. Table 3.15 shows that in 1992 the Boots group accounted for 36 per cent of the CLS supplied by retailers (opticians and pharmacists) in the UK, measured at retail prices. In October 1992 we informed Boots of our provisional finding that a scale monopoly situation existed in that The Boots Company PLC, BTC and BOL together supplied at least one-quarter of the reference goods supplied in the UK at retail level and that the monopoly situation existed in favour of the same three companies.

8.49. Boots did not dispute that group companies accounted for over 25 per cent of the CLS sold at retail level in the UK. It pointed out, however, that the parent company, The Boots Company PLC, was not directly involved in this supply. It was responsible for the procurement of solutions but then transferred them to BTC and BOL which supplied them to customers. We accept that this is the case.

8.50. We therefore conclude that a monopoly situation exists by virtue of section 6(1)(b) of the Act (a scale monopoly) in that BTC and BOL, being members of the same group of interconnected bodies corporate, together supply at least one-quarter of the CLS which are supplied at retail level in the UK.

8.51. Although not a supplier of CLS to third parties, The Boots Company PLC benefits financially from that business as the group's ultimate holding company, holding 100 per cent of the shares in both BTC and BOL, and is involved in the purchasing of solutions. Boots did not dispute that The Boots Company PLC was a person in whose favour the monopoly situation existed. We conclude that the monopoly situation exists in favour of BTC and BOL, and also in favour of The Boots Company PLC.

## **Findings on complex monopoly situations**

8.52. A complex monopoly situation under section 6(1)(c) and (2) of the Act is taken to exist when at least one-quarter of all the goods of a particular description which are supplied in the UK are supplied by or to members of the same group consisting of two or more persons (not being a group of interconnected bodies corporate) who, whether voluntarily or not and whether by agreement or not, so conduct their respective affairs as in any way to prevent, restrict or distort competition in connection with the production or supply of goods of that description.

### ***The suppliers complex monopoly situation***

8.53. In October and November 1992 we informed the suppliers listed in paragraph 1 of Appendix 8.1 of our provisional finding that a complex monopoly situation existed in respect of the supply of CLS in the UK, in that they engaged in one or more of the following practices:

- (a) packaging CLS in a range of different sized containers such that there is no consistency of size within or across brands, no consistent relationship between size of container and recommended period of use and no indication on the label as to numbers of daily doses;
- (b) marketing some CLS in quantities which cannot be exhausted during the recommended period of use if the recommended daily dose is consumed;
- (c) setting recommended prices for solutions; and
- (d) applying different levels of discounts unrelated to cost differences respectively to independent opticians, optical groups and large independent opticians, multiple opticians, and optical and pharmaceutical wholesalers.

We invited the suppliers concerned to comment on our provisional finding and on the issues which appeared to us to arise from it.

8.54. The suppliers responded in writing and most of them also attended hearings. The following paragraphs summarize their views on the four practices listed above.

8.55. On the variability of pack size, suppliers argued that this was an aspect of competition among them, as they sought to differentiate their products. The introduction of large, economy packs had been a particular feature in recent years. The variation was no greater than with many other products. The volume of the pack's contents was always stated on the label and there was no great difficulty for consumers in making price comparisons. Some suppliers said that they marketed the same pack sizes in the UK as their sister companies did in the rest of the world: any requirement to adopt special sizes for the UK alone would raise costs and reduce security of supply.

8.56. We raised with the suppliers the possibility of a requirement that packs might have to state the number of doses contained, as an aid to price comparisons. Suppliers said that while such statements could readily be made for some products, eg those where a specified amount had to be poured into a particular sized lens case, difficulties arose with daily cleaners, where the instructions typically stated that a few drops should be sprinkled into the palm of the hand, or for products used for more than one function, eg

salines and certain multi-purpose solutions. A requirement that labels should state the number of doses, based on some kind of average use, would be misleading given also the variety in users' patterns of lens wear, reactions to lenses, wearing conditions and hence usage of solutions. As with changing pack sizes, the imposition of new labelling requirements would entail regulatory costs.

8.57. On the marketing of pack sizes such that the contents could not be exhausted during the recommended period of use, some suppliers denied that they engaged in this practice. Others agreed that they did market 'over-size' containers but justified this on various grounds: that the products in question were low sellers; that large pack sizes were offered in order to give better value for heavy users or for families with more than one lens wearer; and that the 28-day period of recommended use laid down by the MCA was unreasonably short for some products, notably daily cleaners. Allergan argued that if there was a problem here it was a matter for the MCA, as the authority responsible for product licensing, not the MMC.

8.58. On the setting of recommended retail prices (RRPs), suppliers said that this practice was very widespread in UK markets for consumer products. Suppliers made no attempt to impose their recommendations. There were enough retailers handling CLS to ensure price competition. The MMC's own survey had revealed considerable discounting of branded products by opticians, and the availability of cheaper own-label products represented another form of price competition.

8.59. With regard to differential discounting (point (d) in paragraph 8.53), Alcon said that while its discounts could not be precisely justified by cost savings, they were all cost-related. Discounts reflected the customer's value to the seller, not only because of direct and indirect cost savings resulting from large orders or taking central delivery but also from factors such as the customer's status as a regular, financially reliable buyer. Alcon did not use its discount system for any anti-competitive purpose. B&L said that it offered a graded, volume-related discount on purchases of solutions. It believed its discount structure to be consistent, transparent and non-discriminatory. Sauflon told us that its discount structure was based on the volume of purchases and reflected savings in shipping costs. In addition it negotiated special terms with high-volume retailers which reflected *inter alia* the competitive nature of the market. For large retailers to enjoy better terms of supply than small traders was normal practice, resulting from their bargaining strength and competition among suppliers. S&NP also put forward this argument. It submitted that small manufacturers must retain some freedom of pricing, including the ability to offer discounts which were not wholly volume-related, if they were to compete with the two large suppliers.

8.60. We deal with the positions of Allergan and CV-UK on discounting in the context of our consideration of the scale monopoly situations (see paragraphs 8.148 to 8.151 and 8.160 to 8.162).

8.61. In considering our conclusions on the existence of a complex monopoly situation we have taken account of the suppliers' views as summarized above, as well as all the other evidence bearing on the findings. We believe the wide variation in pack sizes does create difficulties for the consumer wishing to choose between different products and brands. Such a choice involves a number of considerations, for example how each product would fit in with the rest of a lens care system, the fact that different dosages are needed for different products, and the different possible effects on the eye, as well as the relationship between price and volume. The inclusion on the label of information about the number of dosages would ease the difficulties and we return to this issue later (see paragraph 8.227). But we accept that, in the circumstances of this market, differentiation of pack size does not in itself prevent, restrict or distort competition.

8.62. The marketing of solutions in over-size containers is a matter which causes us some concern and we return to this matter too in the context of the regulatory regime (paragraph 8.227). But if this practice has an effect on competition, it lies in the marketing of large pack sizes as an attempt to secure a competitive advantage by offering greater convenience and lower unit price, actions which are a manifestation of competition. We have therefore concluded that this practice, too, should not be regarded as conduct which could form the basis of a complex monopoly group.

8.63. The setting of RRP is a different matter. Although the practice is widespread, its effect has to be considered in the context of the market or markets in question. One of the conclusions of the 1969 MMC report on *Recommended Resale Prices*<sup>3</sup> was that the recommendation of resale prices in conjunction with factors such as restriction of outlets and monopoly in the supplying industry may prevent price competition in retailing, and that in such cases prices were likely to be higher than they otherwise would be. The report found that the effects of the practice differed in different trades and that the balance of the effect on the public interest differed accordingly. It concluded that it would not be possible to define the circumstances in which the listing of RRP should be prohibited and that any such prohibition should be made only after an investigation of the relevant markets.

8.64. In the present case there are two factors which seem to us important. First, CLS are seen by many people as akin to medicines. They are regulated under the Medicines Act and their retail sale is confined to opticians and pharmacists. Medicines are one of the few categories of products which have been exempted from the prohibition of individual resale price maintenance (RPM) in the Resale Prices Act 1976. We received evidence that some pharmacists believe CLS themselves to be subject to RPM. Secondly, our surveys found that over 90 per cent of pharmacists sell all branded CLS products at the RRP (see paragraph 3.203). The position of opticians is complicated by the prevalence of discount schemes but leaving these schemes aside the majority of opticians also sell all branded solutions at the recommended price. In these circumstances it seems to us that the setting of RRP by suppliers restricts price competition among retailers of CLS because retailers' prices would be likely to show greater variation if the practice were not followed. As recorded in paragraph 3.177, the evidence is clear that all the suppliers engage in this practice.

8.65. Differential discounting can be seen as a form of competition or an attempt to distort competition depending on the circumstances. In the CLS market we have found that, while there are similarities in the pattern of discounts given to the various trade channels, there are differences in the practices of individual suppliers. We attach weight to the contention of some of the smaller suppliers that their discounting behaviour is conditioned by, and to some extent responds to, the strength of Allergan and CV-UK, which between them have over 70 per cent of the total market. While there are aspects of the discounting behaviour of Allergan and CV-UK which fall to be considered in the context of the scale monopoly situations in favour of those companies, we do not believe that the practices of the other suppliers are forms of conduct which prevent, restrict or distort competition in these markets.

8.66. Taking account of the views we have set out in paragraphs 8.61 to 8.65 and the evidence recorded in paragraph 3.177, we conclude that a monopoly situation exists by virtue of sections 6(1)(c) and (2) of the Act (a complex monopoly) in that the suppliers listed in paragraph 1 of Appendix 8.1 (being members of one and the same group for the purpose of these provisions) supply at least one-quarter of the CLS which are supplied in the UK and engage in the following practice, namely the setting of RRP.

8.67. We also conclude that this monopoly situation exists in favour of the persons referred to in paragraph 2 of Appendix 8.1. These persons comprise the members of the complex monopoly group itself; their ultimate holding companies (where such exist); API; and CVLCP. Our reasoning for this conclusion is the same, *mutatis mutandis*, as applied in the context of the scale monopoly situations involving Allergan and CV-UK: see paragraphs 8.38 to 8.42 and 8.46.

### ***Own-label suppliers***

8.68. In October and November 1992 we informed the retailers listed in paragraph 3 of Appendix 8.1 of our provisional finding that a complex monopoly situation existed in that they engaged in one or more of the following practices:

- (a) packaging own-label CLS in a range of different-sized containers such that there is no consistency of size within or across brands, no consistent relationship between size of container and recommended period of use and no indication on the label as to numbers of daily doses;

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<sup>3</sup> *Recommended Resale Prices: a report on the general effect on the public interest of the practice of recommending or otherwise suggesting prices to be charged on the resale of goods*, HC 100, 10 February 1969.

- (b) marketing some own-label CLS in quantities which cannot be exhausted during the recommended period of use if the recommended daily dose is consumed; and
- (c) marketing own-label CLS as parts of complex care systems which should not be used with CLS from other brands of care systems.

We invited the retailers concerned to comment on our provisional finding and on the issues which we put to them in connection with it.

8.69. The retailers responded in writing and most of them also attended hearings. The following paragraphs summarize their views on the practices listed in paragraph 8.68.

8.70. The retailers said that their own-label products were virtually always 'resleeved' versions of proprietary branded products, ie they were the same products in different packaging. Licensing approval was needed from the MCA before solutions could be marketed in this way and it was easier and cheaper to obtain approval for pack sizes which were the same as those already approved for the branded version. The selling of pack sizes which were determined by the suppliers and the MCA could not be regarded as a course of conduct adopted by retailers. On the related question of labelling products with the number of doses contained as well as the volume, the retailers put forward arguments similar to those advanced by the suppliers (see paragraph 8.56).

8.71. With regard to the marketing of solutions in 'over-size' containers, too, the retailers' responses were similar to the suppliers' (see paragraph 8.57). Boots and D&A maintained that the pack sizes they sold would normally be used up by the discard date if users complied fully with the recommended regimes of lens care. Specsavers commented that the pack sizes which it sold had been approved by the MCA.

8.72. On the marketing of own-label CLS as part of complex care systems, the retailers said that this practice was attributable to the product licensing regime. There were serious limitations to the possibilities for users to switch from one product to another even where the products were of the same type (eg peroxide disinfectants). Specsavers told us that it had found that user compliance was much better when opticians recommended a complete lens care system. D&A said that although own-label retailers recommended complete systems, their ability to draw on different suppliers in making up those systems provided an entry route for suppliers with individual products, rather than a complete range.

8.73. Our view of the first two practices listed in paragraph 8.68 has been set out in the context of the suppliers' complex monopoly situation where the same points arose (see paragraphs 8.61 and 8.62): in brief we have decided that these are not practices which prevent, restrict or distort competition.

8.74. As regards the marketing of CLS as parts of complex care systems, our concern had been that the marketing of complete systems might be used to shut out other products which, on their individual merits, offered good value for money. But we received no complaints about such consequences, and it became clear during the inquiry that the marketing of systems is an aspect of inter-brand competition. We therefore do not believe that the practice forms the basis of a complex monopoly situation among own-label retailers.

8.75. Given the views we have now reached on these matters, as recorded in paragraphs 8.73 and 8.74, we conclude that there is no complex monopoly situation among own-label suppliers of CLS.

### ***The retailers complex monopoly situation***

8.76. In October and November 1992 we informed the retailers listed in paragraph 5 of Appendix 8.1 of our provisional finding that a complex monopoly situation existed in that they and others sold CLS at, or only just below, RRP. We also wrote to bodies representing opticians and pharmacists inviting them to comment on this finding and the issues which appeared to us to arise as a result. These bodies are listed in paragraph 7 of Appendix 8.1 and their membership and role are set out in Chapter 7.

8.77. The retailers argued that there was substantial price competition between brands. There was also considerable discounting of CLS by opticians. Moreover CLS were available at prices below the level recommended by suppliers via retailers' own-label products. Those retailers who sold own-label solutions preferred to concentrate their price competitiveness on their own products.

8.78. Boots said that the market in CLS was not price-sensitive. It chose to compete primarily on other factors (see paragraph 8.172). It had no fixed policy always to price at the recommended levels but had seen no sufficient reason to depart from them. D&A told us that its chosen strategy was to set the prices of branded solutions at 2 per cent below the suppliers' recommended levels in order to give itself an edge over its competitors. In addition it offered prices up to 15 per cent below recommended levels via its contact lens care scheme. Lloyds Chemists plc (Lloyds), which had told us that all the solutions it sold were at the recommended price, said that price-cutting would encourage excessive use of CLS, which was not in the interest of the consumer.

8.79. Two of the opticians' representative bodies commented that the low margins available to opticians left little room for discounting.

8.80. The National Pharmaceutical Association said that soundings of its members suggested two reasons for pharmacists selling at recommended prices: first that some believed that CLS were proprietary medicines and hence subject to RPM; and second that the professional input in supplying advice with CLS products needed to be financially rewarded.

8.81. In considering these arguments we note that nearly two-thirds of CLS are sold by retailers who sell all branded solutions at the recommended price. This calculation is heavily influenced by the position of Boots, which alone has 36 per cent of the market. But in addition D&A, which has around 10 per cent, sells branded solutions at only just below recommended price except for those customers who are prepared to join its discount scheme, and according to our survey other opticians with over 11 per cent of the market between them sell branded solutions at the full recommended price except under their discount schemes.

8.82. We do not ignore the existence of discount schemes offered by a significant number of opticians but we do regard them as an imperfect form of price competition since the price benefit is only available to customers who are prepared to be tied to buying solutions from the optician in question. For other customers, branded solutions are only available at or close to the recommended price in a very high proportion of outlets. In this respect CLS differ from many other consumer products for which there are RRP. In the light of these considerations we believe that the selling of CLS at, or only just below, recommended prices is a practice which restricts competition at retail level.

8.83. The evidence for the existence of this practice comes from two sources. First, as recorded in paragraph 8.78, the four retailers named in paragraph 5 of Appendix 8.1 (BTC, BOL, D&A and Lloyds) told us that they charged prices at—or, in the case of D&A, 2 per cent below—the suppliers' RRP. Secondly, since it was impracticable to get similar direct evidence from all retailers, we carried out surveys of opticians and pharmacies. These surveys are described in Appendix 3.7 and the results are summarized in Appendices 3.8 and 3.9. We are satisfied that the results of these surveys may be relied on, as orders of magnitude though not as precise percentages, as evidence of opticians' and pharmacists' pricing behaviour.

8.84. Paragraph 3.204 shows that the four named retailers have about 47 per cent of the retail market, while the other, unnamed retailers engaging in the practice account for about a further 35 per cent.

8.85. We therefore conclude that a monopoly situation exists by virtue of sections 6(1)(c) and (2) of the Act (a complex monopoly) in that the retailers referred to in paragraph 5 of Appendix 8.1 (being members of one and the same group for the purpose of these provisions) supply at least one-quarter of the CLS which are supplied in the UK and engage in the following practice, namely selling CLS at, or only just below, RRP. We further conclude that this situation exists in favour of those same retailers and, for the reasons given in paragraph 8.51, in favour also of The Boots Company PLC.

### *The opticians complex monopoly situations*

8.86. In October and November 1992 we informed the opticians listed in paragraph 8 of Appendix 8.1 of our provisional finding that a complex monopoly situation existed in that they engaged in one or both of the following practices:

- (a) giving little weight to the cost of particular types and brands of CLS when making their recommendations to patients; and
- (b) failing to make sufficiently clear to patients, before they purchase contact lenses, all relevant information about the prices of the CLS they recommend, in particular the likely overall annual cost to the patient of complying with the recommended regime.

We also wrote to opticians' representative bodies inviting them to comment on this provisional finding and the issues which we had identified as arising from it. These bodies are listed in paragraph 10 of Appendix 8.1 and their membership and role are described in Chapter 7.

8.87. The evidence underlying our provisional conclusion was based on our surveys of opticians and consumers. With regard to the first practice our survey of opticians (see Appendix 3.8) showed that nearly three-quarters of opticians in the sample did not give 'reasonable cost to the customer' as one of the three main reasons for recommending a particular disinfecting system. Three-quarters of opticians said that they normally recommended a peroxide system for wearers of soft lenses while 13 per cent recommended a chlorine system and 5 per cent a cold chemical system. At the same time 79 per cent said that most wearers could satisfactorily use a chlorine system and 50 per cent said the same for cold chemical systems, compared with 93 per cent for peroxide systems. Chlorine systems are significantly cheaper than peroxides, and cold chemical systems are cheaper again (see paragraph 8.15).

8.88. The evidence concerning the second practice comes from our survey of consumers (see Appendix 3.10). Approaching three-quarters of the sample said that when they were first considering wearing contact lenses the optician did not discuss with them the likely future costs of buying solutions, while nearly 30 per cent of those who were told about this said that they were informed after they had made their decision to wear lenses.

8.89. On the first point opticians submitted that they were under a professional duty to give first priority to clinical considerations, not cost. It was therefore correct for opticians to have said, in reply to our survey, that the three most important reasons for recommending particular solutions were concerned with effectiveness, comfort and ease of use. The survey results were consistent with opticians having regard to cost factors once these primary considerations had been satisfied. As to the recommendations of particular systems, there were sound clinical reasons for the pattern which the survey had found.

8.90. Concerning the second point, opticians' representatives said that opticians had a duty to make clear to customers, before the customers committed themselves to buying lenses, what costs would be involved both on supply and on a continuing basis. This duty was specifically stated in the guidelines issued by the British College of Optometrists (see paragraphs 2.50 to 2.53). Opticians' representatives maintained that the costs of lens care were explained to new customers and cited the results of our opticians survey in support of this contention (see paragraph 19 of Appendix 3.8). They attributed the results of our consumer survey to forgetfulness on the part of consumers, pointing out that nearly half of wearers fitted in the year immediately before the survey was conducted said the optician had discussed the cost of solutions. Such forgetfulness was not surprising since opticians had to put across a good deal of information all at once to people contemplating wearing contact lenses for the first time. Some opticians pointed to the growing use of regular payment schemes which showed customers very clearly what the monthly cost of solutions was.

8.91. We have carefully considered the evidence and views put forward on these points. On the first practice the opticians survey provides clear evidence that a substantial majority of opticians normally recommend peroxide disinfectants (see paragraph 8.87) and this is supported by other information, notably the rapid growth in the proportion of the disinfectant market taken by peroxides (see Table 3.2). Equally the survey shows that a substantial majority of opticians believe that chlorine systems could be satisfactorily used by most lens wearers. It appears to be the case that most opticians recommend peroxides

in order to avoid the risk of adverse reactions which would affect a relatively small proportion of people. Optician witnesses told us that it was normal practice for opticians to recommend a particular lens care regime to a customer and not to discuss alternative possibilities (see Chapter 7). We consider that it would be quite feasible, however, for opticians to explain the options to customers, bringing out the cost as well as other implications, and not simply make a single recommendation. We believe that their failure to do so limits the effectiveness of price competition among suppliers and therefore restricts and distorts competition.

8.92. On the second practice the position is less clear because there is a conflict of evidence between the optician and consumer surveys. However, even if we give greater weight to the replies from consumers who were first fitted with lenses in the 12 months before the survey, the proportion saying that the overall costs of lens care were not discussed with them by the optician is still around half, while about a third of the remainder were informed after making their decision to buy lenses (see paragraph 3.148).

8.93. On balance we rely on the evidence of the consumer survey on this practice because the consumers had no reason to claim that the subject of cost had not been discussed if in reality it had been. Even if, in some cases, the consumers forgot what the optician had said about costs, this suggests that the subject may have been given insufficient emphasis. We have in mind that over time the costs of solutions are likely to exceed the cost of lenses, both those originally supplied and any subsequent replacements, possibly by a considerable margin, a fact of which many consumers are probably unaware. We consider that this conduct limits the ability of consumers to make well-informed choices based on an accurate knowledge of costs, and hence distorts competition.

8.94. As in the case of the retailers complex monopoly situation (see paragraph 8.83) we have perforce to rely largely on survey evidence in arriving at a picture of the conduct of opticians in advising their customers. The evidence concerning the first practice listed in paragraph 8.86 comes from our survey of opticians and is set out in paragraphs 3.141 to 3.146. This shows that about three-quarters of opticians did not give 'reasonable cost to the customer' as one of the three most important reasons for recommending solutions to customers. The survey indicates that most of the opticians working for BOL and D&A were among these three-quarters. We have shown in Chapter 3 that opticians account for nearly 60 per cent of the CLS market at retail level. It follows that three-quarters of all opticians account for about 45 per cent of total retail sales of CLS. Even allowing for the possible imprecision of survey evidence, the proportion of opticians engaging in the practice is clearly well above 25 per cent. BOL and D&A, the two named members of the group, have about 15 per cent of the retail market between them.

8.95. We conclude that a monopoly situation exists by virtue of section 6(1)(c) and (2) of the Act (a complex monopoly) in that BOL, D&A and other opticians engaging in the practice referred to below (being members of one and the same group for the purpose of these provisions) supply at least one-quarter of the CLS which are supplied in the UK and engage in the following practice, namely giving little weight to the cost of particular types and brands of CLS when making their recommendations to patients. We further conclude that the monopoly situation exists in favour of those same opticians and, for the reasons given in paragraph 8.51, in favour also of The Boots Company PLC.

8.96. As mentioned above, the evidence for the second practice comes from our survey of consumers, the findings of which are summarized in Appendix 3.10. We agree that more weight should be placed on the evidence of consumers who had been fitted with lenses in the 12 months preceding the survey. On this basis, as noted in paragraph 8.92, around half of opticians fail to discuss the costs of lens care with new customers, while about a third of the remainder do so after the customer has taken the decision to wear lenses. As a proportion of total retail sales of CLS, therefore, the two-thirds of opticians engaging in this practice account for about 40 per cent—again, well over the 25 per cent threshold. In this case, however, the evidence is not specific to any named persons.

8.97. We therefore conclude that a monopoly situation exists by virtue of section 6(1)(c) and (2) of the Act (a complex monopoly) in that the opticians engaging in the practice referred to below (being members of one and the same group for the purpose of these provisions) supply at least one-quarter of the CLS which are supplied in the UK and engage in the following practice, namely failing to make sufficiently clear to patients, before they purchase contact lenses, all relevant information about the prices of the CLS they recommend, in particular the likely overall annual cost to the patient of complying with the recommended regime. We further conclude that the monopoly situation exists in favour of those same opticians.

## The operation of the market

8.98. Before we turn to the issues arising from the monopoly situations it is necessary to highlight the key features of the market's evolution in the last few years and of its current operation.

### Demand

8.99. Table 3.2 shows that at current prices sales of CLS in the UK more than doubled in the period 1988 to 1992, though the growth rate has slowed in the last two years. CLS sales have recently tended to increase more rapidly than lens sales. This appears to be due to the shift to soft lenses, which require greater use of solutions to keep them in good condition, and to the growth in popularity of peroxide disinfectants which are more expensive than other systems.

8.100. The prospects for demand are difficult to assess. Penetration of contact lens wear in the UK is far below the USA but the industry does not appear confident that rapid growth in lens wear will resume. Nor will demand for solutions necessarily grow as rapidly as lens wear if disposable lenses take an increasing share of the market. The concept of lenses being worn continuously (ie day and night) for periods of a week or two and then discarded has been introduced to the market. This mode of lens wear requires little or no use of solutions. Serious doubt has, however, been cast on the safety of wearing lenses day and night and it appears likely that daily wear will continue to predominate. The possibility that disposable lenses might be made so cheaply that they could be worn for a day and then discarded also remains uncertain. We do not believe therefore that the market for solutions will collapse. There are nevertheless major uncertainties about demand prospects, and we received evidence that suppliers' strategies for the future were affected by this. The uncertainty may also discourage new entry.

8.101. The importance of disinfectants has increased so that they now represent over 60 per cent of the total value of solutions sold, the bulk of it in the form of peroxides. Cold chemical preserved disinfectants have declined in popularity. Peroxides are the prime source of the high market shares held by Allergan and CV-UK.

### Suppliers

8.102. The pattern of suppliers' shares in the overall CLS market has not changed fundamentally over the last five years (see Table 3.9). CV-UK had a clear lead in 1988 but lost ground steadily until 1992, when it appears to have achieved a modest recovery. Allergan's share increased between 1988 and 1989 at CV-UK's expense but has since remained broadly constant. The combined share of these two leading suppliers declined from 77 to 72 per cent between 1988 and 1990 but has since held steady. Among the other suppliers Alcon has seen little change in its share, Sauflon and B&L/M&L have increased theirs and S&NP has lost ground.

8.103. Positions in the individual product markets and sectors have been more volatile. For example, Allergan, having introduced a peroxide product later than CV-UK, doubled its share of sales in the oxidative sector of the disinfectant market at CV-UK's expense, the combined shares of these two companies falling only from 89 to 85 per cent between 1988 and 1992 (see Table 3.5). In surfactant cleaners the combined share of the three original leaders (Allergan, CV-UK and Alcon) fell from 85 per cent in 1988 to 64 per cent in 1992 while the share of B&L/M&L rose from 16 per cent in 1989 to 27 per cent in 1992 (see Table 3.3). In salines CV-UK's share fell from 36 to 21 per cent while Sauflon's rose from 12 to 23 per cent over the period 1988 to 1992 (see Table 3.7). Allergan's position in protein removers has remained very strong: its share fell from 74 to 66 per cent between 1988 and 1989 but then stabilized and in 1992 recovered to 70 per cent (see Table 3.8).

8.104. No new suppliers have entered the market in the last five years. Sauflon acquired the solutions part of an optical business in 1985 and has increased its CLS sales fivefold since 1987. CIBA Vision entered the UK CLS market in 1983 and greatly increased the size of its operations in 1988 by acquiring the lens care business of The Cooper Industries Inc. Other significant acquisitions were those of Hydron International by Allergan in 1987, of Barnes-Hind Ltd by Pilkington plc also in 1987, and of M&L by B&L in 1989.

8.105. In the second half of the 1980s the main area of product innovation was the introduction of preservative-free solutions. This began with disinfectants where CV-UK's 10.10 (introduced in 1985) and Allergan's Oxysept (1987) are now the top-selling CLS products. Alcon and Sauflon introduced their chlorine tablets around the same time. The move to preservative-free products continued with surfactant cleaners and salines. Relatively few new products have been introduced since 1988. The only one to make a significant impact on the market so far is a protein remover, Ultrazyme, which Allergan launched in 1990: Ultrazyme enables protein cleaning to be carried out at the same time as disinfection but is licensed for use only with Allergan's Oxysept. At the beginning of 1993 Allergan launched Oxysept One-Step which allows the disinfecting and neutralizing processes to be carried out in a single operation.

8.106. The introduction of own-label solutions by some of the biggest retailers (but largely sourced from the suppliers listed in paragraph 8.17) has been an important feature of the market in the last five years. The market share figures cited earlier in this chapter include the suppliers' sales for retailers' own-labels as well as branded sales. The share taken by all own-label sales seen as a separate category has risen from 3 per cent in 1988 to 17 per cent in 1992, measured at suppliers' prices, and between 20 and 25 per cent at retail prices (see Table 3.9 and paragraph 3.163). Since prices for own-label products are below those for branded products, the share of suppliers' own-label sales measured by volume must be higher, but no statistics are available on that basis. CV-UK is the leading supplier of own-label solutions with 53 per cent of the total in 1992, the other main suppliers being Sauflon with 21 per cent and Alcon with 11 per cent. Allergan was a late entrant to this business and had only 4 per cent of the total in 1992.

8.107. The breakdown between trade channels (see paragraph 8.26) was little changed between 1991 and 1992 but over a longer period there has been a substantial shift towards sales through pharmacists. The pattern varies considerably among the different suppliers. In particular some companies (B&L, Sauflon, PBH) choose to sell only to opticians or optical wholesalers. Of the two leading suppliers, CV-UK is more dependent on sales to Boots and D&A (50 per cent of its total business) than Allergan (37 per cent): see Table 3.11.

8.108. In money terms RRP's of solutions have risen in almost all cases over the period 1988 to 1992 but by widely varying amounts: see Tables 3.17 to 3.20. Adjusted for changes in the Retail Price Index (RPI), prices of preservative-free products have generally fallen. Thus the inflation-adjusted prices of Allergan's Oxysept and CV-UK's 10.10 peroxide disinfectants declined by about 6 per cent over the period (taking the standard pack size as the measure). Real prices of older-generation preserved products, on the other hand, have tended to increase, despite their declining popularity, although cold chemical disinfectants are still substantially cheaper than peroxides (see paragraph 3.192). Of the four product markets identified in paragraph 8.21, only in salines have real prices fallen across the board.

## **Retailers**

8.109. Since the introduction of the current regulatory regime governing the supply of CLS in 1983, the retail sale of solutions has been restricted to opticians and pharmacists. Allergan told us that in the early 1970s almost all sales of solutions were via opticians. Since then the share of pharmacists has grown to reach an estimated level of just over 40 per cent of total CLS sales at retail level in 1992. The bulk of this consists of sales by Boots pharmacies, which alone accounted for 31 per cent of the total market in that year. Lloyds, the second biggest chain of pharmacies after Boots, has only 1 per cent of the market.

8.110. The other notable trend in the retail market has been the growth of own-label sales (see paragraph 8.106). In 1988 these sales, at suppliers' prices, totalled £0.7 million, but by 1992 they had grown to £8.4 million (Table 3.9). Nearly all these sales were made to three retailers: Boots, D&A and Specsavers. Boots told us that own-label products accounted for 35 per cent of its total turnover of solutions in 1992. D&A, which introduced own-label solutions only in 1990, stated that they accounted for about 65 per cent by volume of its CLS sales in 1992. UniChem PLC (UniChem), which is one of the two leading pharmaceutical wholesalers and also owns a chain of pharmacies, told us that it planned to launch a small range of own-label solutions in March 1993. We also heard of other retailers who have been considering such a step, including some who are not currently permitted to do so by the regulatory regime but who hoped that the restrictions on distribution channels would be eased.

8.111. As in many other consumer product markets, own-label solutions allow retailers to enhance their reputation for giving good value for money, by making available sound quality products at prices below those of equivalent branded products, and to encourage customers to come back specifically in order to buy those products in future. There is an additional factor in the CLS market because of the opticians' role in recommending products to customers: Boots, D&A and Specsavers all told us that their opticians recommended their own-label products wherever it was appropriate to do so in an individual case.

8.112. Retailers are able to negotiate lower prices from suppliers for own-label products because of the value of the business on offer and because retailers do not contribute to suppliers' marketing costs. As a result, despite lower selling prices both Boots and D&A achieve gross margins on own-label products which are significantly higher than on the equivalent branded products. Boots submitted that this differential was necessary to cover its higher costs in marketing own-label products (see paragraph 8.177).

## Competition

8.113. Competition among suppliers takes various forms:

- (a) *Product innovation.* Suppliers have sought to introduce products which would reduce the incidence of adverse reactions, in particular by dispensing with the use of preservatives. The two-step peroxides have established themselves as the leading disinfectants despite being more expensive and more complicated to use than chlorine tablets and cold chemical preserved products. The current focus appears to be on the introduction of products which combine convenience with comfort: one-step peroxide disinfectants, and so-called 'all-in-one' solutions which carry out all necessary functions except protein removal. We were told of a variety of approaches being pursued by suppliers. The need to obtain a product licence from the MCA appears, however, to have substantially slowed the introduction of new products to the UK market compared with other countries (see paragraphs 8.116 to 8.118).
- (b) *Setting recommended prices.* As discussed further in paragraph 8.193, suppliers frequently pitch the recommended prices of individual products at levels designed to give them an edge over competing products.
- (c) *Discounts to retailers.* Most suppliers offer discounts for volume orders but also negotiate individually with specific customers. All the major suppliers give their biggest discounts to Boots and the second-biggest to D&A. Allergan and CV-UK offer bigger average discounts to opticians than to wholesalers. At our request Allergan calculated its relative costs and savings in supplying different trade channels. The results showed that after taking account of the relative discounts, Allergan's costs of doing business with opticians are on average greater than with Boots, which orders in large volumes and takes delivery at a central warehouse. CV-UK was unable to make a comparable calculation but its pattern of average discounts is similar to Allergan's. Both companies said that they gave opticians favourable prices because of the importance of opticians as advisers to lens wearers; Allergan referred to this as the 'gatekeeper role' in relation to the marketing of CLS (see paragraphs 8.10 and 8.11). By contrast in 1987 Allergan took the lead in cutting discounts to optical wholesalers from the traditional level of 25 per cent to 15 per cent, the same as for pharmaceutical wholesalers, and was followed by CV-UK's predecessor company and S&NP. Allergan told us that in its view optical wholesalers performed a largely passive role and had little

ability to influence the market. Most other suppliers still give 25 per cent discounts to optical wholesalers.

- (d) *Starter packs.* The free issue of starter packs to consumers (see paragraph 8.10) enables them to try out the lens care regime for perhaps two weeks before returning to the optician for a further consultation. From the supplier's standpoint the aim is that the consumer, having thus had a free trial, will thereafter continue to use the same system. (Some opticians, however, told us that they may recommend a system made up of different suppliers' products, in which case they will change the contents of the starter pack.) The supply of starter packs is the largest element in suppliers' marketing and promotion budgets.
- (e) Other aspects of suppliers' promotional activities are also focused primarily on opticians. For example, suppliers produce literature for opticians giving technical information about their products and comparing them with competing products as regards effectiveness, RRP and margin available for the optician. Allergan told us that it had run television advertising campaigns in South-East England but in general there is little advertising aimed at consumers.
- (f) Suppliers' ability to provide an efficient distribution service and to give technical advice to opticians whenever it is needed are important factors in influencing opticians' perceptions.

8.114. At retail level the principal features of competition are as follows:

- (a) *Prices of branded products.* As described in Chapter 3 (see paragraphs 3.201 to 3.205), opticians do to some extent engage in price competition in selling branded products, though pharmacists generally do not. Some retailers, such as D&A, follow a policy of always pricing below recommended levels; others do so as part of temporary promotions.
- (b) *Discount schemes.* Nearly half of opticians offer schemes which enable regular customers to buy solutions at less than the recommended price. Such schemes are sometimes linked with the replacement of lenses and periodic consultations with the optician (see paragraphs 3.199 and 3.200).
- (c) *Own-label products.* As described in paragraphs 8.110 to 8.112, the leading retailers have introduced own-label solutions priced below the equivalent branded products.
- (d) *Advice.* Opticians advise customers on all aspects of lens care, including the implications of switching between different types and brands of solutions. Pharmacists provide more limited advice.
- (e) *Ranges stocked.* Boots told us that one aspect of its competitive stance was the number of CLS lines which it stocked, which it said was much higher than those of other leading retailers.
- (f) *Convenience and service.* Pharmacists offer a much wider range of other products than opticians, thus enabling customers to combine the buying of solutions with other purchases in one visit.

In considering the relative importance of opticians and pharmacists in this market it is relevant to note that there are some 6,000 optician outlets and 11,000 pharmacies in the UK, most of which sell solutions. As mentioned in paragraph 8.26, we estimate that opticians have nearly 60 per cent of the retail CLS market and pharmacists just over 40 per cent.

## **The effect of MCA regulations**

8.115. MCA regulations (see paragraph 8.7) affect the CLS market in two main ways: by the impact of product licensing on the introduction of new products, and by the restriction of retail distribution to opticians and pharmacists.

8.116. Among the suppliers, Alcon and B&L, big players in the USA and certain other major CLS markets, have a significantly weaker presence in the UK. This is primarily a consequence of their inability to secure MCA approval for the main products which they have introduced in recent years to compete in the disinfectant market.

8.117. B&L told us that its 'all-in-one' solution, Renu, had been on the market in most other advanced countries for some years and was probably the leading product world-wide measured by opticians' recommendations to new lens wearers. B&L cited the example of Australia, where Renu had been marketed since 1985/86. According to B&L, both Renu and Alcon's soft lens disinfectant Optifree, which was similarly not available in the UK, had made significant inroads against Allergan which had been the market leader with its peroxide system. Alcon told us that the UK system of product licensing was different from that in most other countries. In Alcon's view the UK regulatory regime deterred new entry and hindered the introduction of products which were already being safely and successfully marketed elsewhere. Alcon's product range in the UK was typically a couple of years behind other countries (see paragraphs 6.193 and 6.194).

8.118. CIBA Vision, despite its high market share, was also critical of the UK licensing system which it said was widely acknowledged to be the strictest in Europe and probably in the world. Companies faced considerable problems in deciding what data would be required to satisfy the licensing authority of the product's quality, safety and efficacy even when the product had been marketed in other countries for a period. CIBA Vision said that the UK market was probably two generations of product behind many other markets which had moved on from two-step non-preserved systems through single-step non-preserved systems to products (such as Renu and Optifree) based upon new preservatives which appeared to cause less irritation to the eye. [

*Details omitted. See note on page iv.*

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8.119. Allergan, on the other hand, said that it strongly supported strict regulation of solutions. It believed this was in the interests both of the public and of suppliers, in that it was important for consumers to have confidence in the safety of the products. Allergan said that the regulatory hurdles were clear and were applied in an efficient and non-discriminatory way (see paragraph 6.3). It did not consider them to be barriers to entry to the UK CLS market. Allergan launched its one-step peroxide, Oxysept One-Step, early in 1993 having applied for the necessary product licence during 1992.

8.120. The MCA itself said that the product licensing system was straightforward and easily interpretable via well-publicized guidelines. The MCA's assessors were willing to explain the system to potential applicants and had frequently given advice to companies about specific products. The guidelines were interpreted flexibly and it was open to applicants to make a case for whatever information they considered would demonstrate that their products satisfied the criteria. Ultimately the requirements were met by virtually all applicants.

8.121. The MCA accepted that UK standards were more stringent than those in some other countries but maintained that there were good reasons for this. The MCA took account of clinical and market experience in other countries when considering applications for products which were already marketed elsewhere, but in the absence of a system of mutual recognition such experience could not remove the need for a complete dossier to be submitted to meet UK requirements.

8.122. The MCA pointed out that under the Medicines Act the only criteria for deciding applications were quality, safety and efficacy. Within this constraint it was able to take account of a product's ease of use, which might make for better user compliance. But it could not take account of cost factors, for example that cheaper products might lead to improvement in compliance.

8.123. The MCA acknowledged that there had in the past been excessive delays in processing applications but this had greatly improved since 1989. UK processing times were now at least as fast as any EC member state and faster than the USA.

8.124. We have thus been presented with conflicting accounts and opinions. Our considered view of the evidence presented to us is that the effect of the product licensing system has been seriously to inhibit competition in the supply of CLS in the UK. Apart from the direct impact on suppliers who have not been able to obtain licences for particular products, the system evidently causes substantial uncertainties—as to

the time and costs involved, as well as the outcome—which are likely to influence suppliers' approach to the UK market. These effects may be at least partly a consequence of the original decision that CLS should be controlled under the Medicines Act, which imposes certain constraints on the regulatory authority. Most of the suppliers told us that they expected some relaxation of standards as a result of the decision that solutions should in future be regulated under the EC Directive on Medical Devices. The Directive may not be fully implemented for five years, however, and we believe that earlier action should be taken to remedy the situation (see paragraph 8.218).

8.125. In the course of the inquiry we noticed two detailed aspects of the product licensing regime which seemed to us unsatisfactory:

- (a) The warning 'Do not mix with other fluids except as directed' (see paragraph 8.8) is capable of two quite different interpretations. The MCA told us that the intention was to warn against the physical mixing together of different solutions, but some other witnesses (including suppliers) interpreted it as a warning against combining different solutions in the same lens care system. The latter interpretation may reinforce users' reluctance to switch between products in order to get better value for money.
- (b) We found that some products, particularly surfactant cleaners, were sold in amounts which would not normally be used up within the period of recommended use (see paragraphs 3.29 and 3.30). We received letters from members of the public complaining that they either had to waste money by discarding unused amounts or to use the solution beyond the discard date. The MCA told us that more products could probably be used for longer than the normal 28-day period but the onus lay with the licence holder to make out a case for a licence variation allowing a longer period of recommended use to be stated on the container (see paragraph 5.27). Allergan said that it regarded a 28-day recommended use period for its surfactant cleaner LC-65 as unrealistically short but that to support an application for a longer period would have required lengthy and expensive clinical trials which it believed would have been a waste of time and money. It may be true, as Allergan said, that no health risk results directly from this situation. The danger is that if users find that this aspect of the instructions is not to be taken seriously, they will adopt a more casual attitude to other aspects which do matter.

8.126. A further element in the regulatory regime is to restrict the retail outlets for CLS to opticians and pharmacists. As noted in paragraph 8.64, a substantial majority of retailers sell all branded CLS at RRP. CLS are available at prices below the recommended level via retailers' own-label sales but the extent of the reductions is not large compared with other product markets: Boots in particular sells its own-label solutions at a weighted average of about 6 per cent below the recommended price for the equivalent branded products, which is at the low end of the range of discounts at which it sells own-label products generally. We believe that this lack of price competition would not be possible without the restriction on outlets. This situation is exacerbated by the fact that there are also restrictions on the opening of new pharmacies: see paragraph 2.55.

## Public interest issues

8.127. We now address the remaining questions in our terms of reference (see Appendix 1.1) and in particular whether any of the monopoly situations gives rise to facts which are against the public interest.

### Allergan

8.128. Allergan is the market leader in terms of share of CLS sales overall, having held about 38 per cent of the total since 1989. It is the leading supplier of surfactant cleaners (35 per cent), cold chemical disinfectants (38 per cent) and most notably protein removers (70 per cent), and is very well represented in every type of solution. Although its advantage over CV-UK in the overall CLS market is only a few percentage points, it is the stronger company in several respects. Its product strength is more broadly based than CV-UK's, whose position depends heavily on its 10.10 peroxide disinfectant. It is less dependent on sales to Boots and D&A, the two most powerful retailers. Nearly all its sales are of branded products

whereas over a quarter of CV-UK's sales are for retailers' own-labels. Its average discount off trade prices is lower than CV-UK's. It does not appear to have experienced the production difficulties from which CIBA Vision has suffered in the start-up of production at the Macclesfield plant. Above all it is far more profitable: the net margin on turnover achieved by Allergan and API on UK CLS business has averaged 31 per cent over the last three years compared with 10 per cent for CV-UK and CVLCP.

### ***Prices and profits***

8.129. The assessment of Allergan's profitability has been an important element in our inquiry. (As mentioned in paragraph 8.3, the apparent earning of high rates of return was one of the principal reasons for the inquiry being set up.) Allergan itself is purely a distribution company and as such has relatively little by way of physical assets. It obtains all its supplies of CLS from other companies in the Allergan group, around 90 per cent coming from API. Allergan provided us with the information necessary to combine its results with API's in such a way as to show the profitability of the two companies jointly on UK CLS business. Table 8.2 sets out these combined figures, which allow for Allergan's full share of group royalties, research and development (R&D) and central overheads (only a small proportion of these costs are included in Allergan's statutory accounts).

TABLE 8.2 **Allergan and API: results on UK CLS business**

	Years ended 30 November					£ million
	1988	1989	1990	1991	1992 (est)	
Turnover	8.0	12.0	14.8	17.3	18.7	
Operating profit	3.1	3.8	3.9	4.7	6.0	
Average capital employed	3.1	4.1	4.5	4.3	5.0	
Return on turnover (%)	38.8	31.7	26.3	27.2	32.1	
Return on capital employed (%)	100.0	92.7	86.7	109.3	120.0	

Source: Allergan.

8.130. Allergan argued that two further adjustments were needed to the figures in its statutory accounts:

- (a) It said that its practice until 1991 was to lease most of its assets rather than purchase them. Most of the leases were operating rather than finance leases, hence following standard accounting practice the assets were not capitalized in its statutory accounts. Allergan submitted that in order to show a true return on capital employed (ROCE) figure for the business these assets should be treated as capitalized.
- (b) Allergan also urged that, given the importance to its business of R&D and product promotion, expenditure under these headings should be capitalized as intangible assets rather than written off in the year it was incurred. It presented figures for its results adjusted in line with this proposal.

Table 8.3 shows the effect of both these sets of changes on the ROCE figures set out in Table 8.2: fuller details of the adjustments made are given in paragraphs 4.7 and 4.14.

TABLE 8.3 Allergan and API: results on UK CLS business on different accounting bases

	Years ended 30 November				£ million
	1988	1989	1990	1991	1992 (est)
ROCE as in Table 8.2	100.0	92.7	86.7	109.3	120.0
ROCE with operating leases capitalized	67.4	61.2	56.9	67.6	74.7
ROCE with operating leases and intangible assets capitalized	49.3	42.8	35.4	37.3	41.7

Source: Allergan.

Even after making every adjustment proposed by Allergan we note that its ROCE figures in this period have been around twice the average achieved by UK manufacturing companies measured according to standard accounting practice (see Table 4.48).

8.131. In putting to Allergan our provisional findings we invited it to comment on whether the existence of a scale monopoly situation in its favour had enabled it to make higher ROCE and to charge higher prices in respect of CLS than would otherwise have been possible. Allergan agreed that it had made good profits on this business in recent years but regarded these as an appropriate, not an excessive, reward for its performance.

8.132. In amplification of this view, Allergan submitted that the UK CLS market was highly competitive. The other large multinational groups which were prominent in the CLS business world-wide were all active in the UK, and the success of Sauflon showed that small firms could also compete in this market. The suppliers found themselves dealing with increasingly powerful retailers. Product development was dynamic and market shares of the different product types were volatile. This competition had led to real reductions in prices: Allergan said that the recommended prices of its own solutions had fallen by an average of 12 per cent in real terms over the past five years.

8.133. Allergan said that the market was also risky. Technological change was rapid. Suppliers had to invest continuously in R&D with no assurance that marketable products would result. Because of developments in the lens market there was considerable uncertainty over demand prospects for CLS.

8.134. Allergan argued that its good results were due to its success in developing and marketing products which met customers' needs and gained the support of opticians. This had led to a virtuous circle of rising sales and falling unit costs as API had been able to load its production facilities fully. Allergan's prices were attributable, not to its monopoly position, but to the quality of its products. Peroxide disinfectants commanded premium prices because they had brought a breakthrough in comfort for wearers of soft lenses. Yet Allergan had had to pitch the recommended prices of its Oxysept disinfectant below CV-UK's 10.10 in order to make inroads into the latter's entrenched position. Allergan had also been the first to introduce a larger pack size at a lower unit price. Competitive pressures had obliged Allergan to cut the real prices of its products. Even in protein removers, where it had been the first in the field, it faced competition from five other suppliers and had seen its share fall despite real reductions in price and the introduction of an innovative new product, Ultrazyme. Allergan said that it had also kept a tight rein on its overhead costs.

8.135. Allergan presented figures, collected at our request, which it said showed that its recommended prices in the UK were generally below those of Allergan group products in other countries, apart from the USA.

8.136. Allergan said that seen in this context its profits were not excessive. Its high accounting returns did not reflect the true position, hence the adjustments which it submitted should be made to its statutory accounts. Its profitability was comparable with that of pharmaceutical companies, with which Allergan's CLS business had much in common.

8.137. We have noted these arguments carefully. But there is another side to the story. Of the two leading suppliers, Allergan has been significantly the stronger in recent years, as noted in paragraph 8.128. Although Alcon and B&L also operate in the UK, their impact on competition in key parts of the market has been adversely affected by UK product licensing requirements (see paragraphs 8.116 and 8.117).

8.138. In disinfectants, which account for over 60 per cent of the overall total, Allergan and CV-UK have nearly 80 per cent of the market between them and about 95 per cent of sales of peroxides, which are currently by far the most popular product type. There is rivalry between Allergan and CV-UK but, considering the extent of the price difference between a peroxide system and a chlorine system (see paragraph 8.15), we do not regard the movements in RRP's for peroxides over the last five years as evidence of strong price competition (see paragraphs 3.187, 3.198 and Table 3.18).

8.139. We cannot attach much weight to the comparisons of retail prices of Allergan group products in different countries, since (as Allergan itself argued) such comparisons may be affected by a wide variety of factors, and we have not been able to carry out a study in the depth which would be required if firm judgments were to be based on the results. We accept that the figures presented by Allergan and other suppliers give no ground for believing that prices in the UK are above average among European countries, though we note that, as with many other products, prices in the more competitive environment of the USA appear to be significantly lower.

8.140. The weakness in competition at retail level which we discuss later in this chapter has benefited Allergan, in common with other suppliers, in as much as retailers are less likely to put pressure on the suppliers to cut prices than they would in a more competitive market where retailers themselves were under pressure.

8.141. As to the level of Allergan profits, we note Allergan's arguments about the treatment of operating leases. Other CLS suppliers also make substantial use of operating leases, however. To the extent that we need to assess the profitability of Allergan against that of its competitors and of other companies, this has to be done on the basis of standard accounting practice. Similarly as regards R&D and promotional expenditure, since these are not capitalized in Allergan's statutory accounts we see no sufficient reason to depart from the company's own practice in making our calculations of ROCE. We consider that the way to meet Allergan's point is to assess the company's profitability by reference to the results of other companies for which similar considerations arise.

8.142. It follows that the profitability figures which we consider appropriate as the basis for assessing Allergan's results are those in Table 8.2. These show ROCE averaging 102 per cent over the last five years, with the highest level of 120 per cent resulting from the estimated results for 1992.

8.143. Comparing these figures with the results of pharmaceutical companies, we find that the Allergan ROCE far exceeds the average of three major UK companies specializing in pharmaceuticals, namely Glaxo, Wellcome and Fisons: see Table 4.48. Allergan submitted to us the results of a consultants' survey of the accounts of pharmaceutical manufacturers (see paragraph 4.106). These showed that the ROCE of UK-based groups had averaged about 50 per cent in 1989 and 1990: about half the level achieved by Allergan and API on their UK CLS business.

8.144. The usual argument for high profits in the pharmaceutical industry is that the business is R&D-intensive and high risk. We consider that this argument is less valid for CLS since the products are less complex and the suppliers' level of spending on R&D, an average of about 5 per cent of turnover, is about a third of the norm for pharmaceutical companies (see paragraph 4.110).

8.145. We have also compared Allergan's profitability with that of the other CLS suppliers (see Appendix 4.1). Such comparisons have to be treated with caution because of differences in the operations of the companies concerned. The most appropriate comparisons are with CV-UK and CVLCP combined and with Sauflon, since in each case the figures encompass manufacturing as well as distribution. Allergan's net margin on turnover was far above that achieved by the other two suppliers (and indeed all the others active in the UK) in the period 1989 to 1991. The picture as regards ROCE is more varied but the only companies to have achieved returns as high as Allergan in any year are Alcon and B&L/M&L which are distributors only and therefore have a low capital base.

8.146. We asked Allergan to allocate its costs to individual products in order that we might examine the profitability of its leading solutions in the individual product markets which we identified (see paragraph 8.21). The results, for 1991, are set out in Table 1 of Appendix 4.2. These figures too must be treated with caution because of the assumptions underlying the cost allocations, but we note that Allergan's net profit margin on Hydrocare Fizzy, its leading protein remover, was 50 per cent higher than the average for seven

of its main products. We regard the size of this differential as evidence that Allergan has made particularly high profits in the protein removal market where its share is 70 per cent.

### *Finding on Allergan's prices and profits*

8.147. Allergan has achieved high levels of profitability in each of the last five years, well above the average even for pharmaceutical companies. This may have been partly the result of Allergan's success in product innovation, its efficiency in production and marketing, and its low overheads. But we consider that Allergan has also been able to charge higher prices than would have been the case in a more competitive market and we conclude that this is contrary to the public interest.

### *Discounts*

8.148. In 1987 Allergan cut its normal discount to optical wholesalers from 25 to 15 per cent, having previously invited the other suppliers to a meeting to inform them of its intention and to explain its reasons (see paragraphs 6.74 to 6.78). Two of the other suppliers followed suit. We make no public interest finding about this action, although we consider that it indicates an unhealthy lack of competition in the market at that time.

8.149. Allergan now gives discounts to opticians which are on average higher than its discounts to wholesalers, even though opticians frequently place smaller orders than wholesalers (see Table 4.41). Allergan said that this was in recognition of the importance of the services which opticians were able to provide to it. It told us that it gave 25 per cent discounts to opticians who agreed to recommend Allergan products to customers wherever it was professionally appropriate. The opticians who gave oral evidence told us that they never entered into such agreements, which they would regard as cutting across the optician's duty to recommend whatever products were judged most suitable for the individual customer. We have considered whether this practice distorts competition in a way which might be contrary to the public interest. We have concluded that its effects on competition are unlikely to differ significantly from other practices—such as the linking of discounts to size of order, the offering of retrospective discounts, and indeed simply selling CLS to opticians at a price which gives the retailer a bigger margin than competing products—all of which give the optician a financial incentive to recommend one product in preference to another. This is inherent in a situation where opticians act both as retailers of CLS and as professional advisers to customers (see paragraph 8.11). Overall we find that Allergan's discounting practices are not contrary to the public interest.

### *Resale of Allergan products*

8.150. One optical wholesaler told us that it had found it impossible to deal profitably in Allergan products after the discount which it received from Allergan was cut from 25 to 15 per cent. It had been able to obtain supplies at a lower price from opticians, who were buying from Allergan at a 25 per cent discount and reselling to the wholesaler. Allergan told us that it was opposed to any of its optical retailers, to whom it gave a 25 per cent discount in consideration of services provided, reselling the products to customers who did not provide these services. Such action enabled the wholesaler in question to compete unfairly with other wholesalers and to give the benefit of a differential discount to retailers who did not provide the services. Allergan had not so far prevented such resales but believed it should be free to say to retailers that the discount on any products which they were reselling would be 15 per cent, as befitted a wholesaler.

8.151. This situation has arisen because of Allergan's segmentation of the market by giving bigger discounts to some customers than others unrelated to cost savings or size of order. For Allergan to cut its discount to certain opticians in the circumstances described might constitute a refusal to supply, in the terms of the Resale Prices Act 1976, and would be tantamount to its exercising control over the resale of its products with the purpose of preserving this market segmentation. Given Allergan's market power and the weaknesses which we have identified in the competitiveness of the CLS market, we believe that such action could further restrict competition in a way which might be contrary to the public interest. The relevant authorities might also need to consider how the action stood under the Resale Prices Act 1976.

## ***Conclusion on Allergan***

8.152. In response to the questions in our terms of reference (see Appendix 1.1) we have concluded that Allergan's pricing policy constitutes a step taken for the purpose of exploiting the monopoly situation in its favour and that this is a fact which operates against the public interest, with the specific adverse effect that it has caused prices of CLS to be higher than they otherwise would have been.

## **CIBA Vision (UK)**

8.153. CV-UK was the market leader in 1988, the year in which CIBA Vision acquired the UK CLS business of The Cooper Industries Inc, with 43 per cent of the overall market. It owed this position mainly to its dominance of peroxide disinfectants—The Cooper Industries Inc had been the first company to introduce a peroxide product into the UK market in 1985, and CV-UK still had nearly 70 per cent of the total sales in 1988. As we have seen (see paragraph 8.102), CV-UK's position was steadily eroded over the following few years until 1992 when it appears to have staged a modest recovery, taking its overall share from 32 to 34 per cent. Its main strength still lies in peroxide disinfectants, where its 10.10 solution (including supplies to Boots and D&A for sale under their own labels) is the top-selling product in the CLS market. CV-UK's position in the other product markets is much less prominent: compared with its 42 per cent share of the disinfecting market in 1992 it had 17 per cent of the surfactant cleaner market and 21 per cent of the saline market, and it has no protein removal product. [

*Details omitted. See note on page iv.*

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8.154. CV-UK along with S&NP was one of the first suppliers to sell solutions to retailers for resale under their own labels. Estimates for 1992 indicate that it still made more than half of all such sales of CLS by suppliers in that year, and these sales represented over a quarter of its total turnover in solutions. For the reason given in paragraph 8.106, the proportion by volume must be higher. Clearly CV-UK, unlike Allergan, espoused own-label business at an early stage as a means of protecting and enhancing its position in the market. One consequence of this policy is that 50 per cent of its total CLS sales in 1992 were to the two leading retailers, Boots and D&A, which are also the leading own-label retailers.

8.155. Following its acquisition of the UK CLS business of The Cooper Industries Inc, CIBA Vision decided to build a new manufacturing plant in Macclesfield as the main European production source for the CIBA Vision group. It has invested over £20 million in this plant, which is operated by CVLCP and now supplies the great majority of CV-UK's requirements for solutions. Previously CV-UK had its own, much smaller manufacturing unit at Southampton which closed in May 1991, following the commencement of production at Macclesfield in late 1990. CIBA Vision told us that it had encountered considerable production problems with the new plant as a result of which CV-UK had had to obtain supplies from other sources including subcontractors. The production problems had now been largely overcome but they had caused both supply shortages and extra costs for CV-UK in 1990 and 1991.

## ***Profits***

8.156. The effect of these problems can be seen in the group's financial results which are set out in Tables 4.10 to 4.13. CIBA Vision represented to us that the best way to assess its profitability was to look at the combined figures for CV-UK and CVLCP since they embraced the CLS manufacturing as well as distribution activities. On this basis Table 4.13 shows that on UK CLS business the CIBA Vision group earned a margin on turnover averaging 10 per cent over the five years, fluctuating in a fairly narrow band from 7 to 13 per cent. ROCE, however, fell from 66 and 56 per cent in 1988 and 1989 respectively (the years before CVLCP existed) to 11 per cent in 1990 and 8 per cent in 1991 before recovering to an estimated 16 per cent in 1992.

8.157. This sharp fall in ROCE is due to a big increase in capital employed as a result of the investment in the Macclesfield factory and to losses being incurred by CVLCP in its first two years. Production from the plant was initially devoted mainly to the UK and so CIBA Vision has attributed the bulk of the losses and capital employed to the UK, though less so in 1991 than 1990 as production and export sales built up. We consider that these attributions have depressed the profitability of the CIBA Vision UK CLS business below what would reasonably be expected, in that the Macclesfield plant was designed to serve many other markets besides the UK. CIBA Vision told us, however, that it regarded the estimated results for 1992 as reasonably indicative of the results they expected to achieve over the next few years. For our part we would expect some further growth in output by CVLCP in view of the amount invested in the Macclesfield plant and the fact that the production problems were still being overcome in the course of 1992. This may lead to higher levels of profitability.

8.158. CV-UK was highly profitable in terms of ROCE in 1988 and 1989, although margin on turnover in those years was modest at 7 and 12 per cent respectively. CIBA Vision told us that the high ROCE was largely due to the fact that the assets in CV-UK's production plant at Southampton had been substantially written down. The separate figures for CV-UK in 1990 (see Table 4.11) show ROCE even higher at nearly 100 per cent and margin on turnover rising to 22.5 per cent. According to CV-UK these levels of profitability were the result of running the Southampton plant at a high level of output in anticipation of its closure and the transfer of production to Macclesfield. The company therefore achieved high output and low unit costs from equipment with a low capital value. This was a temporary state of affairs pending the full coming on stream of the Macclesfield plant.

8.159. Because of these changes in operations, it has not been possible to arrive at a complete picture of the underlying profitability of CIBA Vision's UK CLS business over recent years. The information given to us, however, indicates that it is unlikely that profits have been particularly high during the five years 1988 to 1992 taken as a whole. For some products, notably 10.10, CV-UK's RRP's have been a little higher than Allergan's competing products. But CV-UK has been obliged to concede higher discounts on branded products (see Tables 4.41 and 4.43) and a much higher proportion of its sales are for retailers' own labels and command lower prices than branded products. The evidence we obtained, including that relating to profits, is that CV-UK's prices have not been contrary to the public interest.

## ***Discounts***

8.160. In common with other suppliers, CV-UK gives its highest discounts off trade price to Boots and its second highest to D&A. Like Allergan its standard discount to wholesalers is 15 per cent (though the average given in practice is a little higher) and it grants considerably higher discounts to opticians than to wholesalers (see Table 4.43). (Coopervision Ltd, The Cooper Industries Inc's UK CLS subsidiary, was one of the suppliers which joined Allergan in 1987 in cutting the standard discount to wholesalers from 25 to 15 per cent: see paragraph 8.148.) We regard CV-UK's discounting policy in general as a response to market conditions and as a means by which it seeks to compete with Allergan and the other suppliers.

8.161. Unlike Allergan, CV-UK makes significant use of retrospective discounts which customers can earn by achieving sales targets in quarterly periods. CV-UK has such agreements with seven customers (three optical wholesalers and four chains of retail opticians) together representing 12 per cent of its sales in 1992. The value of the retrospective discounts is, however, a small proportion of the total discount offered to these customers. CV-UK told us that it introduced these arrangements at the beginning of 1992 because it understood that similar arrangements were being used by some of its competitors. Experience with these discounts had so far been mixed, in that some customers had hit their targets in one or both of the periods elapsed to date while others had not.

8.162. Retrospective discounts can be anti-competitive in some circumstances, particularly if used by a company with market power seeking to shut out smaller suppliers. We do not believe that this is currently the situation with CV-UK.

## *Negotiations with major retailers*

8.163. CV-UK told us that in late 1990 Boots observed that D&A was selling CV-UK products to consumers under its own label at prices below those which Boots was charging for the same products under the Boots brand. According to CV-UK, Boots informed it that unless D&A brought its prices in line with Boots', Boots would match D&A prices and expect CV-UK to pay the difference of any erosion in Boots' margins. CV-UK said that it presented this scenario to D&A which realigned its prices from being 5 per cent below Boots' to 2.5 per cent below. CV-UK said that although Boots had raised the matter with it on two further occasions, it had taken no further action, explaining to Boots that it was not in a position to cause D&A to bring its pricing into line with Boots (see paragraphs 6.135 to 6.137).

8.164. Boots confirmed to us that it had raised with CV-UK the prices at which D&A was selling CV-UK products though its account of the episode differed in some respects from CV-UK's. In particular it denied that it had put pressure on CV-UK, though it said that CV-UK was aware of the importance which Boots attached to maintaining its margins (see paragraphs 7.12 to 7.14).

8.165. D&A told us that CV-UK had said D&A should be mindful of its discounting policy for own-label solutions as Boots would react in a competitive manner. D&A said that this comment was never taken into account when pricing discount decisions were made in respect of its own-label products. Changes in D&A's own-label prices had not been effected until October 1991 (see paragraph 7.61).

8.166. Although there are discrepancies between these statements it is clear to us that Boots attempted to use its power over CV-UK to influence D&A into increasing its prices for own-label solutions. We return to this matter in the context of our consideration of Boots' scale monopoly situation. As far as CV-UK is concerned we consider that its statement to D&A might be construed as an attempt to take advantage of its strength as a supplier to avoid pressure being brought on it by Boots to increase its discounts to Boots. But CV-UK does not appear to have tried very hard to influence D&A, according to D&A did not succeed in doing so, and did not take any further action in response to subsequent promptings from Boots. We conclude that CV-UK's action did not amount to an action attributable to its monopoly situation.

## *Conclusion on CV-UK*

8.167. Having considered the evidence we conclude, in the terms of the Act, that CV-UK is not taking any steps for the purpose of exploiting or maintaining the monopoly situation in its favour, and that there are currently no actions or omissions on its part which are attributable to the monopoly situation. We have found no facts, in the course of our inquiries into this monopoly situation, which operate or may be expected to operate against the public interest.

## **Boots**

8.168. Boots has rapidly increased its share of retail sales of CLS, measured at retail prices, from 29 per cent in 1989 to 36 per cent in 1992. (Information on suppliers' sales shows only 28 per cent going to Boots in 1992. The explanation for this difference is that Boots buys at lower prices than any other retailer but sells all branded solutions at the RRP and sells own-label solutions at an average of only 6 per cent below the recommended prices of the equivalent branded products. In addition BOL sources some branded solutions through optical wholesalers.) All the increase in Boots' sales between 1989 and 1992 came from its pharmacies, which by 1992 accounted for some 85 per cent of the Boots total. Boots is the only retailer which is well represented among both opticians and pharmacies and is therefore in a uniquely advantageous position in the CLS market. Unlike many other large opticians BOL has no discount scheme for CLS: it sells them on the same terms as BTC. Boots is also the only pharmacist to sell own-label solutions although we were told of plans by UniChem and by another pharmacist to launch own-label products during 1993 (see paragraph 8.110).

8.169. We invited Boots to comment on whether the scale monopoly situation:

- had adversely affected competition in the supply of CLS at retail level;
- enabled Boots to charge higher prices and achieve higher margins on own-label CLS, by not passing on to customers the benefits of the lower prices which it secured from suppliers, than would otherwise have been possible;
- enabled Boots to extract larger discounts from suppliers than would otherwise be possible; and
- enabled Boots to sell branded CLS at RRP rather than passing on to customers the benefits of the larger discounts which Boots received from suppliers, thus achieving higher margins than would otherwise be the case.

8.170. Boots said that it did not believe the monopoly situation adversely affected competition in the retailing of CLS. BTC had only 9 per cent of pharmacies and BOL only 4 per cent of opticians' practices in the UK; overall Boots operated about 6.6 per cent of all retail outlets selling CLS. The consumer had a choice of outlet almost everywhere.

8.171. Boots said that its share of CLS sales had exceeded 25 per cent only in the last three years but the characteristics of the market and Boots' activity in it had been constant for much longer. Boots therefore submitted that the existence of the monopoly situation had not affected the market at all. For example, Boots' pricing policies were the same, and its margins on CLS broadly the same, as before the monopoly situation existed.

8.172. In response to our questions Boots said that it had a unique competitive mix among CLS retailers which was based on the provision of advice and service, the range of products stocked, and value for money, all provided in convenient high street locations in which it had invested heavily. Boots did not regard CLS as a price-sensitive market. The fact that it had rapidly increased its sales and market share without engaging in aggressive pricing showed that it was giving customers what they wanted. There was price competition and Boots was ready to respond if necessary but in view of the success of its present strategy it had seen no good reason to cut prices.

8.173. Boots told us that it needed good gross margins in order to cover the costs of its highly qualified staff and its expensive high street locations. At the net level its profits were not out of line with other retailers. Since it took central delivery of bought-in goods and acted as its own wholesaler, it needed bigger margins than retailers who enjoyed delivery direct to store. Healthcare products such as CLS were particularly staff-intensive. Boots also needed bigger gross margins on own-label than on branded products in order to cover the extra marketing costs involved, particularly on the provision of free starter packs.

8.174. Boots said that its general policy in selling own-label products was to price them in the range 5 to 15 per cent lower than the equivalent branded products. It told us that its prices for own-label CLS were about 5 per cent below the equivalent branded products. The prices of its own-label solutions were largely dependent on the price charged by the manufacturers, only two of which could offer the technologically advanced products which Boots wanted. The manufacturers would be reluctant to supply for own-label sale if the price differential on the shelves was such as to undermine their proprietary products. Boots also argued, however, that the weighted average price of its own-label solutions was 12 per cent below that of the branded products.

8.175. The information we have collected shows that Boots' share of the CLS market has exceeded 25 per cent at least since 1989 and probably earlier: see Table 3.15. We therefore do not accept that the monopoly situation has existed for only three years, as Boots contended (see paragraph 8.171). In any case the question whether Boots' behaviour changed after it attained a 25 per cent share of the market is not relevant to our analysis: 25 per cent is the level used in the Act for the purpose of defining whether a scale monopoly situation exists, but that does not preclude the possibility that a firm with a market share somewhat below that level may behave in an anti-competitive way.

8.176. Information we received from Boots showed that BTC's gross margins on CLS have averaged 53 to 54 per cent in the three years to March 1992. This compares with 50 to 51 per cent for the rest of BTC's non-dispensing healthcare business (of which CLS form part) and a 41 to 43 per cent average for BTC as a whole: see Table 4.33. (These figures are based on Boots' supplies to retail stores—see paragraph 4.67—and are a little higher than gross margins on actual sales would be, but comparisons with other figures on the same basis may properly be made.)

8.177. BTC's gross margin on own-label CLS has averaged 61 per cent in the last two years compared with 50 per cent for branded CLS. Boots told us that a similar pattern could be observed for its business in own-label and branded over-the-counter medicines. When allowance is made for the extra costs incurred in marketing the own-label solutions (see paragraph 4.74) the difference in gross margin falls to two percentage points according to figures Boots gave us for 1991/92. Boots added that because of the lower prices at which it sold own-label solutions, its average gross margin on their sale was slightly lower, in cash terms, than the average margin on branded solutions. The gross margins on BOL's sales of own-label and branded CLS are similar to BTC's.

8.178. Boots does not calculate net profit margins or ROCE at product level. BTC as a whole earned net profits before interest and tax rising from 8.4 per cent of turnover in 1990 to 10 per cent in 1992, years in which the average for the UK stores sector as a whole fell from 7.9 to 6.2 per cent (Table 4.50). BTC's ROCE in 1992 was 25.4 per cent after adding to capital employed the value of properties (which are owned by a different group company), compared with 14.3 per cent for the stores sector (Table 4.51).

8.179. It will be seen that CLS gross margins are well above the average for BTC, and that BTC's overall net profit is well above average for the stores sector. It is against this background that we examine Boots' behaviour in the market.

8.180. It appears to us that, aided by the number, location, size and quality of its stores, Boots exercises substantial market power, in that it has room to make its own decisions without regard to the reactions of other players in the CLS retail market. Its position is also strong in relation to the large suppliers, all of whom are dependent on Boots for a big proportion of their sales. In 1992 Boots took 37 per cent of CV-UK's sales of CLS, 31 per cent of Allergan's and 28 per cent of Alcon's (Table 3.11). Most of the smaller suppliers who deal exclusively or mainly with opticians do not sell to Boots at present but they will find it difficult to raise their market shares very far without being obliged to trade with Boots.

8.181. The main suppliers told us that the big discounts which they accorded to Boots were attributable to Boots' negotiating strength. Allergan said that both Boots and D&A required high discounts as a precondition of listing a supplier (see paragraph 3.217). CV-UK said that Boots insisted on a minimum level of profit before it would stock a product (see paragraph 6.133) and gave us an example of a solution which Boots had refused to take because this profit could not be achieved. Alcon said that Boots required a 50 to 57 per cent discount off RRP (see paragraph 6.201).

8.182. Boots argued that there were only two strong suppliers: their products were 'must stock' items and Boots was therefore obliged to deal with them. On the other hand Boots is the only scale monopolist at retail level, with a share of the retail market far greater than the next biggest retailer. It therefore has the ability to play off Allergan and CV-UK against each other. Boots' position *vis-à-vis* smaller suppliers is stronger again.

8.183. Figures given to us by the suppliers show that Boots receives the biggest discounts off trade price in its purchases of solutions (see paragraphs 4.88 to 4.99). In 1991 Allergan's average discount to Boots was 34 per cent compared with 30 per cent to D&A, 20 per cent to opticians and 16 to 17 per cent to wholesalers. CV-UK's discounts showed a broadly similar pattern, the corresponding figures being 38, 37, 27.5 and 18 per cent. Alcon's figures indicate a much higher average discount for Boots, at 44 per cent, and a bigger differential over D&A (35 per cent), opticians (23 per cent) and pharmaceutical wholesalers (13.5 per cent). Our analysis of differences in the gross margins earned by retailers on CLS shows that, among 17 major products, Boots' margin exceeded the average for opticians by more than 20 per cent on all but two (see Table 4.47).

8.184. Allergan drew our attention to the significance of the own-label business of major optical chains such as Boots and D&A. It said that the introduction of an own-label product, accompanied by an instruction to opticians to recommend that product to their customers, virtually guaranteed a certain sales volume for the supplier at the expense of its competitors. Allergan cited the example of its Oxysept peroxide system: once CV-UK commenced supplies of 10.10 for Boots' sale under its own label it had become very difficult for Allergan to achieve recommendations from Boots' opticians (see paragraphs 6.23 to 6.26). (Although the RRP for the standard size of Oxysept packs is a little below 10.10's, it is a little above the Boots own-label version.)

8.185. Boots said that its opticians always advised new patients to use Boots' own-label solutions unless there were clinical reasons to the contrary. They did so because they regarded those products as the best available on the UK market and because, being priced below the recommended price of the equivalent branded products, they offered the best value for money.

8.186. In 1992 own-label solutions accounted for 35 per cent of Boots' total sales of CLS, and 45 per cent of its sales through BOL. This is well below the equivalent proportion for D&A (an estimated 65 per cent by volume in 1992). But we note that between 1989 and 1992 sales of Boots' own-label solutions grew much faster than sales of branded solutions; indeed in the case of BOL, own-label sales nearly quadrupled whilst branded sales fell (see Table 3.16).

8.187. Boots told us that it had no contracts for its supplies of own-label solutions because it preferred to retain flexibility to respond to events. [

*Details omitted. See note on page iv.*

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8.188. Boots' ability to exercise market power in relation to other retailers puts it in a strong position to retaliate against any perceived threat to its business. It is worth noting also that overall demand for CLS probably does not respond much to changes in price. Few of our witnesses thought that a reduction in the price of solutions would stimulate an increase in the number of lens wearers and hence boost demand for solutions. Retailers collectively therefore cannot greatly expand the volume of CLS sold and to that extent have less motivation for cutting prices than is the case for many other products.

8.189. We observe that Boots buys at the lowest prices and yet sells all branded CLS at the recommended price and gives only a small reduction on its own-label products, thus failing to pass on the benefits of its aggressive purchasing to its customers. (For some non-CLS products, such as paracetamol, the difference between Boots' own-label price and the branded equivalent is much greater than the 5 to 15 per cent range which Boots cited to us (see paragraphs 3.206 to 3.211).) As a result it enjoys the substantial margins referred to in paragraph 8.176. Boots' evidence indicates that this is due to a lack of sufficient competition in the retail market. This is partly the result of the regulatory controls which not only restrict outlets to opticians and pharmacies but also have the effect of weakening competition among suppliers and hence reducing retailers' ability to negotiate terms. But we believe the competitive weakness is also due to the position and behaviour of Boots, which exercises price leadership. The MMC's 1981 report on *Discounts to Retailers*<sup>4</sup> found that the granting of discounts to large buyers had tended to increase concentration in retailing but that the benefits of lower buying prices had been substantially passed on to consumers. This is not the case as far as Boots' operations in the CLS market are concerned. Boots' conduct towards CV-UK, described in paragraphs 8.163 to 8.166, indicates that when it felt threatened by price competition from another major retailer Boots' reaction was not to cut prices in response but to apply pressure with a view to persuading the other retailer to raise its prices.

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<sup>4</sup>*Discounts to Retailers: a report on the general effect on the public interest of the practice of charging some retailers lower prices than others or providing special benefits to some retailers where the difference cannot be attributed to savings in the supplier's costs*, HC 311, May 1981.

8.190. We also note that BOL, unlike other major chains of opticians, has no discount scheme covering CLS. Uniquely it is able to recommend its own-label products without having to attract customers back to its own outlets. Instead customers can buy the products from BTC which relies on the convenience factor and on the other elements in Boots' 'competitive mix' to generate trade, not on price.

### ***Conclusion on Boots***

8.191. We conclude that Boots' pricing policy in relation to CLS is a step taken to exploit its monopoly situation and is a fact which operates against the public interest, with the particular adverse effect that it causes prices for CLS to be higher than they otherwise would be.

### **Suppliers complex monopoly situation**

8.192. The practice which we consider in this section is the setting by suppliers of RRPs (see paragraph 8.66).

8.193. The views which the suppliers put forward in arguing that setting recommended prices did not amount to 'complex monopoly' behaviour are relevant here also (see paragraph 8.58). In addition suppliers argued that recommended prices were helpful to retailers, giving them a bench-mark against which to reach their own pricing decisions; and to suppliers who wanted to compete on price, by enabling them to demonstrate how their recommended prices compared with those of rival products. Examples of such behaviour were Allergan, which set its recommended prices for Oxysept below CV-UK's 10.10 in order to attack the latter's entrenched position; and Sauflon and PBH which said that their publicity material used recommended prices in order to highlight the value for money offered by their own systems compared with those of the market leaders. In the absence of price recommendations, suppliers said that retailers would rely on traditional mark-ups and independently published price guides. There was no reason to think that retail prices would be lower, rather than higher, if recommended prices were not set by suppliers, nor that competition would increase.

8.194. In assessing the effect of this practice it is important to draw a distinction between the conduct of suppliers in listing recommended prices and that of retailers in responding to those recommendations: consideration of the latter belongs to the next section (paragraphs 8.198 to 8.203). In paragraph 8.63 we noted that the recommendation of retail prices in conjunction with the restriction of outlets was among the circumstances identified in the MMC's 1969 report as possibly causing prices to be higher than they otherwise would be. Since outlets are indeed restricted in the CLS market, we have to examine the effect of suppliers' price recommendations with particular care.

8.195. Some of the smaller suppliers choose to sell only through opticians but the leading players supply pharmacies as well. As a result most of the 17,000 outlets of opticians and pharmacists combined sell solutions. All the suppliers also make a significant proportion of their sales through wholesalers. In these circumstances it would be impossible for the suppliers to control the pricing behaviour of all retailers of solutions. They could attempt to influence the market by seeking to enforce their price recommendations on the leading retailers but we received no evidence that they did so. A significant proportion of opticians do sell branded solutions at a discount from the RRP, although this is often done only in the context of discount schemes for regular customers, which have disadvantages as a form of price competition (see paragraph 8.82).

8.196. We have attempted to judge whether prices would be likely to be higher or lower if suppliers were banned from publishing recommended prices. We believe that many pharmacists would continue to look to a source of external guidance, such as the *Chemist & Druggist* which publishes a great deal of price information, and would simply attempt to follow the market. To the extent that they took their own decisions, we cannot exclude the possibility that some of them would choose to increase prices particularly in areas where there is little competition, having regard to the fact that for many pharmacists, particularly small, independent outlets, CLS are probably slow-moving and not particularly profitable products. The same might well be the case with some of the smaller opticians. For such retailers, recommended prices effectively set a maximum price: the evidence we received suggested that very few retailers charge prices above the recommended level. A prohibition on the setting of recommended prices would therefore be

likely to lead to a wider dispersion in retail prices, with some being lower but also some higher than would be the case if recommended prices continued.

8.197. Taking account of these factors we have concluded that the setting by suppliers of RRP is not a practice which in this market operates against the public interest.

### **Retailers complex monopoly situation**

8.198. We next consider the other side of this coin, namely the practice by a substantial majority of retailers of selling branded CLS at, or only just below, RRP (see paragraph 8.85).

8.199. Again the views expressed by retailers and their representative bodies which we summarized in the section on the existence of the complex monopoly situation (paragraphs 8.77 to 8.80) are also relevant to the consideration of the public interest.

8.200. We have considered why such a high proportion of retailers observe the suppliers' recommendations on retail prices. There appear to be three reasons. First, we judge that many retailers share the view of Boots that consumers are not price-sensitive. We received evidence that lens wearers tend to follow their opticians' advice as to choice of lens care system. Our survey of consumers found that only 12.5 per cent of the sample had changed solutions for reasons of price. Neither suppliers nor retailers thought that overall demand for solutions would increase if prices were lower. On the other hand retailers still have the motive of pricing keenly in order to take a greater share of the available market.

8.201. Secondly we accept that for many small retailers, particularly independent opticians and pharmacists who obtain their supplies through wholesalers, the margin between the price they pay their supplier and the RRP may not leave much room for discounting. This is not the case for the optical chains, however, still less for Boots; and the evidence on discounts suggests that even quite modest-sized opticians (eg independents with a few outlets) will enjoy terms a good deal better than the normal retail margin.

8.202. Thirdly we believe the structure of the market weakens retailers' motivation to compete on price. Several factors are at work here. The MCA prohibition on the sale of solutions other than by opticians and pharmacists prevents the entry of other types of retailer, notably supermarkets and drug-stores, which would be more likely to price competitively. Boots' practice of selling all branded CLS at recommended price provides a shelter for other retailers to do the same, while its powerful position deters others from risking retaliation if they were to cut prices significantly. Boots' own-label products are priced at only a modest discount to the recommended prices of the equivalent branded products. Finally, as noted in paragraph 8.64, there is a tendency among pharmacists to treat CLS as if they were proprietary medicines and hence subject to resale price maintenance.

8.203. While some of the factors set out above are not attributable to retailers (and we address those elsewhere in this report), we believe that many more retailers could sell branded CLS at less than the recommended price while still making a sufficient return, thus offering consumers better value for money. Moreover if there were more price competition, retailers would be likely to put more pressure on suppliers to cut the prices at which they sell to retailers and this would act as a stimulus to efficiency among suppliers. We conclude that the observance of recommended prices by a substantial majority of retailers is a step taken for the exploitation of the monopoly situation and operates against the public interest, with the effect that it causes prices of solutions at retail level to be higher than they otherwise would be.

### **Opticians complex monopoly situations**

8.204. These situations arise from the two practices listed in paragraph 8.86, both of which concern the advice and information given by opticians to patients. Paragraphs 8.89 and 8.90 set out the views of opticians and their representative bodies on how widespread these practices were and whether they constituted 'complex monopoly' behaviour.

8.205. Opticians further argued that, in respect of opticians' recommendations of particular lens care systems to patients (the first practice), there were very good clinical reasons for not recommending cold chemical disinfecting solutions for soft lens wearers. The majority said that there were also good grounds for recommending peroxide disinfectants in preference to chlorine tablets for soft lenses, although one major optical chain told us it considered that chlorine systems were just as effective as peroxides and were easier to use, as well as cheaper.

8.206. We cannot comment on the respective merits of different solutions. Our concern is that opticians should tell customers about the alternative systems available and the advantages and disadvantages of each, including relative costs. Opticians could still make clear which system or combination of products they favoured. We cannot accept that this approach would conflict with an optician's duty to give the best advice. Because of the potential conflict of interest inherent in the dual role of opticians (see paragraphs 8.11 and 8.149), it is important that opticians should not put themselves in the position of appearing to favour solutions which are more expensive for consumers and bring higher cash margins for opticians. We regard the failure of most opticians to put a range of options to patients, and thus enable them to take account of relative costs in choosing solutions, as an omission attributable to the existence of the monopoly situation and we conclude that this omission is a fact which operates against the public interest, with the specific adverse effect that it restricts consumers' ability to exercise informed choice in purchasing solutions.

8.207. As regards the second practice, opticians have a duty, which is laid down in the guidelines of their regulatory bodies, to make clear to customers what the continuing costs of wearing contact lenses will be (see paragraph 8.90). We believe the evidence of our consumer survey shows that many opticians are failing to observe this duty so far as solutions are concerned. As a result customers may take on a financial burden which they had not expected, with various further possible consequences, including weaknesses in compliance with lens care regimes (see paragraph 8.16). We conclude that this practice is an omission attributable to the existence of the monopoly situation and that it operates against the public interest because it deprives customers of information they need in order to make soundly-based decisions about contact lens wear and care.

## Summary of conclusions

8.208. Whilst there is evidence of—sometimes quite keen—competition in various parts of the CLS market, there are also important weaknesses in the competitive process and in the way the market operates. We have found a number of features which in our view operate against the public interest.

8.209. We have concluded that three scale monopoly situations exist in relation to the supply within the UK of CLS by virtue of sections 6(1)(a) and (b) of the Act (see paragraphs 8.31 and 8.50). We have concluded that these monopoly situations exist respectively in favour of Allergan, API and Allergan Inc; CV-UK, CVLCP and CIBA-GEIGY; and BTC, BOL and The Boots Company PLC (see paragraphs 8.43, 8.46 and 8.51).

8.210. We have also concluded that four complex monopoly situations exist by virtue of sections 6(1)(c) and (2) of the Act. These concern suppliers (paragraph 8.66), retailers (paragraph 8.85) and opticians (paragraphs 8.95 and 8.97). Paragraphs 8.67, 8.85, 8.95 and 8.97 set out our conclusions as to the persons in whose favour these monopoly situations exist.

8.211. We have carefully considered the facts found in the course of our inquiry, including those which flow from the monopoly situations which we have identified. We have concluded that there are facts arising from the scale monopoly situations in favour of Allergan and Boots, and from the complex monopoly situations in favour of retailers and opticians, which operate against the public interest. These facts are set out in paragraphs 8.152 (Allergan), 8.191 (Boots), 8.203 (retailers) and 8.206 and 8.207 (opticians). We have specified in those paragraphs the particular adverse effects which those facts have or may be expected to have.

8.212. We are required by section 54(3) of the Act to consider what action (if any) should be taken for the purpose of remedying or preventing the adverse effects we have identified, and we may if we think fit make recommendations as to such actions.

## Recommendations

8.213. As described in our report (paragraphs 6.56 to 6.58 and 7.27 to 7.31), we explored in general terms with Allergan and Boots the implications of direct remedies for the adverse effects which we have found to result from the scale monopoly situations in their favour. Essentially these remedies would entail the imposition of controls on prices and/or profits. Such controls would have serious disadvantages, in particular by causing further distortions in the market, and we see them very much as second-best to measures which would introduce new competition and enable the market to work better.

8.214. We have remarked at various points on the influence on the market of the regulatory regime operated by the MCA. While there are other imperfections in the market, our judgment is that the adverse effects we have identified would not exist, or would exist to a much lesser extent, if it were not for this influence. Our preferred remedies therefore concern changes in the regulatory framework. These would address the adverse effects arising from the retailers complex monopoly situation as well as from the scale monopoly situations in favour of Allergan and Boots.

8.215. As far as product licensing is concerned, we have carefully considered the arguments put forward by the MCA and others (see Chapter 5) to justify the stringency of the current regime. In our view, however, there is a lack of balance in the assessment of applications in that too little weight is placed on considerations of ease of use and none at all on considerations of cost to the consumer. The MCA told us that it did have regard to ease of use in considering applications for product licences since decisions were ultimately a judgment of the balance between risk and benefit. We attach importance, however, to the evidence of Alcon, B&L and CIBA Vision to the effect that the UK market has so far effectively been closed to a number of products which are available in most other developed countries (see paragraphs 8.116 to 8.118). We received no evidence that in those countries the use of these products had given rise to any serious worries about safety. The 'all-in-one' solution marketed by B&L and the new generation disinfectant products of CIBA Vision and Alcon are designed for ease of use, and we consider that this factor should weigh more heavily in the appraisal process. Moreover the availability of such products could be expected to enhance the overall competitiveness of the market and bring down prices, with a further beneficial effect on users' compliance with lens care regimes.

8.216. The MCA told us that the terms of the Medicines Act prevented it from taking any account of price considerations, whether affecting particular products or the overall state of the market. This appears to be a consequence, therefore, of the original decision that solutions should be regulated as medicines: we note that under the agreement recently reached on the scope of the EC Directive on Medical Devices the great majority of CLS will be regulated as devices (being ancillary to contact lenses), not as medicines.

8.217. The implementation of the EC Directive on Medical Devices will bring major changes in the system. The expectation of most of our witnesses was that these changes would enable a wider range of products to be marketed in the UK. Such a development would foster competition among suppliers and widen choice for consumers.

8.218. The Directive, however, may not come fully into force until 1998. We therefore recommend that:

- (a) The present regulatory authorities (the MCA, CDSM and the Secretary of State for Health) should take note of the adverse consequences of the present system, as identified in our report, and consider what changes should be made, consistent with safeguarding the health of contact lens wearers, to improve the situation. The changes should be designed to give greater weight to factors, including convenience and price/cost to consumers, which influence users' compliance with lens care regimes. In this respect the interpretation of the Medicines Act should be re-examined. We would expect such a change of approach to lead to the speedier availability of products which have been approved for use in other countries.

- (b) The Government should give priority to the implementation of the EC Directive so that UK requirements may be brought closer into line with those in other EC member states well before 1998. In this regard we have noted the view of one supplier that implementation of the Directive by other member states ahead of the UK would give companies based in those countries an unfair advantage, since they would be able to import into the UK products which had been approved elsewhere while domestic companies were still handicapped by the UK regulatory system.

We suggest that the Government's Deregulation Unit in the Department of Trade and Industry should be fully consulted about the health authorities' response to this recommendation.

8.219. With regard to retail outlets, we have carefully considered the arguments put to us by many parties—though not everyone in the CLS business shares this view—in favour of the current restrictions (see Chapters 5 to 7). These arguments are essentially threefold: that expert advice should always be available at the point of sale; that widening the range of permitted outlets would lead to a deterioration in compliance with lens care regimes; and that such widening would lead to a 'trivialization' of the products, particularly since removal of the restrictions would have to be complete, with the result that solutions, like GSL medicines, could be sold from all kinds of retail outlets.

8.220. On the first point we could see an argument for confining the sale of solutions to opticians, so that consumers would typically buy solutions from the optician who had fitted them with lenses and held the records of their optical history. In our view the drawbacks of such a restriction, in terms of loss of competition, choice and convenience for consumers, would clearly outweigh the advantages. What we consider unsustainable is the present arrangement whereby solutions can be bought off the shelf in pharmacies but not in other types of retail outlets such as drug-stores and supermarkets. Pharmacies have been permitted to sell solutions from open shelves since 1989 and Boots told us that it was not aware of any increase in customer problems, such as use of the wrong solutions, as a result of that change. In this respect solutions are treated like GSL medicines. Although a distinction can be drawn between solutions, which are usually required for everyday use, and GSL medicines which are in principle to be taken only at times of need, solutions generally pose less of a risk than certain GSL medicines (such as paracetamol) if misused.

8.221. It was put to us that customers did not always know they needed advice before going to buy solutions: for example, if a product was out of stock, customers would require advice on what alternatives would be suitable. We believe that in the great majority of cases customers would either know they needed advice, in which case they would probably contact their optician, or would definitely not require it. To deal with the small minority of customers who found they needed advice once they arrived at a retail outlet, it could be made a condition that retailers other than opticians and pharmacies should display notices telling customers to seek advice from opticians if they were in any doubt about the use of solutions or about the products they should buy. Moreover, any retailer who failed to stock complete ranges of products, or who allowed particular lines frequently to go out of stock, would be unlikely to attract customers for long.

8.222. The second argument—that widening the range of outlets would worsen the compliance problem—is linked to the first, since the availability of advice is thought to reduce the risk of lens wearers making mistakes. But it appears to us that the main causes of poor compliance (see paragraph 8.16 and Appendix 3.10) are not related to the availability or otherwise of advice when solutions are purchased. Indeed the restrictions on outlets may worsen the compliance problem since the weakness in competition which results from them keeps CLS prices high. Moreover the wider availability of solutions, particularly in supermarkets, would be likely to lead to some consumers buying them more regularly.

8.223. We do not attach much weight to the third argument, that wider availability of solutions would lead to their trivialization in the eyes of consumers. Again the comparison with GSL medicines is relevant: if the authorities deem it safe for those products to be on general sale, solutions could be treated in the same way. Indeed because the retailing of solutions is restricted via the product licences (see paragraph 8.7), it would be possible to widen the range of permitted outlets in a more controlled way than for products whose distribution is regulated according to routes laid down in the Medicines Act. This point also deals with concerns expressed to us about the conditions in which solutions were stored and the need to be able to recall faulty products.

8.224. We have also had regard to the situation in other countries. Although the pattern of retail distribution in the rest of Western Europe appears to be generally similar to that in the UK, solutions are sold without restriction as to range of outlet in other parts of the world, notably the USA and Canada. The USA alone accounts for about half the world's contact lens wearers. Despite our specific requests, no witness presented any evidence that this situation had led to a higher incidence of contact lens-related problems among wearers. In our view what has proved satisfactory for the world's largest contact lens market should be satisfactory for the UK.

8.225. In the light of the considerations set out above, we recommend that the retailing of CLS should be opened up to all retailers who wish to sell them and can satisfy reasonable and objective standards as to their arrangements for storage and product recall.

8.226. As long as the present restrictions remain, the existence of controls on the opening of new pharmacies (see paragraph 2.55) exacerbates the detriment to competition at retail level. While we recognize that any decision to ease or remove those controls will not be taken on the grounds of the effect on a small market such as CLS, we wish to reinforce the comments made in the MMC's February 1992 report on mergers in the pharmacy trade<sup>5</sup> to the effect that the controls have an adverse effect on competition.

8.227. There are three other points concerning the regulation of CLS which have caught our attention (as recorded in paragraphs 8.61, 8.62 and 8.125) and on which we make the following suggestions:

- (a) the MCA should take the initiative to resolve the present unsatisfactory situation as regards the stated periods of recommended use for certain products: since this has implications for the general credibility of instructions to wearers, it should not be left to suppliers;
- (b) the standard warning against the mixing of solutions without advice should be clarified; and
- (c) the MCA should discuss with the suppliers the possibility of including statements of the number of doses, or the number of days' use, on the labels of all solutions as an aid to price comparisons.

Since these suggestions do not flow from the adverse effects which we have identified as attributable to the monopoly situations, they cannot be formal recommendations. We hope that the MCA nevertheless chooses to implement them.

## **Fall-back remedies**

8.228. As stated in paragraph 8.214, we consider that the changes we have recommended in the regulatory system are the appropriate remedies for the adverse effects we have found to result from the scale monopoly situations in favour of Allergan and Boots and from the pricing behaviour of retailers generally. If for any reason they were not to be implemented in full, the question would arise whether direct action should be taken to address those adverse effects, which in each case essentially concern prices being too high. We discussed such possibilities with Allergan and Boots only in general terms, since they are not our preferred remedies.

8.229. As far as Allergan is concerned we recommend as a fall-back position that the weighted average of the RRP's which Allergan sets for its solutions should not be allowed to increase by more than the RPI less a specified factor (a formula commonly known as RPI minus X). Such a formula would be applied to an average of Allergan's prices weighted by each product's current or forecast contribution to Allergan's total revenue from sales of solutions. As to the level of 'X', Allergan told us (see paragraph 8.132) that its average price had fallen by 12 per cent over five years against the RPI, or about 3 per cent a year. We consider that the formula would need to bring a sharper real reduction in prices than has occurred in the recent past, bearing in mind our findings about Allergan's profits, and that 'X' should therefore be at least five. Any attempt by Allergan to pass on the impact of this remedy to its customers, by increasing the level of its trade prices relative to the RRP's or by cutting discounts, would be constrained by the remedy we

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<sup>5</sup> *UniChem PLC/Macarthy PLC and Lloyds Chemists plc/Macarthy PLC: a report on the proposed mergers*, Cm 1845, February 1992.

propose for Boots and its wider effect on competition in the retail sector, and by Allergan's need to continue offering favourable terms to opticians.

8.230. In the case of Boots our fall-back recommendation is that Boots should be required to set its prices for all branded solutions at least 10 per cent below the RRP. Boots too might try to pass on the impact of such action to its suppliers by pressing them to grant even bigger discounts than those which Boots already receives, and the suppliers might react by putting up RRPs in order to restore the previous position. But if Allergan was subject to price control on the lines proposed above it would not be able to increase its recommended prices and the other suppliers would lose business if they did so while Allergan did not. A reduction of 10 per cent on recommended prices would have the effect of reducing Boots' average gross margin on CLS by about five percentage points but it would still be well in line with the average for BTC's non-dispensing healthcare business and well above the overall BTC average (see paragraph 8.176).

8.231. We cannot specify the precise circumstances in which these fall-back remedies would be appropriate or for how long they might prove to be necessary. That will be a matter for the Secretary of State to judge in the light of the action taken on our principal recommendations and in response to the EC Directive on Medical Devices. If fall-back action proves to be necessary, the Secretary of State will also have to consider in the case of Allergan whether, taking account of any price changes which it may introduce following publication of our report, an initial cut in recommended prices should be made before the programme of annual control begins.

8.232. The wider impact of these fall-back remedies, particularly in the case of Boots, would also address the adverse effect which we have found to result from the retailers complex monopoly situation.

8.233. Apart from the central problem that these fall-back remedies would further distort the market, however, we suspect their value might erode over time as the parties adapted their behaviour to the new situation. It is for these reasons that the regulatory changes we have identified, whether resulting from the EC Directive or otherwise, are the only satisfactory way of dealing with the adverse effects we have found.

## **Opticians**

8.234. Finally as regards the opticians complex monopoly situation we recommend that the relevant regulatory or representative bodies should strengthen the guidelines for opticians to take account of the deficiencies which we have identified. We were glad to note that two of the bodies which responded to our Issues Letter (the General Optical Council and the Association of Optometrists) said that they intended to pursue the point that opticians should take care to inform patients fully about the prices of CLS and the likely overall annual costs of lens care.

8.235. The guidelines issued by the British College of Optometrists, which we take as an example, already address this latter issue, stating that 'it is essential ... that before patients are asked to commit themselves to being supplied with contact lenses, they understand precisely what costs and fees will be involved both on supply and on a continuing basis' (see paragraph 2.53). The guidelines do not, however, specifically refer to solutions, nor do they address the need for patients to be given information about costs of alternative lens care systems. We recommend therefore that these guidelines, and their equivalents in other opticians' bodies, should be amplified to provide that opticians should give clear information to patients, before they commit themselves (implicitly as well as contractually) to buying contact lenses, about:

- (a) all the costs, both initial and ongoing, involved in wearing lenses, including specifically the costs of solutions; and
- (b) the alternative types of lens care products available, together with the relative annual costs of the different systems. In this respect we suggest that opticians be required to prepare an information sheet containing information about the monthly or annual costs of lens care, and the costs of the various systems which they sell. The opticians' organizations might devise a standard format for these sheets to ensure that they satisfy the need which we have identified.

8.236. The opticians' bodies should put in place arrangements for monitoring the implementation of these guidelines. One possibility would be for them to carry out periodic surveys of customers recently fitted with lenses to find out what their experience had been.

H H LIESNER (*Chairman*)

C M BLIGHT

G C S MATHER

D MILLER

J F PICKERING

S N BURBRIDGE (*Secretary*)

26 February 1993