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IN THE COMPETITION

Case No.: 1407/1/12/21, 1411/1/12/21-1414/1/12/21:

APPEAL
TRIBUNAL

Salisbury Square House
8 Salisbury Square
London EC4Y 8AP

Tuesday 22nd November-Friday 23rd December 2022

Before:

The Honourable Mr Justice Marcus Smith
Professor Simon Holmes
Professor Robin Mason
(Sitting as a Tribunal in England and Wales)

BETWEEN:

Appellants

(1) ALLERGAN PLC (“Allergan”)

(2) ADVANZ PHARMA CORP. LIMITED & O’RS (“Advanz”)

**(3) CINVEN CAPITAL MANAGEMENT (V) GENERAL PARTNER LIMITED &
O’Rs (“Cinven”) (4)**

(4) AUDEN MCKENZIE (PHARMA DIVISION) LIMITED (“Auden/Actavis”)

(5) INTAS PHARMACEUTICALS LIMITED & O’RS (“Intas”)

AND:

Respondents

COMPETITION AND MARKETS AUTHORITY (“The CMA”)

APPEARANCES

Mark Brealey KC (On behalf of Advanz)

Daniel Jowell KC & Tim Johnston (On behalf of Allergan PLC)

Sarah Ford KC & Charlotte Thomas (On behalf of Auden/Actavis)

Robert O'Donoghue KC & Emma Mockford (On behalf of Cinven)

Robert Palmer KC, Laura Elizabeth John & Jack Williams (On behalf of Intas)

Marie Demetriou KC, Josh Holmes KC, Tristan Jones, Nikolaus Grubeck, Michael Armitage,
Professor David Bailey & Daisy Mackersie (On behalf of the CMA)

Thursday, 8 December 2022.

(10.00 am)

PROFESSOR TOMMASO VALLETTI (continued)

Cross-examination by MR PALMER (continued)

THE PRESIDENT: Mr Palmer, good morning.

Professor Valletti, good morning.

MR PALMER: Professor Valletti, against the background that we were discussing yesterday I want to turn now to the constraints on Accord-UK's product.

A. Do you mind, before the start, if I just mention one piece of evidence which I think that would be useful for the tribunal in the context of a discussion I had with Mr O'Donoghue first? I read the transcript and I think there is a piece of evidence that --

THE PRESIDENT: I think if you have anything to say to supplement the transcript, Professor, then please do.

A. Yes, so in the transcript, for instance, page 128, line 1 {Day9/128:1}, thank you. So, at several points I was asked questions about some characteristics of the supply agreement concentrating only on the supply side purely on the cost. So they were saying at that point in time, for instance, AMCo is buying and the proposition there, is it not rational for Auden if they have costs of 90p to sell above that cost, okay? Imagine they could make 1.78, would it not be rational

1 to do so?

2 Several times I answered to that question by saying
3 that the question in the context of an agreement which
4 has a horizontal component is an incomplete question at
5 best, because you cannot avoid talking about the price
6 effect in the final market. So I gave that answer
7 several times at several points.

8 So, the piece of evidence I would like to refer you
9 is in the Decision, {IR-A/14/247}. Paragraph 3.574. At
10 that point of the Decision the CMA is talking about the
11 wording of the contract, the wording of the contract,
12 and there is a quote from John Beighton. He is the CEO
13 of AMCo, so one of the two parties to the agreement, and
14 he is saying the cost of goods sold, "CoGs", from Auden
15 obviously are higher than Aesica, and there is a price
16 there. I may even tell you, since I cannot tell you the
17 numbers, the numbers are more or less what Mr O'Donoghue
18 was talking about, and Auden was actually 50% more
19 expensive. They were more expensive, but remember AMCo
20 buys from Auden, not from Aesica.

21 Then there is a very interesting business language:

22 "... though to be honest it is hardly worth fussing
23 over ..."

24 And "fussing over" means fussing over this cost of
25 goods sold, so the wholesale price they are buying, and

1 they should buy cheap by that point of view,
2 "especially", they are talking about the contract here,
3 the agreement:

4 "... especially as the price is going up in the
5 market and it is over £50 now."

6 So this is just a piece of evidence which is saying,
7 which is linking explicitly the price in the retail
8 market which under the agreement they expect to be 50
9 and above, which is a consideration of first order
10 compared to these other details, which of course are
11 important for businesses but is saying, to be honest it
12 is hardly worth fussing over.

13 So in my view it encapsulates the arguments I was
14 trying to make. Thank you.

15 THE PRESIDENT: Thank you, Professor. Mr Palmer.

16 MR PALMER: Thank you very much, Professor. Direct
17 constraints on Accord-UK's product is what I want to
18 discuss with you first. If we turn to your
19 paragraph 32, that is {F/1/15}. You say there that you
20 agree with the CMA that skinny label products, actually
21 there is a direct constraint on the price of the full
22 label product. One of the determinants of choice will
23 be the relative prices of the two products.

24 A. Are you agreeing?

25 Q. That is your fourth, fifth line there; do you see that?

1 A. So what I say in my report is that I agree that both --
2 there were both direct and indirect constraints.

3 Q. Yes.

4 A. Yes, and it is very difficult to disentangle between the
5 two of them. But yes, I agree that a combination of
6 those constraints -- yes.

7 Q. Yes, and we will deal with both and I totally accept
8 your point about the combination. You say that when the
9 price of skinny is lower some pharmacies will switch, as
10 indeed 50% of the volumes were in fact switched, and
11 this puts downward pressure on full label prices.

12 A. Yes.

13 Q. That is because, as you say in the final sentence there:

14 "The supplier ... has an incentive to lower
15 the price of full label tablets in order to reduce the
16 losses to skinny label tablets, or even to recapture
17 some of those losses had the price ... remained
18 unchanged."

19 That is your view there. Can I just show you in
20 that context {IR-B5/1/14}, which is Dr Burt's witness
21 statement. I expect you will have reviewed that,
22 Dr Burt, formerly of Intas. Look at paragraph 48. You
23 see there that he says that:

24 "... competitors had entered the market ... [so
25 that] by the time of acquisition [that is January 2017],

1 and they continued to enter after the acquisition.
2 Accord-UK had lost market share to these
3 competitors ..."

4 That had already happened in large part by then:

5 "... and would have continued to lose further share
6 if it had not dropped its prices. My view that the
7 market was functioning normally did not change post
8 acquisition."

9 So you see there his concern was that if they did
10 not drop prices they would lose further share beyond the
11 share that they had already lost by that stage; do you
12 see that?

13 A. Sure, this is the view of Dr Burt, yes.

14 Q. Yes, and I think you agree that there was an ongoing
15 constraint beyond the initial switching presented by
16 skinny products. Can I take you to the transcript from
17 day 5 which was when Mr Holt was giving evidence. It is
18 page 165, lines 1-6 {Day5/165:1-6}.

19 What you see there is a question from Mr Holmes on
20 behalf of the CMA, and he asked Mr Holt to accept that
21 there were:

22 "... some pharmacies with regulatory concerns for
23 whom the price differential, if it became too
24 pronounced, could have led them to switch, that would
25 have implications for the direct competitive constraint

1 that skinny label tablets would impose on full label?"

2 I think you agree with that proposition as well, if
3 I have understood your evidence.

4 A. I agree.

5 Q. Of course, the strength of that competitive constraint
6 thereby imposed lies in part in the fact that Accord
7 would not know at what point its prices, if it did not
8 lower them enough, would push any particular pharmacy
9 into undertaking precisely such a re-evaluation as
10 Mr Holmes was referring to there?

11 A. Well, again, let me see again your phrase. So would not
12 know. So I think that to assess the strength, and we
13 will get to that point, there is empirical evidence in
14 front of us. So in order -- I can, whatever was known
15 or unknown, what is uncertain and was in front of them,
16 I can see how the markets reacted, yes.

17 Q. Yes, but I am just asking you to think for the moment
18 from the perspective of Accord, who do not have that
19 data in real time at the time. They do not know in
20 advance what a particular customer is going to do. It
21 is dealing with the wholesalers, who are in turn dealing
22 with the pharmacies. Beyond that they do not know what
23 is behind that veil, what kind of price differential is
24 going to have the sort of effect that Mr Holmes is
25 referring to there.

1 A. So it really, it is a quantitative assessment that you
2 would have to do. You will have some uncertainty, and
3 if you do or do not change your prices you will try to
4 assess under that uncertainty how many customers you may
5 retain or you may lose. So the magnitude will be very
6 relevant. That is why I say it is an empirical question
7 at that point. So it is not a general statement.

8 Q. That is, if you like, the mechanism, is it not?

9 A. It is always, it is always the mechanism under any
10 circumstances when we are assessing market power. If
11 you change your price the price goes up, you are going
12 to lose customers in expectations.

13 Q. Yes. So that is the ongoing constraint you are
14 referring to in your evidence --

15 A. Of course.

16 Q. -- about the need to reduce prices to avoid losing more
17 volumes, and that is essentially the dynamic by which
18 that may or may not happen.

19 A. So we would agree that then we have to assess the degree
20 of that constraint, how strong is that constraint?

21 Q. Right, okay. We will come back to that later on.

22 Direct -- the other direct constraint obviously this
23 one we will have to deal with briefly, it is the NHS
24 tenders for hospital pharmacies, still very much part of
25 the market and they operate under a completely different

1 mechanism. But there obviously skinnies represent
2 a direct constraint on full.

3 A. Yes, although this -- in my opinion this is a large --
4 so, first of all in quantitative terms it is a rather
5 small part of the market, so I would tend to separate it
6 compared to the pharmacies. It seems to be quite
7 a different market.

8 Q. It has not been defined as a separate market here, has
9 it?

10 A. No, no, but it is not representing a big impact on the
11 profitability of --

12 Q. It is there.

13 A. It is there, of course.

14 Q. All right. Indirect constraints. You agreed with
15 Dr Bennett, I think, on the workings of the drug tariff.
16 I think you were happy to agree that much.

17 A. It is a mathematical formula so you cannot disagree on
18 that.

19 Q. Yes, we do not need to go over that. We know, I think,
20 that you agree that the prices of AMCo's skinny product
21 feed in, they enter in May 2016 and those prices take
22 effect in the drug tariff from October 2016. That is
23 your understanding, is it?

24 A. Yes.

25 Q. Again, so that starts, that mechanism is in place before

- 1 the start of the Intas period in January 2017.
- 2 A. Yes.
- 3 Q. Of course it is strengthened as then Teva come in in
4 February 2017, pretty much immediately and in due
5 Resolution and so forth.
- 6 A. Just for context, the biggest weight in the drug tariff
7 mechanism is still played by the full, so it is still
8 done by Auden.
- 9 Q. It is still done by this time by Accord, and as their
10 prices are driven down by the combination of those
11 two -- once the indirect constraint has kicked in you
12 have --
- 13 A. You have already -- stepping, one step ahead, but
14 mechanically the biggest weight is Accord and then there
15 are the skinny labels --
- 16 Q. Yes.
- 17 A. -- and the price of Accord may be itself affected by
18 direct competition.
- 19 Q. Yes, exactly.
- 20 A. This is the difficulty in unravelling all this --
- 21 Q. I am not going to challenge that at all, I totally
22 accept that from October 2016 you cannot unravel the
23 two. Whatever cumulative effect they have on Accord's
24 prices, that is what gets fed into the drug tariff and
25 that is what creates that ratchet downwards under the

1 drug tariff mechanism.

2 A. Yes.

3 Q. The effect of that is that Accord never put prices up
4 after that point during the Intas period. They are
5 continually falling, are they not?

6 A. Absolutely.

7 Q. In that context, can we just look at a further document.
8 This is {IR-H/1107/1}. This is, you can see, dated
9 17 January 2018. It is Alliance Healthcare's response
10 to some questions from the CMA. We can see from that
11 document that Alliance lists thousands of products.
12 I just want to find -- I am sorry, I am missing the
13 reference. (Pause) If you read, I am going to ask you
14 to read to yourself the content of that table.

15 A. Which row, please?

16 Q. Starting from "Standard Generics".

17 A. Okay. (Pause)

18 Q. That is just in general. I am going to come to the
19 specific position of Hydrocortisone over the next page.

20 A. So this is how Alliance is saying they are purchasing?

21 Q. Yes, this is Alliance purchasing process.

22 A. From Intas or generic?

23 Q. Generic, I think.

24 A. Generic first, yes.

25 Q. It is talking about its suppliers generally there, just

1 for context.

2 A. They are saying it is not necessarily linked to the drug
3 tariff.

4 Q. The foot of page 2 is where I want to take you to
5 {IR-H/1107/2}. Where you see the question becomes,
6 "Since July 2015", do you see that in question 2:
7 "... how frequently, if at all, has Alliance
8 negotiated Hydrocortisone Tablets prices ... please
9 provide the dates when Alliance has tried to secure
10 a price decrease from Actavis UK for its Hydrocortisone
11 Tablets."

12 Do you have that?

13 A. Yes.

14 Q. Then do you see the answer:

15 "Alliance lists thousands of products and we don't
16 routinely record all attempts at seeking to negotiate
17 a revised price with our suppliers. Alliance has
18 negotiated the cost prices with Actavis UK on a regular
19 basis throughout the period (from July 2015 to
20 present) ..."

21 And over the page and on to 4, please {IR-H/1107/4}:
22 It is also noted there from April 2016 to the present,
23 that is closer to the period I am concerned with:

24 "During this period the Category M reimbursement
25 price has consistently fallen [it gives those figures].

1 As Alliance were not aware of any alternative
2 suppliers of the full label product [for obvious
3 reasons] the only leverage to be used in price
4 negotiations was the margin available against Drug
5 Tariff. Therefore, the price was renegotiated each time
6 a new category M price was issued."

7 Do you see that?

8 A. Yes.

9 Q. "Alliance attempted to seek more discount to Drug Tariff
10 than was offered by Actavis UK, however Alliance were
11 unsuccessful in securing any additional reductions above
12 Actavis UK's initial offers. Alliance presumes that
13 Actavis UK were able to take this stance as they too
14 were aware that there were no alternative suppliers of
15 the full label product."

16 That was Alliance's experience there; do you see
17 that?

18 A. Yes.

19 Q. There was a re-negotiation each time a new category M
20 price was issued.

21 A. If I may comment, just on what you have just shown me,
22 which is the first time I see it. It also says that
23 Alliance were unsuccessful in securing additional
24 reductions and they just had to take whatever they were
25 offered.

- 1 Q. That was their experience, yes.
- 2 A. That was their experience. It says in different jargon
3 that they did not have any buying power.
- 4 Q. That is what they are saying.
- 5 A. That is what they are saying.
- 6 Q. That is why I am showing it to you.
- 7 A. May I just clarify here. Two pages earlier, can we go
8 back, to the way they described their purchasing
9 activities. Earlier on, please {H/1107/1}. The
10 purchase price, so spot buy. Maybe that is
11 a difference, I do not know, the spot buy. The purchase
12 price is not linked to the drug tariff, it says, and
13 later on they say, "We were renegotiating any time the
14 drug tariff changes."
- 15 So I do not know, these are general things so --
- 16 Q. The question concerns Hydrocortisone tablets, but the
17 answer --
- 18 A. It is a bit inconsistent but it is fine. I wasn't sure
19 if I understood the context.
- 20 Q. The answer is general to all suppliers of Hydrocortisone
21 tablets, I think I should clarify, rather than all
22 suppliers.
- 23 A. I see some incoherence there, but I may be wrong. As
24 I say --
- 25 Q. I will show you what I want to show you.

1 A. Please, please.

2 Q. I now want to take you to AAH's experience, which is at
3 {IR-H/1115/1}.

4 A. So this was Alliance.

5 Q. That was Alliance, yes, and now we go to AAH. The same
6 questions are being asked, and you can see that this is
7 2 February 2018, so about the same time. Do you see
8 that? Do you see question 2 at the foot of the page is
9 asking the same question.

10 A. Same question.

11 Q. "Since July 2015, how frequently", etc.

12 If you turn to the next page {H/1115/2}, and you can
13 see that there it is said that "AAH checks the market
14 prices available", you see that in the first paragraph:
15 "... from suppliers on a monthly basis and where it
16 can, it has used this as leverage to renegotiate with
17 Actavis UK, where it has been the incumbent supplier.

18 AAH does not keep a central record of all such
19 negotiations, but has (i) reviewed prices offered for
20 Hydrocortisone tablets over the period and
21 (ii) conducted searches of e-mail correspondence between
22 members of its generics procurement team ...

23 From that review, we identified that Actavis UK
24 offered significantly reduced prices for its 20mg
25 product ... in March ... and April ...

1 Our review of e-mails identified a number of
2 occasions where AAH challenged Actavis UK's pricing and
3 attempted to seek discounts for Hydrocortisone as
4 follows:"

5 And it sets those out:

6 "On each of the above attempts, AAH successfully
7 negotiated the discount it sought. Generally, the
8 reason for the negotiation was because another supplier
9 had challenged the price of the incumbent. However,
10 many negotiations are done orally, in meetings or by
11 telephone, so there will not always be a record of such
12 discussions or how a choice of supplier has been arrived
13 at.

14 We did not find any evidence that AAH attempted to
15 negotiate rebates with Actavis during the period
16 beginning July 2015 [so that is the earlier period];
17 however, we confirm there was a rebate agreement in
18 respect of that date."

19 So there you find that AAH is managing to use its
20 leverage to negotiate the supply of Hydrocortisone, and
21 I think over the page --

22 A. Again, if I may comment, what they are saying is that
23 they were not renegotiating earlier because the prices
24 were kind of stable. Then price starts going down
25 and -- but this is --

- 1 Q. Yes.
- 2 A. -- the same as Alliance, because the price is going
3 down, we need a different price as well otherwise we are
4 going to be squeezed out.
- 5 Q. Yes.
- 6 A. Over and above what they were offered they were unable
7 to obtain additional discounts.
- 8 Q. I think they are saying they are able to get some
9 additional sales. They were successful, they said,
10 in --
- 11 A. They are successful in getting the price lower than the
12 previous period. I do not know what that means. So
13 I do not -- again, but I read what you read as well.
- 14 Q. Well, what it is, in each of the --
- 15 A. Your interpretation is going a little bit too far,
16 but --
- 17 Q. It says, "AAH successfully negotiated the discount it
18 sought."
- 19 So you are going beyond just simply taking a price
20 that was put on the table in front of them.
- 21 A. Okay, all right. I do not have any quantitative
22 evidence to understand what that means, but that is
23 fine.
- 24 Q. But you will not, though, that both are consistent,
25 saying neither kept a record of those negotiations.

1 A. Absolutely.

2 Q. Did you pick that up?

3 A. Indeed.

4 Q. Not, perhaps, surprising in the real world. But you
5 remember, if we could look at {H/1111/3}. This was
6 Intas's response to the CMA, and you were taken to this
7 by Mr O'Donoghue. He took you to the second paragraph
8 under question 2:

9 "Actavis is not able to provide the CMA with any
10 written documentation ..."

11 Do you remember he stressed that, showing AAH or
12 Alliance overtly threatening to switch, and so forth.
13 Do you remember that?

14 A. Yes.

15 Q. But if you look at the paragraph above that, which
16 I think Mr O'Donoghue skipped over:

17 "Actavis UK has no guarantee that this situation
18 will continue in the future and [AAH] or [Alliance] are
19 able -- as customers with significant bargaining
20 power -- to credibly threaten to switch all or parts of
21 their demand to Actavis ..."

22 And just beyond the sentence Mr O'Donoghue read to
23 you in that paragraph:

24 "Nevertheless, the risk that [AAH] and/or [Alliance]
25 could switch all or part of their supply to any of the

1 alternative suppliers is a real one, as demonstrated by
2 the number of customers who have already done so."

3 That was their perception of that market and that
4 negotiating relationship.

5 A. Yes.

6 Q. So this indirect constraint does give rise to
7 countervailing buyer power to that extent, does it not?

8 A. It does.

9 Q. They were always, against that background of being able
10 credibly to switch, they will always be concerned at the
11 very least to maintain their margin below the drug
12 tariff, and that is not something which in the real
13 world Accord-UK will have any control over, will it?

14 A. In the real world is something that Accord -- no,
15 I disagree with that, because the margins of Accord over
16 the period are very high, so they do have control over
17 their margins of course.

18 Q. I am talking about the margin which the wholesaler is
19 seeking to get under the drug tariff, so the --

20 A. No one has provided me with an assessment of the margins
21 of the pharmacies or the wholesalers over the period, so
22 I do not know.

23 Q. No, that has not been looked at. So we have one figure
24 which I will show you in a moment. But again, Dr Burt
25 says competitors were always able to negotiate in his

1 witness statement. The point I am putting to you is
2 that an increase in differential between the price at
3 which customers purchase and the drug tariff effectively
4 represents a situation where -- let me show you.

5 I think if I show you the figure probably -- then
6 I can put it to you. Let us turn up {IR-D5/1/31}. Can
7 we have the IR version so we have it complete. Can we
8 focus on the figure, please. This is Mr Bishop's
9 figure 5 which you will remember, which shows us, does
10 it not, an analysis of the relative differentials, as we
11 can see, between the drug tariff prices and Accord's net
12 selling prices to those customers who the CMA described
13 as captive customers. We can see that blue line is the
14 retail customers and the yellow line is the supposedly
15 captive wholesale customers.

16 Now, the period of the Intas period is marked by
17 those red lines, but I want to invite you to look beyond
18 that on either side because that has no particular
19 significance for this purpose. Overall you can see that
20 there is a broad upwards trend throughout much of that
21 period, certainly up to 20 -- late 2018, early 2019. Do
22 you see that? Running from September 2015.

23 A. Right, what this figure is telling me, and of course it
24 is a figure that I have considered, it is basically
25 saying that Accord is not discriminating between captive

1 and non-captive wholesale customers, that is all it is
2 saying. It is saying nothing about whether they have
3 market power or not. They are simply saying they are
4 offering them more or less the same price.

5 Q. This does not show non-captive customers, this is the
6 captive customers.

7 A. Captive retail -- on the relative -- no, sorry, this is
8 the relative differentials, yes?

9 Q. You see it is between the drug tariff and the --

10 A. So can you explain me what it is?

11 Q. -- to those customers. Can you see that the broad
12 upward --

13 A. I see, I see. This is -- sorry, it is, yes, I remember
14 now. Yes, this is just the sort of ratio between the
15 drug tariff price and the net selling prices to the
16 captive customers, yes. Captive customers and captive
17 retail.

18 Q. What it is showing is that over time Accord-UK has
19 reduced its prices by --

20 A. I am sorry, but then this is simply saying, sorry,
21 just -- I just want to understand what the picture is
22 actually telling us. This is what Intas is telling --
23 what Intas is getting from, some call them captive
24 wholesale customers, and who are the captive wholesale
25 customers?

- 1 Q. Okay, let us rewind.
- 2 A. Let us rewind, because the wholesale would be Alliance,
3 or -- if you just explain me what that figure is.
- 4 Q. Professor Valletti, let us rewind. I will take it
5 slowly. I want to be quite clear we are both
6 understanding this figure in the same way. This is
7 a figure which shows the difference, the differential
8 between the drug tariff price at any one time and
9 Accord-UK's net selling price at any one time, and only
10 to those customers which the CMA identified as
11 supposedly captive. You know that identified --
- 12 A. I am asking you, the captive retail customers I do
13 remember who they are.
- 14 Q. That is the eight customers.
- 15 A. Yes, and who are the captive wholesale customers?
- 16 Q. AAH and Alliance.
- 17 A. AAH and Alliance, they also are -- they have, like, 30%
18 which are --
- 19 Q. I know, that is why they are not captive at all. But
20 they are identified by the CMA as being captive in that
21 sense, and they are supplying those captive customers.
22 So --
- 23 A. But once again, so my actually -- actually my first
24 answer, instinctive answer because I did remember the
25 context, it is telling me that Accord is selling in

1 different ways, sometimes to a wholesaler, sometimes to
2 pharmacists, and it is not discriminating. So this is
3 evidence of lack of price discrimination. That is what
4 it is. That is the way I interpret it. So my answer
5 was correct.

6 Q. Thank you, I am not asking about price discrimination
7 though at the moment, I --

8 A. Sure. That is the context of the discussion we had with
9 Mr Bishop.

10 Q. Yes. I have heard your answer on that and thank you for
11 it. I just want to focus on a slightly different point.

12 I just want you to focus on the blue line for the
13 moment, which is the differential applying to the eight
14 retail customers identified by the CMA as supposedly
15 captive. We went through yesterday whether or not that
16 was actually so, but ... Can you see that from
17 September 15 broadly running up, up to January/March 19
18 there is a broad upward trend, albeit obviously
19 a material month-to-month variation.

20 A. Roughly, yes. You see it goes up to -- I have not done
21 any calculations.

22 Q. No, I am just asking you --

23 A. You see that after July 18 it goes down again, so ... If
24 I had to look at the period in the round I am not sure
25 I would see big trends. For instance, if I take the

1 whole period you are telling me from September 15 to
2 March 20 actually for instance the yellow lines starts
3 at 20%, it ends up 19%. The blue line starts at 19%, it
4 ends up at 21%. So I do not know.

5 Q. Absolutely right, I am not going to dispute any of that.
6 I want to hold you in your mind at the moment, I think
7 it is a familiar figure in your mind, we do not need to
8 turn it up, during this period obviously both the drug
9 tariff price was going down and net selling prices were
10 going down throughout all this process, and of course
11 towards that latter stage, the right of the graph,
12 the prices were becoming really quite low. There was
13 less room for margin, if you see what I mean.

14 A. Yes.

15 Q. But I am concerned particularly with the period from
16 around April 2016, where there had been significant
17 entry, through the Intas period and indeed just after
18 the Intas period. You can see that during that period
19 there is a broad upward trend.

20 A. Yes, yes.

21 Q. So during that -- what that tells us is that during that
22 period Accord-UK has reduced its prices by more than it
23 needed to if its intention was just to keep the
24 percentage margins earned by customers constant.

25 A. The intention of Auden is not to keep a certain margin

1 constant. The relevant question for us -- and we know
2 that prices are falling, they need to fall, if they
3 start from £71 and are going to go down to £2 they have
4 to. Via the indirect, via the direct. The question is
5 for how long, how quickly, etc. But the relevant
6 question for me is whether in that period despite
7 falling prices -- there were falling prices, never any
8 dispute, mechanical, they have gone from a situation of
9 unalleged abuse to a situation -- so the question is
10 whether, in that period, Actavis retained ability to
11 price at a substantial premium above its own
12 competitors, and this figure is not telling me anything
13 about it. So it is not about market power, this figure.
14 The debate we should be having is about market power.

15 Q. Just focus on the question I am asking you, which is --

16 A. But the question is about the margins, and margin to me
17 is an important indicator --

18 Q. Right.

19 A. -- but I want to see the impact on prices vis à vis the
20 cost.

21 Q. Of course you do, of course you do. You want to look at
22 everything in the end. But I am just focusing on this.

23 A. It is an important element, I would say.

24 Q. The point I am putting to you, I think this is
25 supportive of your view that the direct constraints were

1 here combining with the indirect constraints. What I am
2 putting to you is that if the only thing that Accord
3 needed to do during this period was just keep the margin
4 constant underneath the drug tariff then you would
5 expect a precise correlation here, but in fact what we
6 see is a broad upward trend with Intas having to --
7 Accord having to reduce its prices to a greater extent
8 over time underneath the drug tariff, which suggests --

9 A. No, no, I disagree.

10 Q. That there is some direct constraint as well.

11 A. I have always said there is a combination of both, but
12 from this figure ending up with your conclusion, for
13 instance, in the first two periods between September 15
14 and July 18 everything seems to be pretty flat. Then
15 something goes up in later 2018 and then it goes down
16 again. So I am not able to make a statement about
17 whether it is an upward trend or something there.

18 Once again, margins would -- these kind of margins
19 are not the relevant margins that I would be interested
20 when I look at --

21 Q. It is what purchasers would be interested in quite
22 directly, is it not? It is what purchasers would be
23 negotiating over, in effect?

24 A. Yes.

25 Q. Yes. So it tells us something about their real

1 negotiating power, that that margin increases over time,
2 broadly.

3 A. I disagree that this margin increases. There is -- for
4 three years, for almost three years they are pretty
5 constant. There is just a bunch of data points.
6 I would want to see a similar picture, if you want, over
7 the entire period, not just this. I mean, this is
8 really narrowing the time window. You are concentrating
9 in particular to something happening in September 18 and
10 November 18 and perhaps November 19 perhaps, the blue
11 line, not the yellow line. But again ...

12 Q. Right, okay, that is the point.

13 The next source of constraint --

14 A. But again, if I just did mathematically without any
15 implication, start point of the yellow line, 20%. End
16 point, of the yellow line actually is 10%, okay? So it
17 would be -- it even goes down, which would be the wrong
18 way of analysing the data, of course, so you are making
19 a bit -- something too big out of it, I think.

20 Q. You have to be very careful because towards the latter
21 end of that period the margins available are much
22 decreased from what they were at the beginning of the
23 period --

24 A. Of course.

25 Q. -- so the dynamic changes. That is why I was

1 concentrating on that period before, during and
2 immediately after the Intas period. I have put the
3 point to you. I think we can move on.

4 The next source of constraint is regulatory
5 constraint beyond the drug tariff, obviously, which
6 initially was a voluntary scheme under Scheme M. With
7 effect from 7 August 2017 the Department of Health had
8 new powers, did they not? Are you aware of those powers
9 and the existence of them?

10 A. Yes, I am not an expert on the regulatory matters
11 though.

12 Q. No, I am not going to ask you any detail about that, but
13 just the existence of it. You are aware that the Health
14 Service Medical Supplies (Costs) Act 2017 came into
15 effect on 7 August 2017?

16 A. I take your word.

17 Q. All right. That was an enacted by Parliament in
18 April 2017, and of course there was the whole process
19 before that. So again, Accord-UK could see it coming,
20 could they not?

21 A. They could.

22 Q. It came in into effect on 7 August, and that allowed the
23 Department of Health to limit Accord-UK's prices, if it
24 choose to, with effect from August 2017.

25 A. Again, I take your word for it.

1 Q. I think you have seen the letter, because it was
2 supplied to you by the CMA, you have listed it in your
3 annex C, in which the Department of Health made clear
4 that it was monitoring the market.

5 A. Yes.

6 Q. But no action was taken in fact by the Department of
7 Health under that power in respect of Hydrocortisone.

8 A. That is my understanding.

9 Q. All right. So the position at the end of 2016, if I can
10 just ask you to focus on that, just before the Intas
11 period begins, beginning of 2017, just freeze the frame
12 in your mind there, if I may ask you to do that.

13 Four skinny competitors have entered by that stage.
14 Other competitors are on their way. As at the end of
15 2016 AMCo has also -- perhaps we could look at this,
16 {A/12/98}, just so you have a reference point, and that
17 top table, please. That is just a summary of when there
18 was market entry. Do you see, we see the dates that the
19 marketing authorisation was granted and then the date
20 supply actually started. We have both those dates in
21 that table from the CMA.

22 A. Yes.

23 Q. So as at end of 2016 we have four. We know others are
24 on the way. AMCo have received their marketing
25 authorisation for their Focus manufactured product as at

1 October 2016, and Teva have received their marketing
2 authorisation November 2016 and coming very shortly
3 after that.

4 Genesis will come later in 2017 and Renata will
5 obtain its own marketing authorisation, again in
6 August 2017, although they do not enter until some time
7 later. Do you see all that?

8 A. Yes. By the way in the same period some of these firms
9 also exited.

10 Q. Later on, yes, that is right. But as at the end of 2016
11 already 50% of the market share had been lost at that
12 point.

13 A. Yes.

14 Q. That included, obviously --

15 A. In terms of physical volumes, so we are agreed we are
16 talking about physical volumes?

17 Q. Sorry, I did not hear that answer.

18 A. When you mentioned market shares we agree it is in terms
19 of physical volumes, not in terms of value?

20 Q. Yes, yes. It is at that point that Intas acquire
21 Actavis. We know that, we have all the dates from
22 Dr Burt. We need not go to that, but you will remember
23 it was approved by the Commission on 23 December 2016
24 and completed 7 January.

25 So Intas at this point are well aware of that loss

1 of market volumes, well aware of the existing
2 competition and new competition coming, we can agree
3 that. They had the expectation, they tell us from
4 Dr Burt's evidence, which I invite you to agree was
5 a rational expectation, that their market share would
6 continue to go down absent sufficient price cuts.

7 A. I have read those documents with you, yes.

8 Q. Also they were aware, of course, of the inexorable
9 pressure that the drug tariff will -- is and will
10 continue to exert on their pricing freedom and their
11 ability to price. It is a one-way ratchet, as I said
12 earlier. Prices are only going one way, down, and
13 Accord-UK was powerless to resist those price
14 reductions. That is fair, is it not?

15 A. I disagree with your characterisation of "powerless",
16 because -- a question for the tribunal, can I say
17 something about the case or just do I just need --
18 procedurally or just need to say if I agree or disagree
19 with this specific question, or can I say a bit more?
20 We started yesterday at 2 o'clock, we have two and
21 a half hours of this kind of -- another half an hour
22 now, it is three hours and I am presented a lot of
23 documents I agree with. Can I say something about the
24 economics, or not yet?

25 THE PRESIDENT: Professor, I would rather you gave as full

1 a response as you can to the questions you are being
2 asked. I would not be very keen if you go off piste.

3 MR HOLMES: I hesitate to interrupt, but we have had really
4 a series of factual points being put and I think in
5 fairness at some stage this witness does need the
6 opportunity to give their views on the economic
7 assessment of dominance, and really the manner in which
8 cross-examination is being conducted is not at present
9 conducive. We are having a series of propositions,
10 often densely loaded with propositions not separated
11 out, all of them by reference to the factual record and
12 I have some sympathy with the point that
13 Professor Valletti is putting to the tribunal that there
14 is no opportunity for him at present to express his
15 economic opinion on the trends in the period post-entry.

16 MR PALMER: There will be, on the basis of the facts that we
17 have canvassed, and it is coming up now.

18 THE PRESIDENT: Indeed. Mr Holmes, I think the short answer
19 to your point is I am somewhat less sympathetic because
20 Mr Palmer is taking the course he does.

21 MR HOLMES: Yes.

22 THE PRESIDENT: Professor Valletti's opinion is set out in
23 the reports that he has given, and if those propositions
24 that he advances in those reports are not, as it were,
25 sufficiently broadly challenged, in other words if the

1 witness is only challenged on narrow factual points, why
2 then that is a consequence that will no doubt manifest
3 itself fully in the course of closing submissions and
4 our judgment.

5 MR HOLMES: I see the force of that. I am grateful, sir.

6 THE PRESIDENT: Mr Palmer.

7 MR PALMER: Sir, you were saying you disagreed that --

8 A. Can you just rephrase your question for my benefit.

9 Q. Well, that is my question. You can answer it how you
10 like. But I am putting to you that Accord-UK was
11 powerless to resist those price reductions. It could
12 not simply freeze its prices or increase them by this
13 stage.

14 A. "Powerless" is a term that does not have an economic
15 meaning. In my opinion, over the same period I observe
16 a variety of other factors. I observe, as you said,
17 that their own market share in terms of physical volume
18 was around 50%. In terms of value it was well in excess
19 of 60% and it actually went up during the period you are
20 talking about. I observe, you know, these market shares
21 either relatively constant in terms of physical volumes
22 or increasing, which are completely different from the
23 turbulence which is happening at the lower end of the
24 market with a lot of entry, market shares change a lot
25 and clearly amongst skinny label there is very intense

1 competition.

2 I observe significant price premiums of the full
3 label compared to the skinny label. As -- we can go
4 back to the figures, all the relative prices, the
5 relative margins are going up over the period. So to
6 conclude that, as you put it, Auden is powerless does
7 not seem to be a correct characterisation of what I am
8 observing in the market.

9 Q. I did not put it that way, Professor Valletti. Please
10 concentrate on the question. I said they were powerless
11 to resist those price reductions.

12 A. So those price -- they were making, in very simple
13 jargon, incredibly high profits at the beginning. Very
14 high margin, profits, excessive profits, excessive
15 returns. Those returns were coming down because of
16 those constraints. They could not keep the same level
17 of profits because, as I said earlier, automatically if
18 you start from £72 and you are going to go down to £2
19 and nothing changes at your cost level, obviously the
20 margins are going down. But the fact that they are
21 going down, it does not tell me anything whether or not
22 they were exercising market power. So they had to do
23 some changes. "Powerless" is a strange characterisation
24 to me. It is just as -- maybe we disagree on the term.
25 They had do this -- to, obviously reduce their prices.

1 They had to -- I agree that. They had to because of all
2 the combination, maybe of the regulatory mechanism, etc,
3 etc. This is telling me nothing about their own
4 margins, the relative strength, the strength or the
5 economic power they had.

6 Q. We are coming to all of that now. That is the point --

7 THE PRESIDENT: But, Professor, language is a difficult
8 thing. If we substituted "unable to resist" for
9 "powerless" would you have less difficulty with the
10 question?

11 A. "Unable to resist", I mean, they were not able to keep
12 the price at the same £72.

13 THE PRESIDENT: Yes.

14 A. Yes, absolutely, I agree with that, thank you. Very
15 helpful.

16 MR PALMER: I am grateful for that answer.

17 Now, I want to come now to consider the significance
18 of the market definition exercise and the dominance
19 assessment separately, which I know you have a lot of
20 points to make about that. So that is what I am turning
21 to now.

22 I think we agree that the market definition exercise
23 identifies competitive constraints on a focal product.

24 A. Yes.

25 Q. And you --

- 1 A. Usually we say if they are sufficient. Usually we put
2 an added word to that which is "sufficient constraints".
- 3 Q. Yes, and that is agreed, let us look at that. If we
4 turn to {G1/1/2} which is the joint expert statement.
5 I think you there --
- 6 A. Which proposition?
- 7 Q. You agree that the magnitude of substitution is the key
8 question for market definition, and that the point of
9 market definition is to identify that there are
10 sufficient competitive constraints acting on the focal
11 product?
- 12 A. Sufficient, yes. The purpose of the market definition
13 is to identify if there are sufficient competitive
14 constraints acting on the focal product.
- 15 Q. You say that is to identify --
- 16 A. Importantly, market definition is not an end in itself
17 but a key step in identifying the competitive
18 constraints and providing context.
- 19 Q. Understood, and you say that is, at the foot of the page
20 there, you say there that is:
21 "... to identify if there is a sufficient degree of
22 interchangeability among products such that, from an
23 economic standpoint the profit of the firm supplying the
24 focal product is affected."
- 25 A. Yes.

1 Q. We agree that it does not matter for this purpose
2 whether those constraints are direct or indirect?

3 A. Yes, on the basis -- on the joint basis, the joint
4 evidence of prices and quantity changes in the market,
5 yes.

6 Q. The way you put it in your report at paragraph 27, which
7 is at {F/1/13} --

8 A. Paragraph again?

9 Q. 27.

10 A. Thank you.

11 Q. You say that:

12 "... the purpose of market definition is to identify
13 if there are sufficient competitive constraints acting
14 on the focal product. So the question can be rephrased
15 as follows: what were the constraints acting on full
16 label hydrocortisone tablets that led to the price
17 reductions that started in 2016?"

18 And over the page you say the answer to that is
19 obvious, paragraph 28 {F/1/14}.

20 A. It is entry.

21 Q. Entry:

22 "... reversed the price ... from rising to
23 falling ..."

24 And it is that entry that gave rise both to the
25 direct and indirect constraints, in effect; yes?

1 A. Absolutely.

2 Q. So far so good. Now, the dominance assessment concerns,
3 does it not, whether a particular firm has the ability
4 to act to an appreciable extent independently of those
5 same competitive constraints. It is competitors and
6 customers and ultimately of consumers, that is the legal
7 test you will be familiar with. That is the nature of
8 the assessment, is it not?

9 A. It is.

10 Q. But we are looking at the same competitive constraints
11 that we identified at the market definition stage, are
12 we not?

13 A. Yes.

14 Q. You note at your paragraph 53, let us look at that. It
15 is page 23 {F/1/23}. Sorry, 55 is what I wanted to take
16 you to. You have explored the difference between
17 various legal and economic definitions, but you say,
18 "These concepts are clearly covered by the European
19 Commission", and I think you cite this with approval
20 where you note that the key question in the second
21 sentence:

22 "This means that the undertaking's decisions are
23 largely insensitive to the actions and reactions of
24 competitors, customers and, ultimately, consumers."

25 A. Yes.

- 1 Q. It is a different way of putting the same point,
2 I think.
- 3 A. If I am -- absolutely, and that is what I write and
4 I agree. Usually I agree with what I write, not always.
5 But I start at the dominance paragraph with 53, I am
6 talking in economic terms. Ultimately that is what
7 I am:
- 8 "In economic terms, a firm that is dominant is one
9 that holds substantial market power. Market power [and
10 again, I am referring to an economic concept] is the
11 ability to profitably raise prices above competitive
12 levels over a significant period of time. As a concept,
13 dominance does not mean that a firm is entirely free of
14 all competitive constraints, but it is a matter
15 of degree."
- 16 Q. Yes, and that economic definition needs to be understood
17 and somehow reconciled with that legal test as well,
18 does it not? It needs to be understood in that context?
- 19 A. We are trying to do that, but obviously I would respond
20 in economics, if I may.
- 21 Q. That is a matter for submissions, we are not going to
22 get into -- yes.
- 23 A. I will not comment on the legal standards.
- 24 Q. I am going to ask you to comment in a moment about being
25 largely insensitive to the competitive constraints and

1 seek your view on that. But we agree that this does not
2 preclude some competition, that is a point of agreement
3 between us?

4 A. Yes.

5 Q. But that is the question.

6 A. I think all the experts including Mr Bishop agree that
7 in order to find dominance you do not need a monopolist.

8 Q. Yes.

9 A. We agree.

10 Q. Common ground.

11 A. Very good.

12 Q. Next question: dominance can be lost. We agree that.

13 You have agreed that as trite, as the president puts it?

14 A. Yes.

15 Q. You understand that Intas's case is that Intas contends
16 that by the time of the Intas period any dominance that
17 previously existed had been lost. That is its case,
18 okay?

19 A. So Intas considered by the time the Intas period ended
20 dominance that ... okay, yes, that is what they --

21 Q. Did you know that?

22 A. Yes, of course.

23 Q. Did you understand that?

24 A. I understood that, yes.

25 Q. So in order to evaluate that claim it will be necessary

1 for the tribunal, will it not, to look at market
2 conditions at the time of the Intas period.

3 A. Again, I am sure it is a very interesting legal
4 question. As an economist that is not my understanding,
5 because there has been a change of ownership, a change
6 of ownership in itself. For me, just -- it is a year.
7 One year this firm was owned by A, this other year it
8 was owned by B. So that would be the same as saying you
9 have to do a market assessment 2016, 2017, 2018 which is
10 what we did, because in my analysis I considered
11 throughout -- dominance in this case throughout.

12 Q. Professor Valletti, it is a simple point. No one is
13 suggesting that a mere change of ownership changes
14 anything in itself, just the fact that a different
15 parent company is involved. No one suggests that. But
16 Intas's case before this tribunal is that by this time
17 market conditions had sufficiently changed that Accord
18 was no longer dominant.

19 A. In my assessment. Sorry, maybe we are on the same page.

20 Q. My simple question to you, I know you disagree with that
21 case, we know that.

22 A. Maybe --

23 Q. My simple question to you is that in order to evaluate
24 that claim you have to look at market conditions and the
25 sufficiency and extent of competitive constraints at

1 that time.

2 A. So I have analysed market definition throughout the
3 entire period, therefore including Intas because of the
4 amount of time. I have analysed dominance throughout
5 the period, including the Intas period. So I have
6 analysed it.

7 Q. You told me yesterday you had not conducted any
8 dominance assessment in respect of the Intas period
9 specifically.

10 A. Specifically, so I have not extracted one year. I have
11 not done separate analysis because there is a single and
12 continuous infringement. I haven't done in paragraph 1,
13 2016, in paragraph 2 -- I have analysed and we have
14 looked, I have looked at the data and following what the
15 CMA had said I was looking in the data if I saw any
16 structural changes within the period. Within this
17 period you are talking about I do not see any structural
18 change. I have analysed the period. I have not done,
19 you know, extracting a year on itself because part of
20 the evidence is looking what is happening before and
21 what is happening after. It is part of the exercise.

22 Q. It is necessary to look at that --

23 THE PRESIDENT: Professor, this is a somewhat unusual
24 situation. Normally if one has no change of ownership
25 you can look at a period more in the round and you can

1 say, well, actually it does not really matter when the
2 dominance ended or indeed when it began, because you
3 have a single entity that is responsible for that. So
4 you find dominance, you find an abuse and you slap that
5 entity with a great fine to make sure it does not happen
6 again. So, nice and easy.

7 The point that is being put here is that although
8 the general analysis of dominance remains the same and
9 is unchanged by ownership of firm, when one is
10 considering the incidence of a fine on a separate
11 organisation the question of dominance and abuse is
12 sharpened such that one needs to consider more carefully
13 the beginning and end of dominance and so the beginning
14 and end of abuse, not because it affects the market
15 analysis but because it affects the incidence of
16 a penalty. I think that is the point that is being put.

17 So it requires a finer degree of parsing of events
18 than would ordinarily be the case, and that is why you
19 are being pressed on this. So there is, I think,
20 an unfortunate difference between the economic analysis
21 of a phenomenon and the legal analysis of a phenomenon.
22 So you are being put, I am afraid, points that matter to
23 the lawyer, or may matter to the lawyer, where the
24 economic input is extremely important but where you are
25 being asked to address the question of dominance in

1 a somewhat unusual way.

2 So it is absolutely no criticism of you that this is
3 not the way you would normally do things, but that is
4 why counsel is pressing you on this, and that is why
5 your answers on this point are of particular importance.

6 So that is why we have this tension between the
7 economic view and the legal view, and I hope that will
8 help you answer these rather important questions so that
9 we have the benefit of your expert opinion. I hope that
10 helps, Mr Palmer.

11 MR PALMER: It very much assists, I am very grateful.

12 A. I am grateful, and it you said, it sharpens a lot my
13 understanding, and I am very happy perhaps to qualify my
14 response of yesterday when I said I did not analyse the
15 Intas period. I meant I was not instructed to look at
16 the Intas period alone. That is all I meant, nothing
17 more, nothing less.

18 But when it comes to what is called the Intas
19 period, which is early January 2017 until mid-2018, of
20 course I have analysed it and I have analysed it, and in
21 the context of my analysis on the basis of the
22 parameters which I consider I do find that there was
23 dominance by Intas in that period. So I have analysed
24 it.

25 Q. I understand that is your conclusion.

- 1 A. Yes, that is my conclusion, of course.
- 2 Q. Your conclusion persists right up and throughout the
3 Intas period, I understand that. But I just want to
4 talk about the analysis of that, because in order to
5 evaluate the claim that by the time of the Intas period
6 dominance has been lost you need to look at the
7 competitive constraints as they applied during the Intas
8 period.
- 9 A. Yes, and I do observe during the Intas period that
10 market shares of Intas are substantially above 50% or
11 fluctuate around 50%. I do observe in terms of value
12 they go to 60, 70, 80.
- 13 Q. We will look at --
- 14 A. I do observe the margins. So this is part of my
15 economic assessment.
- 16 Q. Just let me pull you back because otherwise it will be
17 a very long answer as you go through the case again. We
18 will look at each of those factors during the Intas
19 period. At the moment I am just seeking your agreement,
20 which I think you have given me, that we need to do that
21 by reference to the Intas period specifically for these
22 purposes.
- 23 A. So I have looked at 2017 and at 2018, yes. I have
24 looked at it.
- 25 Q. Right, and we need to bear in mind that relevant changes

1 can occur, capable of occurring such as further entry,
2 such as other constraints, growing over time, such as
3 the willingness of -- the increased willingness of
4 customers to switch, increased understanding in the
5 market as to the acceptability of dispensing skinny
6 products off-label. All these things are growing over
7 time, as we went through yesterday. That is something
8 which needs to factor in to that analysis, does it not?

9 A. It does, and we have.

10 Q. That is what we will come to now.

11 Let us look at your paragraph 56, which is on the
12 page just at the bottom {F/1/23}. Again, you are
13 explaining the role of the dominance assessment at this
14 point, and if I just direct you to your final sentence
15 where you say:

16 "An assessment of dominance thus takes into account
17 the intensity of the economic constraints exerted by
18 competitors, as well as potential competition, the
19 possible presence of buyer power, the persistence of
20 high market shares and high profits, and so forth."

21 So a non-exhaustive list of the factors which you
22 have been referring to just now. But it is helpful, is
23 it not, to distinguish between the notion of
24 a constraint and other matters which might evidence the
25 presence or absence of effective constraints. Do you

1 see that distinction I am putting to you?

2 A. I am not sure -- I need to read it again. (Pause) Can
3 you rephrase it, please, for my own benefit?

4 Q. We have just a moment been going through -- a moment ago
5 we went through some of the direct and indirect
6 constraints on Accord-UK; you remember that?

7 A. Yes, absolutely, yes.

8 Q. That includes countervailing buying power, the ability
9 to negotiate, the effect of the drug tariff, all those
10 things which directly or indirectly affect Accord's
11 pricing decisions; you understand that?

12 A. I do.

13 Q. Right. So that is what I am referring to as the
14 "constraints". I am putting to you it is those
15 constraints which matter ultimately for the purposes of
16 the dominance assessment. We are looking at how
17 effective those constraints are.

18 There are other matters which may evidence
19 the degree to which those constraints are or are not
20 effective, which is why we look at other matters such as
21 market shares, price differentials and so forth, the
22 premium that you referred to. They may give us an
23 indication as to whether or not those constraints are
24 effective or not.

25 A. Again, since the language matters I do not know what you

1 mean by "other matters". You are putting at the same
2 level competition from rivals, regulatory constraints
3 and outcomes, and outcomes such as what is the level of
4 prices in the market? So those to me are the outcomes
5 of the evidence of the strength of those constraints.

6 So it is not other matters. These are fundamental
7 things that would tell me as an economist whether those
8 bunch of possibilities you told me which is potential
9 competition, buyer power, persistent -- etc, etc.

10 I want to see what is the -- ultimately, because we
11 heard a lot of evidence about some pharmacies behaving
12 one way, some pharmacies -- I want to see ultimately
13 what is the economic evidence. So what we can observe
14 is going to tell us a lot about whether the ability to
15 act to an appreciable extent independently of
16 competitors bears out in the data or not. That is what
17 an economist can do. It is not that you just
18 hypothetically tell me they could switch, there is
19 a regulator that could intervene. Sure, this is --

20 Q. I think I --

21 A. -- potentially going to moderate market power, and that
22 is the end of the story, how to see whether those have
23 the -- an economic impact on the ability to price, of
24 costs, etc.

25 Q. I think I have answered your point, and I think you are

1 actually agreeing with me, that you look at that
2 evidence as an indication of whether or not those
3 constraints are effective or not.

4 A. Yes.

5 Q. Right. So --

6 A. Effective. I mean, they are strong, yes.

7 Q. Let us look at those matters now. So let us start with
8 price differentials, and I think we are agreed that
9 price differentials are to be expected in a market
10 characterised by product differentiation.

11 A. Yes.

12 Q. You accept that full label tablets were perceived by
13 some pharmacies as being a differentiated product?

14 A. Yes.

15 Q. Market share --

16 A. Sorry, since you are talking about prices, price
17 differential, can I please have document {IR-A/14/398}.
18 This is exactly, so the top figure we are talking about
19 10mg, the top figure 20mg. So this is exactly what you
20 are saying. These are relative prices, relative prices
21 for instance is the pink curve, and during that period,
22 including the Intas, what I observe is evidence that the
23 relative differentials, they go from 100 to 200 to 300
24 to 500%. Just to put it in the context, it means that
25 during this period the price is five -- at the end of

1 the period the price of full is five times more
2 expensive than the price of skinny. So this is a very
3 important matter to me, of assessing market power.

4 So this has not been -- if this had been constant
5 I may have reached a different conclusion, but it has
6 not been constant.

7 Q. You see the absolute levels going down over the Intas
8 period?

9 A. But they have to go down, because they start from two
10 prices and the cost has not changed, and the margins,
11 remember, the cost, to be generous, is around £2,
12 probably less. The margins are enormous. So these
13 prices are -- the price differential between full and
14 skinny label is what it is, £35, £25. These are
15 incredible. These are even the margins, these are
16 differential, because the margins are going to be even
17 higher because the price of skinny was not down to cost
18 yet.

19 Q. Yes, this is price differential. So as the absolute
20 goes down, as it does here, necessarily the relative
21 will go up because the numbers are becoming smaller.
22 The percentage figures go up, do they not?

23 A. No, it depends on -- this is not a general statement.
24 I am sorry, I am not going to engage with that, but it
25 is not a general statement. But it is telling me there

1 are incredible absolute margins, and there are already
2 heavy price differentials. So the market hasn't
3 stabilised towards a condition that I would call off,
4 you know, strong competition at all, so there is
5 evidence of market power. It is one of the elements in
6 itself, in itself. Yes, I agree. What I would agree is
7 that in itself that is not enough.

8 Q. So let us turn to market share. I am going to put the
9 point to you the same way that Mr Holmes put it, for the
10 CMA, to Mr Bishop. You would presumably agree that if
11 an undertaking possesses high market shares over
12 a sustained period, whether measured by volume or by
13 value, that is a relevant consideration when coming to
14 assess market power?

15 A. It is a relevant consideration, yes.

16 Q. But whether a firm is dominant at any particular time,
17 Mr Holmes asked and I ask you as well, is a matter
18 of degree that will require a rounded assessment of all
19 the evidence?

20 A. Absolutely. Can I please have document {IR-F/127/1}.

21 Q. Can I just -- you have agreed with me on, and that is on
22 a holistic basis, that is the point?

23 A. Yes, putting the dots together, of course. But can
24 I please see --

25 Q. I am not sure --

1 A. -- if I may, document {IR-F/127/1}. So this is
2 during -- so I have analysed this, this covers the Intas
3 period and this is the market share in terms of value.
4 Remember, Intas is saying that they did not have market
5 power over the period.

6 Q. Professor Valletti --

7 A. What I observe here is that the market share in terms of
8 volume, not only it has not stabilised, it has even
9 increased. When I analyse in the round, so including
10 years after this, I do see different changes. So there
11 is a cut-off in the data that tells me that until
12 June 2018 --

13 Q. Professor Valletti --

14 A. -- they were commanding 80% of the market.

15 Q. You are beginning to anticipate my next question --

16 A. Sorry.

17 Q. -- rather than confining yourself to answering the
18 question I have asked you. I am not suggesting for
19 a moment this is not relevant; it is relevant in
20 evidence and the tribunal will consider it, and
21 I understand that you have an anxiety to make sure it is
22 before the tribunal.

23 A. I apologise.

24 Q. But you can take it the tribunal have seen this and
25 understand this. So I am asking you to focus on my

- 1 question, please --
- 2 A. I will.
- 3 Q. -- and confine your answer to my question.
- 4 A. I do apologise, Mr Palmer.
- 5 Q. So given that it requires a rounded assessment, if you
6 see a firm maintaining market shares above 50%, just as
7 a matter of general principle I am asking you this, one
8 should not immediately conclude that it has significant
9 power, you should just conclude that it may do and it is
10 necessary to look at other factors as well, such as
11 whether it is maintaining that market share through
12 other competitive responses.
- 13 A. Yes. I will leave it to the lawyers to talk whether
14 there is a legal presumption, a rebuttable presumption,
15 that is another point. But if I take your proposition,
16 isolate it from the rest, I agree.
- 17 Q. That is why I think the European Commission, in its
18 guidance on enforcement priorities, describes it as
19 being no more than a first indication.
- 20 A. Yes.
- 21 Q. Do you remember that, structure of any particular point?
- 22 A. Yes, I agree. But Mr Palmer, again, let us also be
23 realistic and let me push back a little bit. So, market
24 shares are still very important, in the formal sense.
25 If market shares were very small they would not -- we

1 would not even be talking about this. It is like
2 an initial filter. It is like an initial filter,
3 because there is also ample evidence that firms with
4 market power, they command higher shares.

5 Q. So we agree, though, that a high market share can be
6 consistent with effective competition. It all depends
7 on whether a firm is having to respond to the
8 constraints imposed by competitors and customers in
9 order to maintain it?

10 A. It depends on a variety of other factors, not just
11 whether it needs to respond or not. It depends on how
12 strong the market power is.

13 Q. Now, you have just taken us, and I said I would take
14 this to you, you have just taken us to figure 7 on the
15 market share by value. The first thing to consider is:
16 market share by volume and by value, they are both
17 relevant considerations; you agree with that?

18 A. I do.

19 Q. Neither is to be prioritised over the other?

20 A. Prioritised? Yes, then we agree.

21 Q. This is evidence that you take into account, it is not
22 like you say, well, it is the value one that really
23 matters here?

24 A. No, but I -- I do not know when I can put my own dots
25 together, but it is -- the two of them together,

1 together with the price margin, etc, will give me quite
2 a neat view of them, the dominance issue.

3 Q. Let us consider --

4 A. I have considered all of them.

5 Q. Yes, and I am not suggesting that you should not, for
6 a moment. What I am suggesting to you is that when you
7 look first at volumes and then secondly at price
8 differentials, as you explained a couple of days ago, if
9 you multiply one by the other that is when you get this
10 figure, market share by value?

11 A. I agree.

12 Q. You agree with that?

13 A. Yes. It is a mathematical property.

14 Q. It combines the two together. It is not actually
15 telling you anything new or different in a market like
16 this, at least. It is just one multiplied by the other.

17 A. Yes. Of these three figures two are implying the third.
18 I have shown you two figures. I could have shown you
19 two other figures. The third figure is redundant.

20 Q. Thank you. Now, let us turn next to market share
21 stability. Just to put this in context, let us look at
22 your paragraph 67 and that is at {F/1/28}. This is
23 a point that you raised in your report, paragraph 67,
24 where you make the point here, as I have understood it,
25 that the degree of fluctuation amongst skinny label

1 market shares compared to the relative stability of
2 Auden/Actavis's market shares suggests:

3 "... there was considerable rivalry amongst skinny
4 label suppliers while Auden/Actavis enjoyed a more
5 stable customer base, and hence [you say]
6 a considerable degree of market power over those
7 customers, after having lost some more price-sensitive
8 customers ..."

9 That is your point.

10 A. It is.

11 Q. You say it is market power over those customers, not
12 over the skinny label competitors in this context?

13 A. Yes.

14 Q. That is what your focus is. Now, Accord-UK's position,
15 in terms of its market share, largely reflects -- and
16 the stability of that market share, largely reflects the
17 fact that it did in fact retain Boots and Lloyds as
18 customers throughout the period. Those were the two big
19 customers; you agree with that?

20 A. They are the -- but obviously the market share of Auden
21 is much larger than that, than the sum of Boots and
22 Lloyds.

23 Q. There are others too, yes, of course.

24 A. Yes. They did retain Boots and Lloyds and others.

25 Q. If they did not -- the loss of either of that would have

1 substantially had an instant effect on market share,
2 a very large one?

3 A. I agree.

4 Q. Can we go to {IR-D5/2/17} which is in Mr Bishop's
5 report, table 1. We will need the IR version. You
6 remember those figures of Mr Bishop?

7 A. These are the amended figures.

8 Q. No, these ones were not amended. The amended figures
9 were in an annex. These ones remain. I do not think
10 you dispute the figures, at least as amended by
11 Mr Bishop. You do not dispute those figures. I think
12 your point just relates to the coefficient of variation,
13 which you say is a relevant consideration as well?

14 A. Yes, another comment I may make is that all these
15 figures are -- one is linked to the other. If you put
16 the range or the inter-quartile range, on the
17 inter-quartile range it is truly just repetition of the
18 same measure. It is not there are four independent
19 different data points. They are just capturing the same
20 thing, which is the absolute variation in the market
21 share, from 50% to 55%, say, for Accord or to 45%; and
22 for Bristol or for Resolution it would be from 5% to 0%
23 or to 10%. This is what they are saying.

24 Q. Can I put this to you: what matters from Accord's point
25 of view is the aggregate share in the fight for

1 customers. It is competing with the skinny customers.
2 Of course, if one were to aggregate all of the skinny
3 suppliers' market shares and compare the relative
4 stability you would get be one being the exact inverse
5 of the other, would you not?

6 A. So when you say what matters is the aggregate share, in
7 what sense? To fight for customers, so what matters for
8 accuracy is of course the impact on profit, but what are
9 you trying to say?

10 Q. The point you make is that you say this is an indication
11 of market power over customers.

12 A. No, the point I am making there is that when I observe
13 this variation that actually I was just simply reacting
14 to what Mr Bishop had put forward, which was a comment
15 which I did more in an eyeballing way using the previous
16 figures, but my point, it has been confirmed once you
17 look at the coefficient of variation. I observe
18 substantial turbulence amongst skinny, substantial
19 turbulence, and instead relative to that substantial
20 stability relative to that.

21 Q. That is understandable, yes. I have that point. Let us
22 understand what that reflects. That reflects the fact
23 that the skinny suppliers are fighting between
24 themselves for the business of those customers who are
25 prepared at any given point in time to buy skinny

- 1 products.
- 2 A. Yes, so there is intense competition amongst skinny.
3 What this reflects, or at least that is my
4 interpretation, is that there is also a chunk of the
5 market of less price-sensitive people over which the
6 skinny cannot compete --
- 7 Q. Whereas Accord at this point --
- 8 A. -- and Auden retains a relatively stable market share
9 there.
- 10 Q. What it is concerned to do is slightly different, what
11 it is concerned to do is to continue to supply full
12 label tablets to its customers, and it is concerned to
13 continue to persuade its customers to buy full rather
14 than skinny products, because the moment they decide to
15 buy skinny products they are going to be lost to Accord,
16 are they not?
- 17 A. What you are saying? So what is "concern to do", you
18 are talking about Accord?
- 19 Q. Yes.
- 20 A. They want to continue to supply full label tablets to
21 its customer to continue to persuade its customers to
22 buy full, yes?
- 23 Q. Their pricing responses are all aimed at keeping --
- 24 A. They are still -- they are pricing absolutely in a way
25 to keep the full, where they are exercising market

1 power. In doing so they also offer the same price to
2 some skinny products because, as we know, children can,
3 may -- so there are some purchasers outside --

4 Q. My point to you, this variance in the degree of the
5 stability of market share really reflects that position,
6 that the skinny suppliers are fighting between
7 themselves to supply those who are already decided to
8 buy skinny products; Accord is fighting to persuade its
9 customers not to buy skinny products.

10 A. But that is fighting --

11 Q. That is not in itself an indication of market power.

12 A. So, the general point that market shares are not
13 sufficient to prove market power is something we agree
14 with. So obviously, two competing firms in a stable
15 situation, they will have constant market shares, they
16 may or may not be large depending on circumstances.

17 The evidence I have here is that after this initial
18 period where obviously the skinny product was not
19 available and the market divides itself into two
20 segments, and there is -- we have agreed earlier that
21 there are competitive constraints to sufficiently agree
22 to put them in the same relevant market. Then the
23 market partitions into these segments, the skinny and
24 the full, the more price-sensitive, the less
25 price-sensitive. Auden, in my opinion, because of my

1 assessment, has market power over the less
2 price-sensitive. Some pharmacies, you know, etc, etc.
3 They are able to retain a constant market share there.
4 There is no more turbulence for them anymore. There is,
5 of course, plus/minus. We said that plenty of times.
6 Let us not be too mechanical and too formulaic. They do
7 retain a substantial power over those customers, which
8 shows in the relatively constant share of around 50% in
9 terms of volumes, but they also retain substantial
10 market power. Of course their price is going down, but
11 they are able to price to an appreciable extent
12 independently of its own rivals, as shown by a whole
13 plethora of indicators which I have said. So --

14 Q. It just shows its degree of success in continuing to
15 persuade its customers to buy the more expensive
16 product, the full label product. That is all it shows.

17 A. But then this would not be reconcilable with those
18 margins, those -- so there are other elements here.

19 Q. So you say.

20 A. If you are saying that having a relatively constant
21 market share is compatible with competition, on its own
22 it is a principle which is correct and I cannot exclude
23 it. But on the basis of their own evidence it is not
24 what is happening here.

25 Q. Even though you said it stabilises around 50%, you

1 accepted yesterday it varies between 30% and 60% during
2 this time?

3 A. Yes. We had a discussion also, shall we look at the
4 monthly sales, shall we average out over the year
5 because of, you know, purchasing in bulk. So there is
6 a discussion.

7 Q. Let us just look at your emphasis on the coefficient of
8 variation briefly. It may not matter too much, but let
9 us deal with the point briefly. You make the point that
10 there is a significantly lower coefficient of variation
11 when looking at value-based market shares. We can see
12 that at {G1/1/33}.

13 A. Yes.

14 Q. These are your figures in the joint expert statement
15 that you inserted here, and if you look at during the
16 Intas period the coefficient of variation in the first
17 column is based on value market shares. We have volume
18 in the second column. I think your point is in
19 particular the value market shares is lower for
20 Auden/Actavis there than the other measures.

21 That is because Accord-UK's value-based market
22 shares are significantly over 50% during that period, is
23 it not?

24 A. So what this table is saying is simply that -- I was
25 just articulating my point that I had observed

1 sufficiently less variation in Auden compared to the
2 skinny rivals, and if you want to use one metric -- and
3 again, why do we use a coefficient of variation? We are
4 trying to compare changes in time series, okay, in
5 economics, and if time series are similar you can use
6 ranges, you can use absolute values because they are
7 similar.

8 When they are very different because they are at
9 very different levels, looking at absolute changes is
10 not meaningful, it is not meaningful, so you need to
11 anchor it. An example I think I gave in my report is
12 cost of living crisis. Our bill is going up by £200
13 a month, say, it is a lot of money. But it is a huge
14 difference if this £200 a month is happening for
15 somebody who is very poor. A poor, a low income
16 household, that will represent a big percentage of their
17 own yearly expenditure as opposed to a rich household.
18 So you are going to look at coefficient of variations
19 there to put it in context.

20 That is why we use coefficient of variation, just to
21 anchor time series which are at very different levels,
22 and this is undoubtedly true. The average shares of the
23 entrants has been around 5, 6%. The average share of
24 Auden is 10 times as large. So that is why I needed
25 an anchor to compare those changes. That is the only

- 1 point, and then you have --
- 2 Q. So --
- 3 A. -- if we are interested in the numbers they are there.
- 4 Systematically Auden has a lower share of the
- 5 coefficient of variation -- lower number compared to
- 6 anybody else.
- 7 Q. Inevitably, because by construction this divides the
- 8 same standard deviation for those -- sorry, lower
- 9 coefficient --
- 10 A. They do not have the same standard deviation, sorry.
- 11 Q. No, but if you had the same standard deviation it would
- 12 be divided in the same way for between -- in
- 13 Auden/Actavis and competitors.
- 14 A. I would prefer to avoid this kind of discussion, if
- 15 possible.
- 16 Q. You do not want to help us with that. All right, let me
- 17 put it another way: you compare volatility, in this
- 18 context, of Accord-UK's market share with that of
- 19 individual competitors --
- 20 A. Yes.
- 21 Q. -- by using a volatility metric which weighs absolute
- 22 volatility levels by the average market share of each
- 23 competitor. I think that is what you have explained to
- 24 us.
- 25 A. No, no, this weights by average of Auden itself. It is

1 anchored to Auden, not to the competitors. I am sorry,
2 this is not a definition of the --

3 Q. But this will always result in lower -- this approach
4 will always result in lower market share volatility for
5 larger competitors such as Accord compared to smaller
6 competitors operating in the same market?

7 A. So, this is basic, it is a standard deviation divided by
8 the average of that firm. That is what the coefficient
9 of variation is. So of course you are dividing by the
10 average, which pushes down. However, if the standard
11 deviation of this large firm was fluctuating a lot, it
12 is not -- it is going to be an opposing effect. So it
13 depends on the relative components. How volatility is
14 the standard deviation and how large the firm is.

15 Q. Beyond the other measures that Mr Bishop provided,
16 volatility, the only additional thing that this is
17 telling us over and above that is that certain
18 competitors, in this case Accord-UK, have higher market
19 shares than other competitors. It is just simply
20 reflecting the same thing again.

21 A. So the metric of Simon Bishop that you showed earlier
22 instead compared only the absolute changes, they never
23 anchor those changes to any size of those firms. That
24 is the only difference. That is the only difference.

25 Q. You have mentioned also relatively high margins, but

1 they are also potentially compatible with effective
2 competition, are they not?

3 A. So, again, in isolation of course a firm that has
4 a product which is differentiated from the competitors
5 will command a higher price because they are
6 differentiated, but looking at that price differential,
7 at the margin, how it changes over time is very
8 informative as to whether or not there is market power,
9 yes.

10 Q. We can look at all these matters we have gone through,
11 the price differential, the market shares, the relative
12 margins, price -- market share volatility. We can look
13 at all of those, and none of those in and of themselves
14 give us the answer.

15 A. Yes.

16 Q. What they all do is point us to look at the strength and
17 nature of the constraints on the focal product.

18 A. The cumulative evidence -- the cumulative evidence
19 I have seen is not telling me that this is a competitive
20 market, yes. It is a cumulative evidence. It is the
21 joint evidence of those absolute levels, the trends, the
22 shares, the relative difference between these two
23 segments and the competition which is happening.

24 Q. What you are doing there, in expressing that conclusion,
25 is you are referring again, as you said earlier, to

1 exactly the same constraints that you considered for the
2 purpose of market definition, but you are saying as
3 a matter of judgment looking at this evidence, they are
4 not strong enough to constitute effective competition.

5 Is that a fair summary of your position?

6 A. It is the same constraints. We are analysing how
7 effective they are, how strong they are.

8 Q. Yes.

9 A. We analyse the same elements. In here we are assessing
10 and disputing whether they are -- do they allow Auden to
11 exercise market power or not?

12 Q. The point you have come to several time during your
13 answers to me is that all these -- throughout this time
14 you are drawn back again and again to the fact that
15 prices remained higher than they were for skinny
16 competitors. There was still a significant
17 differential?

18 A. It is one of the elements I refer to. It is not just
19 higher, I have seen in relative terms, for instance,
20 they were even increasing over time.

21 Q. Can I put this to you: effective competition is
22 a process, not an end result. Do you agree with that
23 proposition?

24 A. 100%.

25 Q. 100%, thank you. So just, again, to step away from the

1 facts of this case for a moment --

2 A. If I may just qualify, it is a process that -- so, that
3 will end up somewhere. It is not just a process. Just
4 by observing the -- so, a process does not -- let us
5 qualify, because otherwise we get confused.

6 So process of competition does not mean that as
7 I observe a firm entering the market they will be
8 effective competition. We agree with that, I guess. So
9 it is a process where I do observe an equilibrium with
10 being, over time being replaced with another equilibrium
11 and this competitive process leads to a competitive
12 equilibrium which has certain properties, certain
13 characteristics. So prices being around costs, no
14 further entry, etc, etc.

15 Q. So what the competitive equilibrium is at any given time
16 will depend upon the conditions of competition at that
17 time, but that process of competition moving through
18 depends on the effectiveness of the constraints on that
19 product?

20 A. So the duration of that process you mean?

21 Q. I am talking about the process.

22 A. So the process will be affected by the intensity of
23 competition by definition, we said that, yes.

24 Q. Yes.

25 A. The process will affect --

- 1 Q. This is what we are looking for, is it not, in the
2 dominance assessment, whether those constraints are
3 effective.
- 4 A. Yes.
- 5 Q. Not whether we have reached a particular competitive
6 equilibrium at any point of time where prices have
7 a certain relationship with costs.
- 8 A. No, no, but to be fair to the CMA, they decided to
9 prioritise a certain period only for the dominance
10 assessment when they said, we do not go down the way to
11 telling you what the effectively competitive price will
12 be. We have a certain metric, etc, and they are very
13 generous and they cut it about 10 times the costs of
14 production, include the cost plus, actually. So -- and
15 that is where they stopped. So they are saying, we are
16 simply saying that it will be below the £20 level.
- 17 Q. Let me just pick up your terminology there, because you
18 referred to the "effectively competitive price", again,
19 as if that is a given end point.
- 20 A. It is the outcome of this process.
- 21 Q. You say that is the outcome but you have just explained
22 to us that you can have effectively competitive prices
23 which are changing over time?
- 24 A. No, then I did not say. So then I expressed myself in
25 the wrong way. So in this process there will be a guide

1 path of prices. There is a variety of prices. It does
2 not mean that all of them are effectively competitive
3 especially when you start from a monopoly price. It
4 would be absurd to --

5 Q. It does not mean anything to speak about effectively
6 competitive prices in that circumstance because you are
7 straight away looking at one metric and not looking at
8 the strength or otherwise of the constraints?

9 A. I am not looking at -- this is a mischaracterisation of
10 what I am doing because I do not look at one metric.
11 I look at five, six, seven things together and in the
12 round I reach my conclusion.

13 Q. Of course, yes.

14 A. So if it was so simple and to say when the price is 20
15 and that is an effective competitive price, that would
16 be a mathematical formula and it would be very
17 artificial to do that. We are not doing this. We are
18 disputing, we are in disagreement but we are putting
19 together a lot of elements.

20 Q. Take a step away from the factors of this case for a
21 moment and take the example the president gave a few
22 days ago. Do you remember he gave an analogy of the
23 market for face masks during the pandemic. Were you
24 here for that?

25 A. I was but --

1 Q. Before the pandemic there was a limited supply of face
2 masks --

3 A. Yes, and there was entry.

4 Q. -- and demand. The pandemic --

5 A. Yes, yes.

6 Q. But that he was using that as an example to say well,
7 all of that is the process of competition working.
8 There is no single point at which you say, hold on, this
9 is competition not working. Of course it takes time for
10 market entry to happen. It takes time for that to have
11 an effect on the price of face masks but that is the
12 process of competition working all the way through, is
13 it not? You do not step in at some point and say, hold
14 on this is competition gone wrong?

15 A. No, that is why we are very careful with abuse of
16 dominance of this kind.

17 Q. Yes, exactly.

18 A. But this is not that example, if I may comment on it.
19 This is an example where entry occurred because of an
20 abuse, so entry happened because prices went from £2 to
21 £72. Entry happened because the NHS that was paying
22 about half a million a year ended up paying 80 million
23 a year. Over the period the NHS had to pay half
24 a billion pounds in excess of what they were doing
25 before.

1 Q. Stop there.

2 A. So if the process of entry we need that and then we have
3 to pay the costs of 10-years of abuse.

4 Q. Professor Valletti --

5 A. You have to wait for -- I need to comment on that,
6 because that is an important point. It is an important
7 point.

8 Q. That can be done later.

9 A. But always "later". We have been for four hours now,
10 and I can never talk, so -- this is important. This is
11 what this case is about. There have been ten years of
12 abuse where consumers, patients and the NHS suffered
13 greatly, and do we need that in order to wait for some
14 competition to happen?

15 Q. That is the advocacy point.

16 THE PRESIDENT: Mr Palmer, how are you doing on time?

17 MR PALMER: Well, I have estimated up -- I think 12 o'clock
18 I said I would be finished by --

19 THE PRESIDENT: Yes, indeed.

20 MR PALMER: -- and I am on course for that.

21 THE PRESIDENT: You are on course for that?

22 MR PALMER: Yes. So --

23 A. But again --

24 Q. Professor Valletti, can I --

25 A. I am not an expert on this matter, but this should be my

1 cross-examination and it is being from 2 o'clock
2 yesterday until 2.30, two and a half, plus it has been
3 four hours when I can hardly speak. But I am being told
4 I am an advocate.

5 THE PRESIDENT: Professor, let me --

6 A. Fine. Sure, but I talk also --

7 THE PRESIDENT: Let me try to put your mind at rest here.

8 This is a somewhat formal process and you are, I am
9 afraid -- and I appreciate that it is a matter of regret
10 for you, but you are, I am afraid, in Mr Palmer's hands
11 because the way this process works is that you have put
12 in your evidence, your material. That you can take as
13 read because we have read it, and be assured we will be
14 reading it again and again before we reach a judgment on
15 this.

16 The purpose of this exercise is for Mr Palmer to put
17 his client's case and he is, like all the barristers
18 here, very skilled at doing exactly that. Now, it is
19 his duty to assemble the evidence that he needs to put
20 to us in argument in due course. Now, he has to put his
21 case, as we would say as lawyers. What his case is, is
22 a matter for him. He has to put it. If he does not put
23 it and has not challenged your evidence then things will
24 not go well for him in closing arguments, and he knows
25 that. So bear with us.

1 A. I apologise. I am just trying to be helpful to the
2 court, and if I can --

3 THE PRESIDENT: No, no, I quite understand that. But this
4 is, as I say, a formal process to getting to a result,
5 and it is essential for Mr Palmer's clients that he puts
6 the arguments, or he puts the questions that will
7 underpin the arguments he is going to put next week to
8 you, and that is what he is doing and that is why I am
9 keeping quite a close eye on the clock because I am very
10 happy for you to give full answers and encourage you.
11 I have not sought to stop that, but I do want us, if we
12 can, to finish at midday because we have another witness
13 who I think is taking three or so hours. So I am
14 listening very carefully but do not worry about the
15 sense that you are giving only a partial account of
16 yourself, because we are not going to decide this case
17 only on what you were cross-examined. We are going to
18 decide the case on the totality of the evidence which
19 includes, obviously, your evidence-in-chief. I mean, if
20 we did not have written reports you would have spent
21 several days explaining what you have done in your
22 written reports. We do not do it that way because it is
23 inefficient.

24 A. Thank you, Mr President.

25 MR HOLMES: May I just very briefly check on timing, sir.

1 I appreciate we need to get through this witness --

2 THE PRESIDENT: You have some re-examination?

3 MR HOLMES: -- but I have some re-examination, and also

4 I think in fairness the witness and the transcriber

5 should be given a mid-morning break at some point.

6 THE PRESIDENT: Well, indeed.

7 MR PALMER: Yes. Well, perhaps we will just conclude and

8 then take the break. The answer you have just given me

9 collapses abuse into dominance, and I want to separate

10 those two things out.

11 Now, the premise on which I am putting the question

12 is I do not accept that abuse you have alleged, I do not

13 accept that previous dominance that you have alleged.

14 But I want you to think about this: if there was

15 dominance at some point and an abuse at some point,

16 Intas is concerned with identifying whether that

17 dominance, and if so whether that abuse continued into

18 the Intas period; do you understand that much?

19 A. Yes, I think I understand.

20 Q. The point I am putting to you is that by the time of the

21 Intas period that dominance had been lost because

22 whatever had gone before, those prices were tumbling and

23 Intas did not have the power to prevent that decline.

24 We have been through a lot of that and we had your

25 answers on that.

1 A. I disagree with that.

2 Q. You have made clear you disagree with that. It is that
3 context which provides the context in which I am putting
4 this question to you to: that in assessing that claim of
5 loss of dominance what the tribunal will need to
6 concentrate on is the effectiveness of those constraints
7 at that point, not the question of whether a particular
8 price was reached during that point.

9 A. That is what I have done in my report. I have analysed
10 the effectiveness or the degree of market power in 2017
11 and in 2018, which includes the Intas period.

12 MR PALMER: That is a suitable point for a break, perhaps we
13 can do that now.

14 THE PRESIDENT: Thank you. We will resume at a quarter to
15 midday.

16 (11.35 am)

17 (A short break)

18 (11.45 am)

19 MR PALMER: Professor Valletti, before the break we were
20 talking about the process of competition, and I am
21 putting to you, and you have disagreed, is that by the
22 Intas period the constraints were sufficiently strong
23 such that price was being driven relentlessly down, the
24 writing was on the wall, there was nothing that Accord
25 could do to prevent that, and that effect was entirely

1 driven by the entry of skinnies and the direct and
2 indirect constraints which that gave rise to and which,
3 indeed, I think you accept caused that drop of price
4 from -- ultimately from £70 all the way down to £3.
5 That was directly attributable to that process and to
6 those constraints.

7 A. So the indirect and direct constraints, indeed they
8 caused the price to go down from £70 down to 3 over
9 many, many years.

10 Q. So therefore your complaint, if you like, about Accord's
11 conduct is that during the Intas period it did not drop
12 its prices quickly enough?

13 A. That relative to their own competitors, that is one of
14 the points which I have considered. It is not my only
15 complaint.

16 Q. But is that right? That is the complaint, you are
17 saying they should have dropped their prices more
18 quickly than would have happened or did happen, directly
19 because of the effect of those constraints?

20 A. I am not prescriptive as to what Intas should do. Intas
21 knew they were dominant. They should have behaved in
22 the way not to abuse the market power they had. They
23 knew they were dominant.

24 Q. By which you mean they should have dropped their prices
25 more quickly?

1 A. By which I mean -- again, I am not the judge. They
2 should have the special responsibilities of this firm.
3 It is up to them to decide how to interpret the law.
4 Therefore, they should follow the law, yes.

5 Q. So if at the time they had looked at these market
6 conditions, looked at the extent of the competitive
7 constraints on them, looked at the fact that they
8 expected, and this did happen, prices would continue to
9 drop, they could not maintain their volumes if they did
10 not drop, if they looked at all that time you would say,
11 well, I do not know, cannot tell you what you should do
12 here, nothing to be done; that is unrealistic, is it
13 not, Professor Valletti? What you are saying is they
14 should have dropped their prices quicker than demanded
15 by the specific market arrangements put in place by the
16 Department of Health to manage prices in a competitive
17 environment?

18 A. Once again, I am not prescriptive as to what people and
19 firms decide to do in their own business choices. What
20 I am asked in this case is to give you my expert opinion
21 as to whether I think Intas had market power over that
22 period. I do observe the prices were coming down. They
23 had to come down for several reasons because they had
24 started from an incredibly high level, so it is
25 mechanically coming down through the indirect and also

1 through the direct constraints, of course. I have
2 analysed whether in that period Intas retained market
3 power. So they should have -- so, put it differently.
4 If I had observed a different world in which the margin
5 of Intas were different, the prices came down in
6 a different way to different levels, to different
7 margins, I most likely would have reached different
8 conclusions.

9 THE PRESIDENT: Can I put it yet differently: to what extent
10 are we talking about, and I am going to make various
11 assumptions, I want to be clear I am making assumptions
12 here. I am assuming that there was a dominant position
13 and an abuse of a dominant position at a point in time,
14 and we are talking here about the unwinding, if I can
15 call it that, the unwinding of the dominant position.

16 Now, when that point occurred is going to be --
17 whether that point occurred is going to be a question
18 that we will have to debate, but let us assume that we
19 are talking about a situation where there was once
20 dominance but the entity that is dominant or was
21 dominant is no longer, in the sense they have the
22 benefit of extraordinarily high margins, they are trying
23 to hang on to them for as long as they can, but they
24 actually cannot because of certain circumstances, say
25 hypothetically, the entry of the skinny product into the

1 market.

2 Is it an abuse to try to hang on for as long as
3 possible to a market position which is actually, in the
4 short or medium run, unsustainable?

5 A. It is a matter of -- your question, so imagine it takes
6 a very long time to get there, so we are talking about
7 ten years to get at some stage where the market
8 self-corrects. It is an interesting question, so we
9 need to understand when do we think we want to cut out,
10 and it is a matter of judgment, in my opinion this is
11 what the CMA did in its own choice to prioritise
12 a certain period.

13 I also think that the question of whether or not --
14 imagine the market, as you said, self-corrects over time
15 and eventually it reaches an equilibrium, either
16 a competitive equilibrium after the abuse ends. In
17 itself for me it is not relevant for establishing or for
18 disproving what actually -- whether there was dominance
19 during the abuse. So this is a different question.

20 So as an economist I look at all those indicators
21 which are telling me whether there was market power, and
22 there was market power, and then we go to the dominance,
23 to the abuse assessment and we use also there a certain
24 number of indicators to see the various limbs that you
25 are very well familiar with of the *United Brands* test.

1 THE PRESIDENT: I think what you are saying, Professor, is
2 that it is actually the -- if one is looking at price as
3 the "tell" for the loss of dominance, again, let us
4 assume that --

5 A. Sorry, can you repeat. You look only at price?

6 THE PRESIDENT: No, I am just using price as the metric to
7 measure dominance. I appreciate, of course, that there
8 are a number of other factors but let us try and keep it
9 simple for the point of this question.

10 Let us say we have a product which is being sold at
11 an excessive price of £100 a unit, and that the
12 "competitive price" is £2 a unit. Now, if that £100
13 price is being maintained over the years then you have
14 no problem. You have, by definition in this example,
15 an excessive price achieved through dominance. There is
16 an abuse and there is therefore a competition
17 infringement.

18 But let us suppose that the conditions that maintain
19 dominance cease. Now, if it happens from one day to the
20 next that on Day 1 you have a sustainable £100 price and
21 on Day 2 it drops to the competitive price of £2 a unit,
22 then the abuse has ended in that day.

23 If, through resisting market forces the dominant --
24 the transient dominant undertaking manages to delay the
25 fall in price, £100 on Day 1 to, let us say, £2 on

1 Day 10 and the decline is therefore less precipitous
2 than Day 1 to Day 2, in your opinion -- and I appreciate
3 this is in part a question of law, but I am going to ask
4 it anyway -- in your opinion is that extension of the
5 higher price in and of itself an abuse?

6 A. No, so that would not be enough for me.

7 THE PRESIDENT: No.

8 A. So what I think I would look also is how market shares
9 evolve over time. So one of the hallmarks of dominance
10 is the ability to sustain super-competitive on margins
11 and prices for long time periods, and perhaps, just
12 perhaps, if we can take a document {IR-A/14/164} --
13 sorry, 163, because that was the 20mg.

14 So this includes the period of alleged dominance and
15 abuse, and it goes above it. Okay. It goes up to 2021.
16 There, as you can see, so there is one of the hallmark
17 of dominance, I see that market shares were relatively
18 stable in terms of volumes already during the dominance
19 period, but in terms of value they go up. As you can
20 see, instead -- the market shares in terms of volumes
21 they start coming down dramatically after April 2020.
22 So this is telling me that the competitive process has
23 reached maybe a near-final phase, okay, and so this is
24 very different. So for me just the price level without
25 these extra indicators would not be enough, of course,

1 to say dominance, and it is an element that I would
2 consider also to compare the excessively high prices.

3 THE PRESIDENT: Now, of course I appreciate that and it is
4 my fault for trying to keep the parameters as simple as
5 possible.

6 So, okay, let us throw in all of the relevant
7 factors that go to a finding of dominance and a finding
8 of abuse.

9 A. So maybe -- I give you an example. Let us assume there
10 is dominance.

11 THE PRESIDENT: Let us assume on day one there is dominance
12 and an abuse, because the price is £100 and it is
13 maintainable on day one. But because of factors that
14 come in, on Day 2 the price falls, and let us infer
15 market share falls as well, because the only price at
16 which this formally dominant undertaking can sell is £2
17 a unit, and yes, we can say there are lots of other
18 people who have come in selling at £2 a unit, that is
19 why the price has fallen.

20 My question is: what happens if the transiently
21 dominant undertaking that is wanting to abuse by
22 maintaining its price as high as possible, because this
23 is not an intentional tort, this is unintentional, you
24 are trying to keep your prices high and in doing so you
25 manage to fight a rearguard action such that you have

1 stretched your period of higher prices and higher market
2 share from the one-day example to T plus whatever.

3 Now, if it is simply days, I anticipate your answer
4 is, well, you know, the abuse is lost and there is no
5 problem. But what I am trying to get a feel for is
6 whether the gradient of the decline from the dominant
7 position to the competitive position is something that
8 you factor in, in working out whether there is or is not
9 an abuse?

10 A. So, in your example I would have to study in this number
11 of days what is the T period, whether I believe there is
12 still dominance or not. So that would be my first step,
13 and obviously if in the T periods I see turbulence,
14 market shares going down, margins -- if all the
15 indicators are telling me that things are going towards
16 effective competition probably I would not even say
17 there is dominance and then your question does not
18 arise, obviously.

19 If instead during the period I see what I see in
20 this case, but let us forget about this specific case,
21 I see persistently high market shares despite the fact
22 that it is a fringe of super competitive firms,
23 I actually see this. No, the facts of the case, there
24 may be some segments of the market which are very
25 sizeable which have very inelastic demand. All the

1 indicators of market power, the relative prices, they
2 are not going down; if anything they are going up. So
3 all the indicators are telling me there is market power
4 in this -- of course, it would not be days, but over
5 that period, however long it is, then I go to the
6 excessive pricing case and since these are -- I look at
7 the abuse and then I have to look at the nature of the
8 abuse, and the nature of abuse here is setting prices
9 which are excessively high, and the cost, plus, etc,
10 etc, is the most natural starting point for
11 an economist.

12 Have I clarified?

13 THE PRESIDENT: No. Thank you, Professor. I do apologise,
14 Mr Palmer, I am taking up --

15 MR PALMER: That has taken some time, yes, but I am near the
16 end. But just to pick up on the President's point, here
17 the cut-off for dominance was defined by the CMA as
18 being the moment when the price reached £20. That is
19 based on the measure of priorities --

20 A. For 10mg at £50 --

21 Q. The price was taken as the determinant of the end of the
22 period that they were interested in, and the point I am
23 really putting to you, following on from the President's
24 point is actually that is the wrong focus. The right
25 focus has to be on the nature of the constraints and

1 their effectiveness, and nothing actually changes.

2 A. And their intensity.

3 Q. And intensity.

4 A. Yes.

5 Q. Nothing changes in that respect. All the conditions for

6 the loss of dominance are in place by the time of the

7 Intas period: widespread market entry, widespread

8 understanding that skinny is fully substitutable for

9 full products, and as we went through yesterday, free

10 choices being made by pharmacy customers.

11 A. Sure.

12 Q. That does not add up to dominance.

13 A. Mr Palmer, as an economist I also observe market

14 outcomes, so they are all factors that we may or may not

15 know. All heterogeneity, differentiation in the market,

16 we spoke about some pharmacies perceive some things,

17 some others perceive different things. Then I observe

18 in the data as an economist I am a bit more agnostic,

19 I do not have to make a lot of judgment, I just observe

20 the ability of this entity to price over and above their

21 cost and to price over and above their own rivals. So

22 that is what I am assessing. I am assessing the

23 ultimate effect in the market through the analysis of

24 price movements, quantity movements and the like. So

25 I am assessing -- the intensity of all those factors

1 that we agree are very important in principle, we just
2 see how they pan out in practice.

3 Q. The point I put to you is, Mr Bishop's point here, is
4 once you have identified that all this pressure on
5 prices is solely attributable to the market entry by the
6 skinnies, the direct and indirect constraints such as
7 sufficient to bring them into the market, sufficiently
8 proximate and real for that purpose, it is those same
9 constraints which are effective in driving that price
10 down to £3 ultimately, and it is those same conditions
11 which add up to a loss of dominance because what is
12 driving this now is customer preferences.

13 A. What -- you seem to be suggesting, but I may have
14 misunderstood, that then market definition and dominance
15 are the same thing. But you just said, you just said,
16 you identified that there is a pressure on prices
17 because of skinny, there is indirect and direct
18 constraints. They are sufficient to bring -- the same
19 things therefore implies that there is no dominance.

20 Q. We have had the debate. I am putting the point to you
21 in the context of Mr Bishop's view. I think you have
22 given us your response. You do not agree. That is the
23 point I am putting.

24 A. Yes, I do not agree.

25 Q. Right. Very briefly I am going to turn to the question

1 of economic value, which I will deal with in summary
2 form.

3 Measures of cost do not provide a good proxy for
4 economic value; do you agree?

5 A. To start with, I do not think economists have a very --
6 this is not an economic concept. "Economic value", it
7 contains the word "economic" but it is not a well
8 defined economic concept.

9 Q. I accept that. But certainly you would agree that
10 measures of cost omit consideration of demand factors.
11 Cost is a supply side concept, if you like, and this
12 notion of economic value, whatever precisely it is, is
13 essentially a demand side concept?

14 A. Again, if you ask an economist, the starting point of
15 an economist, the honest starting point of an economist
16 would be, well, economic value must be what people are
17 willing to pay for it, which willingness to pay is
18 a demand characterisation. However, once you speak and
19 explain to the same honest economist that here we are
20 talking about prices which are excessively abusive, they
21 will say, well, this must not mean what economic value
22 is implied by the legislator because otherwise no price
23 would ever be abusive. It is what people want, and they
24 understand that, so if you continue along those lines
25 the reasonable honest economist will say, so it must

1 mean that the value is what people pay in a market which
2 is probably subject to some level of competition, some
3 fair level of competition, some similar level of
4 effective competition. So ultimately you boil down it
5 to the observed outcomes in markets, which is coming
6 from demand and supply considerations, and when you come
7 to supply considerations costs are an important matter.

8 Q. For sure, no one is going to suggest that costs are not
9 important, but it does not end there. We look at what
10 consumers demand, customers demand and the
11 relationship -- the value that they attach to those
12 features of a product which are important to them and
13 the relationship with price.

14 A. Yes, but I said that demand alone cannot be an answer to
15 your point.

16 Q. No. Now, so therefore we identify features of the
17 product which are capable of attracting value and having
18 value ascribed to them, and one such value can be
19 attached to protection against regulatory risk at
20 whatever level you perceive that to be.

21 A. Yes.

22 Q. As regulatory risk or lack of it becomes clearer over
23 time, it may well be that the value to be attributed to
24 that protection diminishes over time.

25 A. It is a possibility.

1 Q. If at one point in time you think there is substantial
2 risk and at a later point of time you think there is
3 negligible risk, it may well be that the value you
4 attach to protecting yourself against that risk
5 diminishes over time?

6 A. Yes, but again, Mr Palmer, using your very own example
7 yesterday you said there is so much uncertainty in this
8 market that nobody knows who has risk, who has not,
9 there is all this turbulence, we do not know. By your
10 own words I do not see any evidence that it was --
11 because this is where you are going to, that this idea
12 that risk was being perceived as an important factor was
13 going down over time.

14 Q. I will not go over that with you.

15 A. Thank you.

16 Q. Some customers may attach value to the perception that
17 they have in the market for their patients as being
18 a quality operator?

19 A. They might. I would not know how to measure that, but
20 they might.

21 Q. They might.

22 A. They might, yes.

23 Q. Again, I think you suggested yesterday that customers
24 who are used to a certain product may attach value to
25 that product being continued to be supplied to them?

- 1 A. That is what I said yesterday, yes.
- 2 Q. Again, that is a source of economic value for that
3 product in those circumstances?
- 4 A. Well, that is the demand side. You are again describing
5 the demand side, and I told you that an economist would
6 say that demand side considerations, they are important
7 but they cannot be the only ones when we are talking
8 about this issue, because otherwise we would be
9 conflating value with willingness to pay.
- 10 Q. I have not suggested that. I think you agree that that
11 is something to be taken into account?
- 12 A. I presume.
- 13 Q. Yes. As is perceived patient safety at any given time?
- 14 A. Yes.
- 15 Q. Accuracy and ease of dispensing is a source of value?
- 16 A. Yes, so -- yes.
- 17 Q. Ease of administration is a source of value?
- 18 A. It must be, yes.
- 19 Q. Product characteristics can all engage consumer
20 preferences. That is probably a restatement of the
21 point I have already put to you.
- 22 A. Yes.
- 23 Q. You may have seen Dr Burt's statement, we need not turn
24 it up now, he lists a series of features of the accord
25 product such as security and reliability of supply.

1 That is something to which customers will attach value?

2 A. Yes. Comment if I may, but sorry the time is going on,
3 this security of supply -- so put it this way: these are
4 all correct statements as a matter of principle.

5 Q. Yes.

6 A. I have not seen any evidence about any one of them, to
7 be honest, apart from perhaps their perception of the
8 risk that the skinny presented at first.

9 Q. I will make submissions as to why that is.

10 A. So I have not seen any evidence. So this -- you are
11 putting me --

12 Q. You cannot quantify --

13 A. -- a plethora of possibility results I am going to agree
14 with.

15 Q. I think the point you are making is: you are not in
16 a position to quantify the value of any of these things
17 I have mentioned?

18 A. I said that because it cannot be what the demand side
19 alone is, I will try say something. This is -- I do not
20 want to be pushed too much because also my instructions
21 were very limited on this issue from the CMA. I will
22 say that my understanding of this, that economic value
23 will be the outcome of an effectively competitive
24 process where the prices will be reflecting the costs,
25 so my starting point will probably be observing what

1 the prices are in an effectively competitive market, if
2 we have that benchmark, because --

3 Q. That is the trouble?

4 A. -- that is what consumers pay. That is what consumers
5 pay.

6 Q. It raises a question about what the appropriate
7 benchmark is, that is --

8 A. Yes, and there is a range of benchmarks there, yes.

9 Q. As you say, you have not given --

10 A. But demand side position alone -- I am not in a position
11 to -- so I disagree with you, I have no idea.

12 Q. You have not given any evidence on that in your report,
13 as you fairly say, because you weren't asked it?

14 A. I was not instructed.

15 THE PRESIDENT: Mr Palmer, Mr Holmes, this is a very
16 difficult area and my question at the moment is how far
17 is this actually a question of economic expert opinion?

18 MR PALMER: It may not be.

19 THE PRESIDENT: It may not be.

20 MR PALMER: I have two questions left, if that helps.

21 THE PRESIDENT: Well, in that case --

22 MR HOLMES: If it assists, sir, I think Mr Bishop was very
23 clear.

24 THE PRESIDENT: Mr Bishop was very clear, that is what I --

25 MR HOLMES: I think Professor Valletti's answers are all of

1 a piece with what Mr Bishop said, and the tribunal can
2 draw its own conclusions from that.

3 THE PRESIDENT: What I do not want is, I do not want someone
4 saying something should have been put.

5 MR HOLMES: No, and I think this is something that is better
6 picked up in submission, for my part.

7 THE PRESIDENT: That is my instinct. You ask your two
8 questions, I have one for Professor Valletti.

9 MR PALMER: Two points on which I think I can seek
10 Professor Valletti's assistance. The first is on that
11 question of security and reliability of supply. That
12 may, of course, have particular value attached to it if
13 someone is purchasing for the purposes of marketing
14 their own-brand product under white label arrangements
15 they would be particularly interested in your security
16 of supply, would they not?

17 A. They would.

18 Q. There are other benefits which are listed, logistical
19 advantages, convenience benefits and product quality
20 benefits. Mr Holmes did put a point to Mr Bishop about
21 that which I want to pursue with you, it is the last
22 point. He made the point that the features referred to
23 such as those logistical advantages and so forth,
24 convenience benefits, were not specific to
25 Hydrocortisone tablets but were specific to Accord-UK's

1 entire operation, but including Hydrocortisone tablets?

2 MR HOLMES: Sir, with respect, all I was doing was
3 commenting on what Dr Burt or Mr Burt's evidence was on
4 that point.

5 MR PALMER: My point, no less significant for that, is the
6 point I want to put to you, Professor Valletti: if
7 Hydrocortisone tablets benefit from those arrangements,
8 company-wide or not, that can still be a source of value
9 so far as customers are concerned?

10 A. General statement, I agree. Have I seen any evidence?
11 I have not.

12 MR PALMER: No, thank you very much. I am very grateful,
13 sir, those are my questions.

14 THE PRESIDENT: Thank you, Mr Palmer.

15 Professor, I suspect this is not a question within
16 your expertise but I am going to ask it anyway because
17 it may be.

18 You made the point a moment ago that willingness to
19 pay is not a particularly good measure of economic
20 value, because depending on the number of people who are
21 willing to pay a high price the effect of a test which
22 equates economic value with willingness to pay is the
23 minimisation of consumer surplus.

24 A. Yes.

25 THE PRESIDENT: So you will recall the example that

1 Dr Bennett gave, I think, of the value he subjectively
2 attached to a highlighter pen, cost 50p; his value, it
3 was an example that he gave, his value £10. If you have
4 enough consumers who are willing to pay £10 for
5 a highlighter that costs 50p to produce and the
6 competition situation is sufficiently adverse to
7 consumers, the price will go up to £10 because that is
8 the willingness to pay.

9 A. Yes.

10 THE PRESIDENT: Consumer surplus, provided one has got
11 enough consumers in idiosyncratic position of
12 Dr Bennett, consumer surplus is thereby effectively
13 reduced to the absolute minimum if it exists at all.

14 My question is, and I think it is a value judgment
15 implicit in the question of value, which is why I do not
16 think it is a question for an expert at all, but as
17 I say, I will ask it anyway: is one of the objectives in
18 determining what is economic value a desire that the
19 ultimate consumer have a maximum rather than a minimum
20 of consumer benefit?

21 A. So, as you said, it is not an area of my expertise.

22 I will say the following: the difficulty in answering
23 the question is that if you take a perspective where the
24 consumer is king, whatever they pay is what they must
25 want. But this is immediately conflated to the opposite

1 situation, and it is if there is market power which is
2 being abused this is the highest price that they will
3 take whatever they are being offered. A take it or
4 leave it offer. So it confounds together willingness to
5 pay with the exercise of market power. So you pay a lot
6 not because -- you pay a lot for the pen not because you
7 really like it but because you have been exploited by
8 a big firm. So that is a difficulty.

9 You are asking me a more general question, what do
10 I think the objective of the competition policy should
11 be in a sense, and I would say, and I would qualify your
12 statement, and your statement was the objective is
13 consumer has a maximum and a minimum, we say the
14 consumer surplus, and that is a normal definition of
15 competition policy, is maximise, subject -- subject to
16 all the constraints that businesses make, which is they
17 should make normal returns, they should be incentivised
18 to make investments, and so forth.

19 So yes, I would say that objective of competition
20 policy in the round is to maximise consumer surplus,
21 subject to all those balancing considerations, and the
22 balancing consideration is that we do want to promote
23 investments, we do want firms to make fair returns on
24 their investments, and that is an answer to your
25 question.

1 THE PRESIDENT: Thank you. One other matter. We have
2 spoken over the last few days a great deal about market
3 definition and the importance of it, and the importance
4 of facts underlying it. What I am grappling with is the
5 extent to which one needs to have an anterior analysis,
6 anterior to markets definition, which analyses the
7 competition landscape. I am not going to ask you about
8 this because this is not an area of economic, it is an
9 area of legal analysis. But one of the problems I think
10 that competition law has is that we tend to see things
11 in the prism of the economist's perfect competition, and
12 we ask markets definition almost to work in that
13 somewhat abnormal environment.

14 What I am going to ask you is to identify and to
15 give your views on whether you agree that there are
16 certain peculiarities in any market which cause them to
17 diverge from perfect competition so beloved of some
18 economists, and I am just going to list them. I do not
19 want you to comment on their nature, but I would,
20 I think, be helped in working out whether they are
21 oddities that we ought to have particular regard to in
22 order to understand what is actually going on in this
23 market.

24 So I am just going to read them out and you can tell
25 me whether you think they are matters that we ought to

1 have particular regard to when we are working out the
2 facts, and the facts, I think, matter here.

3 So the first one is that in this case, in this
4 market the ultimate consumer demand, by which I mean the
5 person actually receiving the medicament, the
6 pharmaceutical product, ultimate consumer demand is
7 actually not in this case price-sensitive because
8 whatever the medicine and whatever its actual price they
9 pay the prescription price, assuming they are liable to
10 pay it, or they do not pay anything at all if they are
11 exempt from prescription charge. Would you accept that
12 as a matter that we ought to be thinking about quite
13 carefully?

14 A. So it is well known in drug markets, especially when you
15 are being reimbursed, obviously not every patient is
16 being reimbursed and so in other countries, in the
17 United States, for instance, that would be completely
18 different. But indeed, if you are being reimbursed you
19 are less price-sensitive.

20 However, there are -- so you have to be mindful.
21 Absolutely, the answer to your question, yes. In that
22 respect you also have to take into account, and I am not
23 an expert in this area, two different kinds of
24 incentives as well. So doctors sometimes are subject to
25 pressure to recommend drugs --

1 THE PRESIDENT: I am just going to stop you there,

2 Professor, because --

3 A. No, but in the health economic literatures there is
4 something called an agency problem. So the patient acts
5 on behalf of the doctor, so -- if there is perfect
6 agency.

7 THE PRESIDENT: I understand. I am coming down a list of
8 factors, so I think we may get there and to be clear,
9 I am not wanting to elicit factual evidence from you.

10 A. No, I am describing --

11 THE PRESIDENT: No, indeed. What I am really doing is
12 putting, through you, a shopping list of matters which
13 I would like counsel to think about in the course of
14 next week, and I thought this was probably the best way
15 of getting a complete list.

16 So apologies, you are being used not as an economist
17 again, but I think you are the best medium for doing
18 this.

19 So the second oddity is that we have a chain of
20 supply to the ultimate consumer, the patient, that is
21 long and complex. We have the supplier manufacturer, we
22 have got the wholesaler and the pharmacist. They would,
23 in the ordinary case, be informed by the ultimate
24 consumer's choices -- specifically price sensitivity,
25 the first point we considered, but here that price

1 information, that price sensitivity is more or less
2 entirely absent.

3 A. Yes, so if I understood your points correctly, do you
4 want me to answer now or just --

5 THE PRESIDENT: Well, I am really --

6 A. If you are giving your shopping list --

7 THE PRESIDENT: I am really articulating a shopping list,
8 and I suspect I am going to leave it for commentary
9 because these are ultimately questions of fact that we
10 are going to have to work out. So I do apologise, I am
11 sure you have views on this but I am actually not going
12 to be inviting you to give them.

13 The third oddity is that the price recovered at each
14 stage of this process is highly regulated. We have all
15 these tariffs and forms of agreement which are highly
16 technically legal in their regulation, and it is going
17 to be important for us to understand exactly how they
18 all operate and who was subject to them and who was not.

19 A. Yes.

20 THE PRESIDENT: Fourthly, barriers to entry are again,
21 something of an oddity in this market because not merely
22 do we have the normal cost of market entry, you know,
23 equipping a factory, getting it ready to do blister
24 packs, doing all the testing, these are expenses in
25 their own right which are significant, but in terms of

1 contestability we also have things like the regulation,
2 needed market authorisation, needed in certain terms and
3 that constitutes, well, would you agree again a factor
4 that we ought to be bearing in mind as a particular
5 feature of this particular market?

6 A. Yes, it would.

7 THE PRESIDENT: Then fifthly, and finally, product
8 substitutability is also peculiar because one can
9 through regulation create what is quite clearly
10 a distinction without a difference, if I can be as
11 colloquial as that. I am referring to orphan drugs and
12 the full label skinny label distinction that we have
13 been spending quite rightly a lot of time analysing.

14 Again, is that an oddity which we ought to be
15 particularly bearing in mind?

16 A. Yes, it is an important characteristic.

17 THE PRESIDENT: Is another oddity the fact that we seem to
18 be treating 20mg and 10mg tablets very differently?

19 A. I should answer that.

20 THE PRESIDENT: Please do.

21 A. Because I have not understood otherwise. So they are
22 prescribed in different ways so on the prescription you
23 do write 20 or 10.

24 THE PRESIDENT: It just struck me that we have been treating
25 them as very separate things and yet we have no, as far

1 as I can see, no particular evidence dealing with why we
2 are treating them as separate things in that one could
3 conceivably halve the 20mg tablet and create a 10mg
4 tablet and that is a question which, so far as
5 I understand, has not been asked and it may be that it
6 does not matter. But what I am asking is, do you agree
7 that it does not matter or do you think that it is
8 something that one ought to be thinking about?

9 A. I think these two markets have been analysed in
10 different ways because despite their similarity, there
11 are also some special differences, Waymade has a full
12 label, the drug tariff mechanism. An economic point of
13 view, also the market size is very different. The
14 attractiveness, the entry process is actually different.
15 But these points I will be very happy to elaborate on if
16 so you wish.

17 THE PRESIDENT: I am not going to ask you because these are
18 points which will emerge I think out of the evidence
19 that is in the record and I am going to be keener to
20 hear argument rather than factual submission on them.

21 The reason I am listing them all out is really to
22 ask this question: is there anything else apart from
23 those five factors that you think we should be
24 interested in purely from an investigating the facts
25 point of view of have I got what I have called all the

1 oddities in all that list? Is there anything else that
2 you think as a matter of fact -- I am not asking your
3 views on what the facts are, but what I am asking you,
4 is there anything else when we are lifting the bonnet
5 under this market and looking at the intricacies that we
6 ought to be particularly considering?

7 A. You call them oddities. I call them characteristics of
8 this market.

9 THE PRESIDENT: That is fine.

10 A. It is not a judgment about them and I believe that this
11 is a very useful and interesting list. I also believe
12 that many answers to your questions are actually in the
13 Decision itself.

14 THE PRESIDENT: Indeed.

15 A. It is just a matter of organising the material in
16 a suitable way.

17 THE PRESIDENT: That is essentially the function of a trial
18 judge, to organise the material and reach a decision.
19 It is a glorified filing job.

20 Professor, thank you very much. Mr Palmer, do you
21 have any questions arising out of that.

22 MR PALMER: I do not, thank you.

23 THE PRESIDENT: Mr Holmes.

24 Re-examination by MR HOLMES

25 MR HOLMES: Professor Valletti, I think I can be very brief

1 indeed. I think any I had that Professor Valletti would
2 not find an opportunity to express his economic views on
3 the issues proved to be misplaced. He has given very
4 full evidence.

5 There was just one very small point by way of
6 transcript correction which I wanted to pick up with you
7 if I may. At page 54, line 19. Can we go to page 54,
8 line 19 of today's transcript, please. The answer that
9 is recorded on the [draft] transcript is:

10 "They are pricing absolutely in a way to keep the
11 full ... without exercising ..."

12 A. Market power probably.

13 Q. But I think what I heard you to say was "where they are
14 exercising market power" not "without exercising market
15 power"?

16 A. Yes.

17 Q. Can I confirm --

18 A. They want to continue supply -- I am looking at --
19 exercising -- in -- they are exercising market power and
20 they are also applying the same prices to some skinny
21 products. Sorry, I must have misspoke.

22 Q. No, I heard you say "where they are exercising market
23 power" but the transcript records you as saying "without
24 exercising market power". I just wanted to confirm what
25 your evidence was on that point.

1 A. They do exercise market power.

2 Q. I am grateful. No further re-examination.

3 THE PRESIDENT: Mr Palmer, there is not a problem with that
4 correction. That is what we all heard but I would not
5 want to take away from you an answer you particularly
6 wanted.

7 Re-examination by MR JONES

8 MR JONES: Sir, I apologise, There is actually also
9 a question from me in re-examination, if I may. It is
10 slightly more long-winded I am afraid,
11 Professor Valletti. I want to go back to an aspect of
12 the object case which Mr O'Donoghue asked you about.
13 You had a discussion about the impact of the 10mg
14 agreement on retail prices. I want to ensure that we
15 are all clear about what your evidence is on one
16 particular aspect of that discussion. I am going to
17 show you two things that you said. They are on
18 yesterday's transcript, please. Firstly, page 127
19 {Day9/127:16}. You will see at line 16 you said this:
20 "Answer: We have done this before. If you assume
21 that there is no impact that the supply agreement
22 whatsoever can have on retail prices you have cut off
23 any competitive interaction on the agreement. Instead
24 I am positing a different thing, which is the agreement
25 is written precisely because it will have an impact on

1 downstream prices."

2 So you see that, you were saying there that the
3 agreement will have an impact on downstream prices, and
4 you will remember, Professor Valletti, you made that
5 general comment a few times.

6 A. By "impact" I mean there is an expectation that -- in
7 the agreement you form about downstream prices, yes.

8 Q. So we have that on the one hand. Now, the second thing
9 I want to show you is this: over on the next page,
10 please, at lines 14 to 16 {Day9/128:14-16} Mr O'Donoghue
11 said to you:

12 "Question: But we agree there is no tacit or
13 explicit collusion on price?

14 And you said:

15 "Answer: We did agree on that, yes."

16 Again, you may remember that was a proposition that
17 you again emphasised a few times, and it is in the joint
18 expert report, that you agree that there is no tacit or
19 explicit agreement on price.

20 A. Yes. But we have investigated, so I form no view about
21 that.

22 Q. The question is this: what I want to be absolutely clear
23 about is how those two different things that I have just
24 shown you fit together. So how would the agreement have
25 an impact on price even though there was no tacit or

1 explicit agreement?

2 A. I see. So, there I am not saying that I exclude that
3 there is explicit or tacit collusion. I am simply
4 saying that with independent entry. So put just a very
5 simple case, with very simple -- with independent entry
6 there would be a competitive equilibrium, and instead if
7 the agreement leads to anything above that downstream
8 price, the agreement will be signed -- could be signed,
9 could be. So in my report what I write is that I always
10 find that an agreement with these characteristics will
11 always have a negative effect for consumers, will always
12 lead to higher retail prices, always, always, and
13 therefore from an economic point of view it is something
14 which is bad almost by object for the consumers. Even
15 if they do not reach necessarily the perfect fully
16 collusive price. That is what I am saying. I do not
17 need that perfect coordination downstream with the
18 agreement to make the agreement anti-competitive. Is
19 that clear?

20 MR JONES: Thank you. That is very clear. Thank you. No
21 further questions.

22 THE PRESIDENT: Professor Valletti, thank you, you have
23 borne with us nobly. I cannot imagine it is true for
24 all the economists, a single economist in a room of
25 lawyers. The counterfactual, I suppose, would be

1 a single lawyer in a room of economists. You have borne
2 with us very well. Thank you very much, you are
3 released -- oh, I am so sorry, Professor Mason.

4 PROFESSOR MASON: Just a point of clarification if I might,
5 Professor Valletti. If I could take us to page 73 of
6 today's transcript and I would like to take us down to
7 let us go to line 9 {Day10/73:9} so that we are looking
8 at the sentence of interest. So that sentence starts:

9 "Either a competitive equilibrium after the abuse
10 ends ..."

11 A. "Whether" a competitive, not "either".

12 PROFESSOR MASON: So that is the first clarification. The
13 part that I am interested in, just to check that this
14 came out correctly, is the second half of the sentence
15 that starts:

16 "Whether there was dominance during the abuse. So
17 this is a different question."

18 A. Sorry, let me -- which part?

19 PROFESSOR MASON: So, I am putting the part -- the latter
20 part of that sentence, "... whether there was dominance
21 during the abuse. So this is a different question."
22 I just wanted to clarify.

23 A. So I think, I think I am trying to ...

24 "... whether a competitive equilibrium after the
25 abuse ends. In itself for me it is not relevant for

1 THE PRESIDENT: Of course, Mr Palmer. Thank you very much
2 for your assistance. A mass exodus. Those who leave,
3 no offence will be taken. We quite understand that you
4 have a lot of work to do, so do feel free to take
5 advantage of the break to absent yourselves. We will
6 resume in five minutes.

7 (12.33 pm)

8 (A short break)

9 (12.42 pm)

10 MR JOWELL: May it please the tribunal, I call Mr Robert
11 Stewart. Could Mr Stewart please be shown {IR-A1.1/1}.

12 THE PRESIDENT: Sorry, we had better swear him.

13 MR JOWELL: Forgive me.

14 MR ROBERT STEWART (affirmed)

15 Examination-in-chief by MR JOWELL

16 MR JOWELL: You will see on the screen in front of you
17 a copy of your witness statement and I think you also
18 have a copy in hard copy in a file in front of you.

19 A. That is correct.

20 Q. If you could be shown, please, page 18 {B1/1/18} of this
21 document. You will see, at least on the hard copy you
22 should see a version of your signature?

23 A. That is correct.

24 Q. Are the contents of that witness statement true to the
25 best of your knowledge and belief?

1 A. Yes.

2 Q. Please wait there. Mr Bailey will have some questions
3 for you.

4 THE PRESIDENT: Mr Bailey.

5 Cross-examination by MR BAILEY

6 MR BAILEY: Good afternoon, Mr Stewart, thank you for
7 joining us.

8 A. Good afternoon.

9 Q. I would just like to explain at the outset that when
10 I use the term "Allergan" I am going to use the same way
11 you do in paragraph 1.6 of your statement and that is
12 where you refer to Allergan as the undertaking formerly
13 known as Actavis. Just more generally, I am going to
14 try and use the terminology that you do in your
15 statement to avoid confusion.

16 I would like to begin, if we may, with your role in
17 the business, and you deal with that at paragraph 1.4 of
18 your statement which is at {B1/1/2}. You joined Actavis
19 in November 2009. That is right, is it not?

20 A. Correct.

21 Q. Was that Actavis Inc, as you say at paragraph 1.4, or
22 Actavis Plc, which you say at paragraph 2.1?

23 A. Not 100% sure. We did change our incorporation a couple
24 of times.

25 Q. Not to worry. You were at that time an executive vice

1 president of global operations at Actavis?

2 A. Correct.

3 Q. That meant you were a member of Allergan's senior

4 management team?

5 A. Correct -- well at the time it was Actavis.

6 Q. Indeed. You held that role until May of 2016?

7 A. Correct.

8 Q. And you were based in New Jersey at that time?

9 A. Correct.

10 Q. Then you became chief operating officer at Allergan Plc?

11 A. Correct.

12 Q. And you held that role until January 2018?

13 A. Correct.

14 Q. What has your occupation been since that date?

15 A. I am the CEO of a pharmaceutical company here based in

16 the UK.

17 Q. What is the name of that pharmaceutical company?

18 A. Theramax.

19 Q. You mention your qualifications at 1.5 of your

20 statement. Can I just check, do you have any legal

21 qualifications?

22 A. I do not.

23 Q. So in section 7 of your statement -- we do not need to

24 turn it up -- you talk about the legal implications

25 specifically at paragraph 7.5. You say -- it is

1 {B1/1/13} if you wish to look at it. You say that
2 Allergan was legally precluded from exercising any
3 influence over Actavis UK. That is just your reading of
4 the commitments as a non-lawyer. That is right, is it
5 not?

6 A. No, I actually had counsel. That was during the
7 Hold-Separate period and we were instructed by counsel
8 that there was a different oversight that could be
9 applied to the business at the time.

10 Q. Is that the counsel Cleary Gottlieb which provided
11 advice to Allergan Plc that you exhibit to your
12 statement?

13 A. I believe that is correct.

14 Q. I am going to come to that advice later so I am grateful
15 for that.

16 Then at paragraphs 2.2-2.7 of your statement, that
17 is {B1/2/3}, you are then describing the large Actavis
18 Allergan merger and the structure of the new merged
19 firm. You exhibit a filing to the US Securities and
20 Exchange Commission. Can we just take a look at that.
21 That is at {IR-C1/1/1}. If we just pick it up at the
22 first paragraph and the first two sentences. If I could
23 just ask you to read those. (Pause)

24 A. I am sorry, you are asking me to read which?

25 Q. The words that begin: "As Actavis and Allergan

1 continue". Just read the first two sentences.

2 A. Sure.

3 THE PRESIDENT: Counsel is just ensuring you know what you
4 are going to be asked about.

5 A. Sure. Okay.

6 MR BAILEY: You see there there is a reference to the "new
7 merged firm pursuing a 'one company' philosophy". If
8 you go to page 2, please, and go down to the heading
9 "Country management delivering on our one company
10 philosophy", you will see there it says that:

11 "At a country level, we will be implementing a 'one
12 company' operating approach."

13 So this one company philosophy, that was referring
14 to the new group adopting a single, a uniform operating
15 approach. That is right, is it not?

16 A. Well, it is one country approach in the context of
17 managing all of the back office type of support. This
18 is -- we still had very distinctive businesses that were
19 operating but we were creating synergy for the company
20 and so therefore within the country we did not want to
21 have two supply chains, two logistics contracts. So
22 that was the one country approach we are talking about
23 here.

24 Q. So within the group there would be common logistics and
25 group support and IT and legal. Those would all be

- 1 uniform for all parts of the business?
- 2 A. Well, we would leverage the volume between the two
3 businesses.
- 4 Q. Yes. You describe -- the filing describes the new
5 operating model. If we go back up to page 1, please,
6 under the head "International Commercial Organisation",
7 and that was split into two divisions, was it not, the
8 brands division and the generics division?
- 9 A. The reporting relationships were brand division and
10 a generic division.
- 11 Q. The generic division reported to you, did it not?
- 12 A. That is correct.
- 13 Q. We can see that the international commercial
14 organisation has a vision of growth pharma and as the
15 name suggests that essentially was pursuing various
16 growth opportunities to acquire various pharma
17 businesses. That is right, is it not?
- 18 A. We were changing the company from a generic company into
19 more of a speciality pharma that was focused on growth
20 and revenue growth.
- 21 Q. If we look briefly down at page 3, please, {IR-C1/1/3},
22 we can see reference to this growth vision. It is the
23 first paragraph second sentence:
- 24 "This new model is consistent with our ambition of
25 being growth pharma by investing resources behind the

- 1 best growth opportunities."
- 2 We can see in the next sentence that one of those
- 3 was acquiring Auden McKenzie. That is right, is it not?
- 4 A. That is correct.
- 5 Q. If we go back to page 2, please, where the diagram is.
- 6 {IR-C1/1/2}. I just want to run through with you the
- 7 new operating structure if I may. So there was going to
- 8 one manager for each country, was there not?
- 9 A. There is one president for each country, yes.
- 10 Q. That regional president, they effectively ran the
- 11 business day-to-day for that region for that country?
- 12 A. Correct.
- 13 Q. For the UK and Ireland the regional president was
- 14 Ms [REDACTED]?
- 15 A. Correct.
- 16 Q. She remained regional president until March of 2016,
- 17 that is right, is it not, when she was appointed the
- 18 whole and separate manager?
- 19 A. That is correct.
- 20 Q. If we scroll up to the top of page 2, we can see that
- 21 the regional presidents had a role with three main
- 22 responsibilities. The first is that they were there to
- 23 assess opportunities within their territories. That is
- 24 right, is it not?
- 25 A. Yes.

1 Q. That would have required them to know the businesses
2 inside out within their region, would it not, know them
3 well at least?

4 A. Know them well.

5 Q. Then we have that they were there to ensure alignment
6 with international commercial strategies. So those were
7 strategies set presumably by Allergan at the
8 international commercial level; was that right?

9 A. Well, not necessarily.

10 Q. Could you help the tribunal understand what is meant by
11 international commercial strategies then?

12 A. Well, there was different reporting relationships, so
13 [REDACTED] reported as the country president reporting up to
14 Lars Ramdanborne who then reported in to me but she also
15 had a dotted line responsibility into the branded side
16 with Paul Navare as well. So there were functions
17 within the organisation that had different reporting
18 relationships so that the international commercial
19 strategy meet was different for brands than it was for
20 generics.

21 Q. Agreed, that therefore there was a difference between
22 the branded part and the generics part. But ultimately
23 that Allergan obviously wanted to pursue an overarching
24 strategy, did it not, in terms of seeking to drive the
25 business and grow the business?

1 A. Well, in the context of this announcement it was -- this
2 was done prior to the close of the Allergan transaction
3 and this was announcing those country heads that were
4 going to be able to create the back office synergy that
5 I mentioned before.

6 Q. You have already gone through the chain of command
7 moving up from [REDACTED], she reported into the
8 president of international generics, that was
9 Mr Ramdanborne?

10 A. Yes.

11 Q. Then he reported to you?

12 A. Correct.

13 Q. Am I right that you reported to the chief executive,
14 Mr Brent Saunders?

15 A. Yes.

16 Q. If we could go to paragraph 3.2 of your statement. That
17 is at {B1/1/5}. What you do there is you identify four
18 periods: the pre-acquisition period, AM Pharma period,
19 Actavis UK period and the Hold-Separate period.

20 What I would like to do, if I may, is to discuss
21 each period with you and I would like to start then with
22 the pre-acquisition period. If you go to paragraph 4.1
23 of your statement which is at {B1/1/6}, and by all means
24 take a moment to read it if you wish to refresh your
25 memory of what you say.

1 A. Sure. (Pause)

2 THE PRESIDENT: Mr Bailey, do we want to get the unredacted
3 version up? I do not know if that would assist the
4 witness in --

5 MR BAILEY: I think the witness has a hard copy, sir, but,
6 yes, absolutely. {IR-B1/1/6} will bring up the names,
7 yes.

8 A. Okay.

9 Q. So really you are making three points there, are you
10 not? The first is that the due diligence for the
11 AM Pharma acquisition was mainly done by the UK
12 business. That is right, is it not?

13 A. That is correct.

14 Q. Secondly, members of the US Allergan Plc team, they did
15 provide some assistance with the due diligence process.
16 That is right, is it not?

17 A. For deal support, sure.

18 Q. For deal support and specifically you describe in 4.1.2
19 that they were involved in assessing Auden's portfolio.
20 That is right, is it not?

21 A. Correct.

22 Q. They also provided some of the due diligence summaries
23 as well on the Auden deal, did they not?

24 A. I think in terms of presentation formats and things like
25 that.

1 Q. The third point that you say in 4.1.3 ultimately it was
2 you that was the decision maker as to whether to go
3 ahead with the Auden deal. That is right, is it not?

4 A. That is correct.

5 Q. In making that decision you were relying on the advice
6 from the UK business as well as the due diligence
7 summaries that were being prepared?

8 A. Predominantly the UK business because they were really
9 the experts with the country and understood the asset.

10 Q. Can we have a look at one of the summaries of the due
11 diligence which you discuss at paragraph 4.5. It is the
12 Project Apple presentation which is to be found at
13 {IR-H/922/2}. Project Apple, that was a code name for
14 the acquisition of Auden McKenzie, was it not?

15 A. That is correct.

16 Q. Do you recall seeing this presentation at the time?

17 A. I may have. I do not recall specifically. This was
18 seven years ago.

19 Q. No, of course. Perhaps it might be helpful if we go to
20 page 9. {IR-H/922/9}. This is giving an overview of
21 the due diligence that was done by external lawyers PwC.
22 Then the second bullet says:

23 "All ACT ELT ..."

24 Could I have a go at unpacking that? Does that
25 refer to Actavis executive leadership team?

1 A. Yes.

2 Q. Were you a member of that team or is that part of the UK
3 business?

4 A. I was a member of that team.

5 Q. You were a member of that team. So that is explaining
6 therefore that you were part of the team engaged in due
7 diligence process.

8 Then if we can go down to the fifth bullet, please,
9 you will see that there are "multiple meetings with the
10 management and several detailed Q&A sessions conducted
11 with the Actavis management from UK and NJ."

12 And NJ, that is a reference to New Jersey?

13 A. Sure, we can conclude that.

14 Q. I am grateful. Therefore it is right, is it not, that
15 the New Jersey, the Allergan team kept a close eye and
16 were involved in this due diligence process?

17 A. I think this would imply that there was maybe one or two
18 people from New Jersey that would have been and the
19 names that are on the sheet Dan Motto and Nick Bride(?)
20 were in New Jersey.

21 Q. It does not identify one or two individuals. It just
22 talks about teams, but I take it that is your evidence
23 in terms of who was involved?

24 A. That is correct.

25 Q. I am grateful. I would like to turn just to one more

1 aspect of this presentation before perhaps it is
2 convenient to break.

3 Can we go to page 4, please. {IR-H/922/4}. This is
4 setting out the rationale for the deal. What we can
5 see, if you look at the left-hand side, there is in blue
6 an external message and then at the bottom in green
7 there is an internal message.

8 I would like to start with the external message and
9 that is saying:

10 "Investing where we are strong, our 2nd largest
11 market."

12 Now, that is adopting the global perspective of
13 Allergan, is it not? Because that is not talking about
14 the UK business there. That is saying we are strong, it
15 is our second largest market?

16 A. No, this would be referencing the Actavis business in
17 the UK.

18 Q. What would be the first largest market of Actavis UK?

19 A. The first what -- I am not understanding.

20 Q. The statement is:

21 "Investing where we are strong, our 2nd largest
22 market."

23 So the question I put to you that that was talking
24 about Allergan's perspective that we are investing here
25 and you are saying it is not, it is Actavis UK?

1 A. It is not. This was done during Actavis and this is --
2 the UK market was the second largest in Actavis; the
3 first would have been the US.

4 Q. I am grateful. The third bullet then talks about it
5 being a "straightforward, quick integration". So that
6 is saying that it would be easy to absorb Auden into the
7 Allergan group?

8 A. Auden was a virtual company so it did not have its own
9 manufacturing or research labs. So that removed a lot
10 of complexity of integration because it would just be
11 a commercial integration.

12 Q. Then the fourth bullet then says:

13 "The Auden portfolio and pipeline is well aligned
14 with our existing Gx ..."

15 That is generics?

16 A. Correct.

17 Q. "... strategy -- specialised, niche, low competition
18 products."

19 So Allergan knew that Auden's strategy was very much
20 like its own: focused on niche, low competition
21 products, did it not?

22 A. You have to remember Allergan did not exist yet because
23 we hadn't closed the deal with Allergan. You keep
24 referencing Allergan but this is Actavis. Actavis
25 acquired Auden McKenzie as part of the Actavis generic

1 strategy, not Allergan. Allergan came after.

2 Q. I am very grateful. I was using the term "Allergan" as
3 you do where you in 1.6 of your statement you explain
4 that Allergan formerly known as Actavis Plc. I entirely
5 agree and accept the point that I am using it as
6 a shorthand just for consistency throughout my questions
7 but at this time, yes, it is Actavis Plc knew Auden's
8 strategy was focusing on niche, low competition
9 products. Do you accept that proposition?

10 A. Yes.

11 Q. But it knew a bit more than that, did it not? Because
12 if we look at the internal message we can see that:

13 "Auden McKenzie has a solid business that is highly
14 profitable -- 70% plus EBITDA margin driven by
15 exclusive, semi exclusive products and a low cost
16 structure."

17 At this point in time Hydrocortisone tablets were
18 one of those products, were they not?

19 A. Yes, it would have been.

20 Q. We can see why Actavis Plc, later to become Allergan,
21 were so keen to buy Auden if we just move for a moment
22 to the back story of Auden which is at page 12 of this
23 presentation. {IR-H/922/12}. This is providing an
24 overview of the Auden business and how it was founded
25 and the strategy it adopted.

1 If we look halfway down at the fourth bullet we can
2 see that:

3 "Auden's competence is in identifying semi-exclusive
4 products for the UK market and then optimising
5 the price/volume mix to maximise revenue/profits."

6 Now, in your statement at paragraph 4.11, and if you
7 wish to look at it it is at {B1/1/8}. You say:

8 "Neither the earn-out clause [I am not considering
9 that for the moment] nor the content of
10 the December 2014 Project Apple presentation ... support
11 the CMA's argument that Allergan approved a strategy of
12 exploiting Auden's position in Hydrocortisone
13 tablets ..."

14 Just from what we have just seen, can I just break
15 this down a little bit and see what you agree with and
16 what you disagree with.

17 It is fair, is it not, from this presentation that
18 Allergan knew -- Actavis Plc knew that Auden had
19 expertise in identifying exclusive and semi-exclusive
20 products?

21 A. Yes, they did.

22 Q. Allergan also knew that Auden was very good at
23 optimising price volume mix to maximise its profits, did
24 it not?

25 A. We knew that they were able to find products, bring

1 products to the market that had the benefit of less
2 competition and so as a result in the generic industry
3 you have higher prices as a result of that strategy.

4 Q. Where there are exclusive products, it would not be less
5 competition, it would be no competition, would there
6 not?

7 A. In the Hydrocortisone case we assumed that there was
8 going to be competition.

9 Q. That is right. In the future you were assuming from
10 2015 competition would emerge and I will come on to that
11 after lunch, but actually historically when you were
12 looking back at what Auden had been doing, there was no
13 competition for Hydrocortisone, was there?

14 A. I do not recall at the time, yes.

15 Q. One thing that Allergan did know though that Auden had
16 been highly successful. We saw that reference to 70%
17 earnings before interest tax depreciation amortisation
18 so it had a very high profit level, did it not?

19 A. Well, not all that dissimilar from some of our other
20 businesses within Actavis.

21 Q. Just sticking with Auden for now, you would accept,
22 would you not, that it had been very successful and very
23 profitable as a result of its skill set in identifying
24 these exclusive products?

25 A. Generic companies generally try to target a higher

1 complex type of products with higher margins, yes.

2 Q. So it would be pretty clear, would it not, to Actavis
3 Plc that what Auden had been doing, and I will use a
4 neutral word, was making the most of the market
5 exclusivity it had for those products?

6 A. We saw that they had a business that was consistent with
7 the type of pricing that we would expect in that type of
8 a product portfolio.

9 Q. The type of pricing you would expect would be prices
10 effectively that would maximise their profits?

11 A. Sure.

12 MR BAILEY: I think that would be a convenient moment, sir.

13 THE PRESIDENT: Thank you, Mr Bailey. Would it help if we
14 started 15 minutes earlier or do you not feel the need
15 for the time?

16 MR BAILEY: I think 2 o'clock will be okay.

17 THE PRESIDENT: Very good, Mr Bailey.

18 Mr Stewart, I say this to all witnesses. Do not
19 talk about your evidence over the short adjournment.
20 I am sure you would not want to but do not and we will
21 see you back here at 2 o'clock. Thank you very much.

22 (1.05 pm)

23 (Luncheon Adjournment)

24 (2.00 pm)

25 MR BAILEY: Could we go, please, to {IR-H/922/5}. So this

1 is setting out some of the background on Hydrocortisone
2 and I would like to go through this with you. The first
3 bullet point makes clear that -- and I am going to use
4 the term "Allergan", but here I am using it as you did
5 in your statement to refer to Actavis Plc as it was then
6 known. Allergan knew that Hydrocortisone tablets were
7 the lead Auden product, did they not?

8 A. Allergan, again, did not exist at this time. We were
9 not Allergan. We had not closed. This was a deal team
10 that put this summary together as well as the whole
11 presentation. So it was the deal team that had this
12 conclusion.

13 THE PRESIDENT: Mr Bailey, I think given the witness's
14 discomfort with your use of his terms I think you should
15 stick with what was current then.

16 MR BAILEY: Thank you. Actavis also knew that Auden was the
17 sole supplier of Hydrocortisone tablets with the
18 indication of adrenal insufficiency in adults, did it
19 not?

20 A. The deal team did recognise that that was a driver for
21 the performance of the business.

22 Q. We can also see from this slide that Actavis knew that
23 there was another Hydrocortisone product that had been
24 given an orphan designation, and what that did was
25 prevent marketing authorisations being granted to anyone

1 else for the indication adrenal insufficiency in adults;
2 that is right, is it not?

3 A. What I would say is the deal team noticed there were
4 additional MAs approved, and that is why we anticipated
5 competition coming into the Hydrocortisone market.

6 Q. So you refer there to anticipating competition, and
7 indeed it says in the third bullet from the bottom that:

8 "Actavis [had] modeled competitors entering in
9 2015 ..."

10 With skinny label products, and then a point that
11 you make in your statement that:

12 "Modeled share erosion of 60% and price erosion of
13 90%."

14 So it is fair to say, is it not, that Actavis was
15 keen to understand how competition would affect one of
16 Auden's flagship products?

17 A. What I would say is that the deal team modelled
18 assumptions that they believed at the time, which is
19 ultimately what is reflected here in the presentation.

20 Q. It is not just the deal team, is it, Mr Stewart, it is
21 referring to Actavis here. It says Actavis modelled
22 competitors. So the slide is indicating that Actavis
23 was keen to understand the impact of competition on
24 Hydrocortisone tablets.

25 A. But what I would say is that the deal team modelled --

1 in this case it would be, again, the deal team in the
2 UK, put together their model and they did sensitivity
3 analysis of what that competition could look like.

4 Q. If we could have a look at that sensitivity analysis.

5 THE PRESIDENT: Just pausing there. I mean, the
6 pre-penultimate bullet simply refers to Actavis as
7 modelled, and you have given an answer to say it would
8 have been the deal team within Actavis. Is that
9 something you know and can remember, or is an inference
10 that you draw from what you understood how the
11 organisation worked at the time?

12 A. It is how our team worked at the time. This was
13 a locally driven deal. So [REDACTED] and her group
14 that was based in the UK, they were the ones that knew
15 the market, knew -- they had the data around pricing and
16 modelled in what they believed would be the decline in
17 market share and pricing based on the competition that
18 they believed were coming in.

19 THE PRESIDENT: Thank you.

20 MR BAILEY: Can we go to {IR-H/922/6}, the next page,
21 please. This is a base case setting out a projection
22 for profit and loss. If we can pick it up in the first
23 bullet on the right-hand side. This is saying that
24 Actavis knew that there had been significant price
25 increases on Hydrocortisone; that is right, is it not?

- 1 A. According to this model the price -- the value of the
2 product went up.
- 3 Q. It is not just the value of the product went up, there
4 had been significant price increases had there not? It
5 knew that.
- 6 A. Yeah, we do not specifically talk about price in here.
7 We are talking about the actual value of the product in
8 terms of sales.
- 9 Q. Mr Stewart, I am only putting to you effectively what
10 the words say on the presentation, and you are not in
11 a position to say that those words are untrue, are you?
- 12 A. No, and I would not have been involved in any of
13 the pricing, you know, analysis and that type of thing.
- 14 Q. Then the second bullet point is pointing out that there
15 is going to be an assumption of competition emerging in
16 the second quarter of 2015; that is right, is it not?
17 That is what the model is anticipating?
- 18 A. That is what the model reflects.
- 19 Q. Then if we look at the sub-header on this slide:
20 "Hydrocortisone erosion -- 2015 competitor entry;
21 Revenue Reduced by 90% in 3yrs."
22 Do you see that?
- 23 A. I do.
- 24 Q. I would like to try and put those figures in some
25 context, if I may. If we can go to page 15, please, in

1 this presentation {IR-H/922/15}. This is then providing
2 some further detail on the assumptions that underlie the
3 base case that we were just looking at, so I would like
4 to just go through it with you if I may.

5 If we can start with "Market share (%)", that is the
6 second row, we can see that Auden had a 100% market
7 share from 2012-2014, did it not?

8 A. According to this model, yes.

9 Q. In 2014 if we look at the fifth row, "Price change", it
10 had put prices up by 28%, had it not?

11 A. According to this, correct.

12 Q. The business could not be sure when a competitor would
13 enter, could it?

14 A. You are never sure when competition is going to enter,
15 but we assumed that it would.

16 Q. By parity of reasoning a business cannot be sure what
17 kind of impact a competitor would have either?

18 A. We modelled it out based on what we thought, what they
19 thought at the time of this analysis.

20 Q. We saw in the base case that the best analysis that you
21 had was that entry would arise in 2015; that is right,
22 is it not?

23 A. That was an assumption.

24 Q. Yes, that was the working assumption --

25 A. The working assumption.

1 Q. -- for this purpose. Yes. But if we look at 2015 at
2 price change, actually we see that it is anticipated
3 that prices would go up slightly, would they not? There
4 is a 2% increment in 2015. That was being predicted.

5 A. Well, we hadn't owned the business in 2015, so --

6 Q. No, you are making a forecast.

7 A. Yes, this is a forecast.

8 Q. Yes, but the forecast is that even though entry occurs
9 in 2015 prices still go up by 2%?

10 A. According to this.

11 Q. Yes. So therefore when competition arrives it was not
12 going to have an immediate impact on Auden's prices, was
13 it?

14 A. Well, again, I am not sure how it was reflected in 2015
15 in terms of when the competition would have arisen and
16 what they modelled in terms of impact at that particular
17 time, but you can see that we had modelled competition
18 coming in, in the outer years.

19 Q. We can see that the point where revenue erosion
20 particularly arises is there is a big price drop in
21 2017. Do you see that? That is where there is a 73%
22 drop that has been predicted.

23 A. Yes. You are asking me questions on this. I would not
24 have been -- I would not have been involved in actually
25 putting this sensitivity together, putting this pricing

1 together, making these market share assumptions. It
2 would have been people in the UK that would have been
3 modelling this out, and so I am getting summaries of
4 this at a much higher level.

5 Q. I agree. So you are getting summaries of this provided
6 by the UK business; that is right, is it not?

7 A. Correct.

8 Q. You are using those summaries to form your business
9 judgment as to whether this is a sound acquisition that
10 Actavis should make of Auden McKenzie, because you are
11 the decision-maker?

12 A. Correct.

13 Q. Now, it is right also that this presentation modelled
14 an upside case, is it not?

15 A. We would do typically base case upside and downside
16 cases.

17 Q. This presentation at page 7, there is an upside case.
18 You do not mention that in your statement but I just
19 want to have a quick look at it, just to show -- I think
20 it refers to the sensitivity analysis that you mentioned
21 earlier. Can we go to page 7, please {IR-H/922/7}. So,
22 just like the base case, you can see in the bullet
23 point, it is assuming competition on the Hydrocortisone.
24 Do you see that?

25 A. Mm-hm.

1 Q. We can see also that here, unlike the base case, it
2 forecasts Auden would maintain prices; do you see that?

3 A. Correct.

4 Q. We can see that the prediction, the overall prediction
5 in the header again, rather than revenue going down by
6 90% it is going down by 50% in three years; do you see
7 that?

8 A. I do.

9 Q. So what the base and the upside cases show is that
10 Actavis was looking at the Hydrocortisone business very
11 carefully, was it not?

12 A. Well, it is looking at all products very carefully and
13 modelling it out to the best of anybody's knowledge at
14 that particular time. I want to go back to that growth
15 pharma comment, you know, what I was looking to do is
16 add products in that would grow, and we were modelling
17 here Hydrocortisone was going to decline. So that is
18 why I was actually actively working against this deal,
19 through many of the correspondence I am sure that you
20 have seen.

21 Q. I see. In terms of -- first of all you say it applies
22 to all products, but it is right, is it not, that
23 Hydrocortisone is the only product that is itemised
24 separately in both the upside and the base case?

25 A. Well, because it was forecasting the drastic drop-off.

1 Q. Right. Can we go, please, to page 3, which is the
2 executive summary {IR-H/922/3}. If we look at the fifth
3 bullet point we can see there that the reason why
4 Hydrocortisone is being modelled is because it comprised
5 40% of sales at that time, in December 2014; that is
6 right, is it not?

7 A. Well, and also because of the fact that it was dropping
8 off considerably in the model. So that is why they were
9 detailing that out.

10 Q. The model was seeking to make a prediction about the
11 impact of competition that had not yet arisen but was
12 expected in 2015; that is right, is it not?

13 A. You are buying a business and 40% of the product, 40% of
14 the business was a particular product, and you are
15 modelling that to decline and that is why it was, I am
16 sure, called that.

17 Q. Can we draw a distinction between the product at the
18 time of this presentation and the product when it is
19 being modelled as to its future prospects. In terms of
20 the product Hydrocortisone at the time of this
21 presentation, we can see Actavis is describing it as
22 a near-term cash cow. Now, that is a metaphor that is
23 saying, is it not, that Hydrocortisone tablets were
24 highly profitable and would continue to be so in the
25 short term; that is right, is it not?

- 1 A. Yes, because we were modelling that the profit would
2 decline and the volume would decline.
- 3 Q. Yes, but you are, again, bringing in the future
4 prospects. I am just at the moment deciding what was
5 the position with Hydrocortisone in December 2014 at the
6 time of this presentation, and at that time, let us just
7 take it in stages, Hydrocortisone was 40% of Auden's
8 sales; that is correct, is it not?
- 9 A. Correct.
- 10 Q. It was described as a near-term cash cow, and what that
11 meant was that it was highly profitable. It was 40% of
12 \$170 million, so in other words \$68 million of revenue.
13 So it was a highly profitable product at that time in
14 December 2014.
- 15 A. Yes, again, cash cow declining but the remainder of the
16 business is growing with a significant pipeline, so that
17 was what was attracting us and the interest.
- 18 Q. Can we agree that at the time of the presentation the
19 product was highly profitable. That is the first stage
20 I want to put to you. So at the time of this
21 presentation it was a highly profitable product.
- 22 A. Is that a question or a statement?
- 23 Q. Yes or no, do you agree that it was a highly profitable
24 product?
- 25 A. It was a profitable product at that time.

- 1 Q. Then the business was modelling the impact of
2 competition, and that is why it says "near-term cash
3 cow", because you were predicting that revenues and
4 profits would reduce with competition emerging?
- 5 A. Yes.
- 6 Q. Yes. If we could then look at a different document, it
7 is a PwC report at {IR-H/639/2}, please. Do you recall
8 seeing this at the time?
- 9 A. I may have, but I do not recall seeing it at the time.
- 10 Q. Have you looked at this document for the purposes of
11 preparing your evidence?
- 12 A. I have.
- 13 Q. You have. Presumably someone on your team in New Jersey
14 might have reviewed this report for the purposes of the
15 due diligence at the time?
- 16 A. Well, this was, I believe, PwC in UK. I am not 100%
17 sure of that, but I believe this certainly would have
18 been prepared for the UK.
- 19 Q. So, you're right, if we look at page 4 {H/639/4} we can
20 see there that this is a report that was indeed prepared
21 for Actavis UK Limited.
- 22 A. Correct.
- 23 Q. My only point to you was, it is a very detailed look at
24 the financials and also the tax position and presumably
25 that would have informed the UK business's advice to you

1 so that you could make an informed decision on the
2 acquisition of Auden McKenzie?

3 A. Yes, this would have been factored into their decision
4 making.

5 Q. I am grateful. If we can go to page 7, please
6 {IR-H/639/7}. Here PwC is scoping out its work. I am
7 just showing you this so you can see that PwC felt, you
8 can see it really from the diagram, that it had
9 sufficient access to management, sufficient access to
10 information, so that in PwC's words it could analyse the
11 significant drivers and issues of the business. That is
12 just so that you can see what PwC thought about its
13 access to Auden; do you see that?

14 A. I do.

15 Q. I am grateful. If we can then turn over the page to
16 page 8 {IR-H/639/8}, we have "At a glance -- our views".

17 So this is the executive summary. If we could pick
18 it up, please, at the top in the red italics:

19 "The Target [that is Auden McKenzie] is highly cash
20 generative selling niche, high margin drugs primarily to
21 UK-based distributor and pharmacies ..."

22 Hydrocortisone was one of those niche high-margin
23 products, was it not?

24 A. It would have been.

25 Q. We can see that if we look at paragraph 1:

1 "The hydrocortisone product has been the foundation
2 of the business ..."

3 And it is right, is it not, we were just discussing
4 it, Hydrocortisone was a highly profitable product. If
5 I could just draw your attention --

6 A. But its relevance -- but its relevance in the company
7 was declining, so where you can see it was 59% of the
8 total, declining to 40%.

9 Q. I am going to come on to its relative importance and how
10 things unfolded. I just want at the moment to see what
11 PwC was saying to Actavis at this time.

12 You can also see that there is a recommendation that
13 the commercial, legal and IP due diligence is carried
14 out in relation to the protection afforded by the orphan
15 status and the risk of competition, and Actavis did
16 a lot of work on the orphan designation, did it not?

17 A. The deal team did.

18 Q. The deal team did a lot of work and then that was
19 summarised, and eventually it was passed on to you in
20 summary form.

21 A. It was summarised in the model and reflected in the
22 model, with their best thinking around the status of
23 that.

24 Q. Go to page 17, please {IR-H/639/17}. We can now start
25 to look in a bit more detail at -- starting with

1 "Revenue", and if we can pick it up in the top left-hand
2 corner we can see that at this time Hydrocortisone
3 accounted for 42% of sales, 46% of gross profit, and
4 that:

5 "Management [that is management of Auden McKenzie]
6 [had] focused on significantly increasing prices
7 throughout 2015."

8 So just looking at this, Actavis knew very well, did
9 it not, that Auden's strategy was to increase prices
10 significantly for Hydrocortisone, and I am here talking
11 prior to the model of in the future, just in terms of
12 what happened up until this point. It knew that there
13 had been a significant increase in price of
14 Hydrocortisone, did it not?

15 A. Well, certainly [REDACTED] and company would have
16 known. Yes.

17 Q. Not just [REDACTED] and the company, but Actavis would
18 have known that Hydrocortisone prices had been
19 significantly increased?

20 A. Again, when this gets to my level I am not looking at
21 price increases per year, that type of thing. I am
22 looking at the summary of the P&L.

23 Q. But you would be looking at the pricing and the
24 prospects of one of the products that accounted for
25 two-fifths of the sales made by the target, would you

- 1 not?
- 2 A. This was a very small deal relative to the things that
3 we were working on within the company, and this was
4 happening while we were actually acquiring Allergan, and
5 also preparing for an eventual sale of the generics
6 business. So this -- you are giving me too much credit
7 in terms of being able to get into that level of detail
8 for a transaction like this when I was in the middle of
9 the deal with Allergan, which was the \$77 billion deal.
- 10 Q. I realise comparatively this was small fry, but what
11 I would like to focus on, because that is what the focus
12 of this case is on, is this product and how it was being
13 priced and sold in the UK. If we could start by perhaps
14 looking under the heading "Hydrocortisone" on the
15 right-hand side, we can see it is the largest "SKU".
16 That is "stock keeping unit" or product, is that right?
- 17 A. Say that again.
- 18 Q. The largest -- under the heading Hydrocortisone it
19 refers to the "largest SKU". I assume it means stock
20 keeping unit?
- 21 A. Yes, that's correct.
- 22 Q. It is talking about the 10mg tablets. The ASP, average
23 selling price has increased from £34.38 per unit in
24 financial year 2013 to £39.32 in LTM15. This is not
25 a memory test, so "LTM15" is the last 12 months --

1 A. Correct.

2 Q. -- to October 2015. For the tribunal's note, that is
3 actually explained on page 70 of this document.

4 So what PwC was pointing out to Actavis was that
5 Auden had significantly increased prices and done so
6 successfully, had it not?

7 A. What PwC is doing here is reflecting the historical
8 performance of the business. When we are buying the
9 business we are buying and modelling and valuing the
10 business based on what we think the future projection of
11 the business is. So our interest level in this is, yes,
12 there is a look-back in terms of quality of earnings,
13 but then there is also the forward view, which is what
14 we are interested in, is that what is this business
15 today going to look like when we combine it with
16 Actavis?

17 Q. I agree that you are looking forward. I just want to
18 focus on your quality of earnings point. If we look at
19 page 18, please {H/639/18}. We are now looking at
20 pricing. Again, the message is being driven home:

21 "The Company has successfully implemented
22 significant price increases towards the end of [the last
23 12 months in 2015]."

24 We can see actually, if we turn across the page, the
25 third paragraph beginning, "We understand". PwC is

1 pointing out there have been further price rises -- we
2 understand there have been further price rises applied
3 post 31 October 2014.

4 Now, the thing I want to ask you about is if you
5 look at the first paragraph beginning "Price increases",
6 you see that it points out that:

7 "Price increases across the Hydrocortisone and [the
8 other products] are in the maximum ... dictated by
9 the Government's drug tariff and have to be negotiated
10 with their customers. The increases reflect successful
11 negotiations with customers."

12 I just want to unpack that statement with you, if
13 I may.

14 It is right, is it not, that at this time
15 Auden McKenzie was the sole supplier of Hydrocortisone
16 tablets. The competition had not yet occurred because
17 we are in 2014.

18 A. Yes, with Auden McKenzie, this was before the Actavis
19 deal announcement, they would have had 100% of the
20 market.

21 Q. Exactly, so if a customer wanted to get Hydrocortisone
22 tablets they would have to deal with Auden, would they
23 not?

24 A. Correct.

25 Q. So if you have no one else to turn to Auden clearly had

1 a very strong hand in negotiations with customers, did
2 it not?

3 A. Yes.

4 Q. I am grateful. We can actually see that. PwC makes
5 this point at page 20, if we can go there, to the PwC
6 view on customers {H/639/20}, and you can see they agree
7 with you:

8 "Whilst customer concentration is high, the niche
9 portfolio of products reduces the ability of customers
10 to source alternative suppliers."

11 Now, I would just like to show you a couple of other
12 aspects of the PwC report, if I may. The next is on
13 page 22 {IR-H/639/22} and that is dealing with costs
14 now. This is just to show you, if we look at the
15 number 1 slot Hydrocortisone had a direct cost of €1.29;
16 do you see that?

17 A. I do.

18 Q. For the tribunal's note, the costs in pounds are to be
19 found at tables 5.20 and 5.21, it is £1.09.

20 So would you agree there is a significant difference
21 between the prices being charged by Actavis at this time
22 and their direct costs?

23 A. Oh, we did not own the business at that time so, you
24 have mentioned Actavis again and we -- this was our
25 numbers but that was not, that was Auden McKenzie.

1 Q. We can look at what PwC have to say about this on
2 page 23.

3 A. But PwC, again, is reflecting the performance of the
4 business when it was Auden McKenzie's not Actavis'.

5 Q. I am going to come on to the performance of the
6 business. I am going to follow effectively your witness
7 statement, so here I am in the pre-acquisition phase, as
8 you do in your statement. I promise you I will come on
9 to when you actually own the business.

10 THE PRESIDENT: Just to be clear, we are obviously looking
11 at a pre-acquisition phase, but what was PwC doing in
12 creating this report? What was its purpose?

13 A. The purpose would have been used for validating our
14 model, and they would have given us their assessment on
15 the quality of earnings, meaning that there was no
16 accounting irregularities and then looking at -- so they
17 are doing kind of just a second independent diligence
18 for us so that we know that our model is based on the
19 correct information.

20 THE PRESIDENT: So they would be taking a critical approach
21 to the figures they are provided by the present owners
22 of the company, the target?

23 A. I would actually say it is more of an audit of the
24 numbers, because when we are provided information in
25 a data room they are generally the company's numbers,

1 and what PwC is takes those numbers and then goes back
2 and does their own analysis to make sure that there is
3 no errors in the models and the information that the
4 company is providing to us.

5 THE PRESIDENT: Thank you.

6 MR BAILEY: Just one further slide, we have it up here on
7 page 23 {H/639/23}. When doing this audit of the
8 numbers, as you have just explained, PwC is pointing out
9 the margins and you can see here:

10 "The company has been successful in ensuring high
11 margins across the top ten [products]".

12 That is the PwC view. It is right, is it not, that
13 Hydrocortisone at this time generated the highest
14 absolute gross margin?

15 A. Yes.

16 Q. Could we move to -- well, no, before we move on, would
17 it be fair to say that Actavis and its advisers had done
18 a lot of work to get to grips with understanding Auden's
19 Hydrocortisone business?

20 A. I think they looked at the entirety of the business.

21 They certainly did focus a bit on Hydrocortisone, but
22 that wasn't the only focus.

23 Q. That wasn't the only focus, but we have seen that they
24 looked at pricing costs, customers' margins of
25 Hydrocortisone specifically, have we not?

- 1 A. It is detailed in here like every other product.
- 2 Q. Okay. I would like to turn to a presentation that you
3 gave, sir, in 2015. That is at {IR-H/646.1/1}. This is
4 an investor day presentation. If we turn to page 4,
5 please {IR-H/646.1/4}. This shows, I hope, that that is
6 a reference to you there, Bob Stewart, is that right?
- 7 A. That is correct.
- 8 Q. We can pick it up at slide 25 {IR-H/646.1/25}. Can
9 I just check with you that I have understood the
10 abbreviations. Does this refer to North America and
11 international generics and abbreviated new drug
12 application?
- 13 A. That is incorrect, it is North America and international
14 generics, and the overview ANDA was a distribution
15 business that we owned in the US that basically was
16 a distributor of not only Actavis's generics products
17 but other competitors as well.
- 18 Q. I am grateful. If we look at slide 26, please,
19 {H/646.1/26} you can see here what you are doing. You
20 are doing essentially two things. You are giving
21 a review of the global generics business, how it
22 performed and operations, kind of looking backwards, and
23 then also you are looking forwards at strategies and
24 opportunities for the next year; that is right is it
25 not?

- 1 A. Correct.
- 2 Q. If we can go to slide 28 {IR-H/646.1/28} we can see that
3 you there sit at the top with the various parts of the
4 generics business reporting to you, and it is right, is
5 it not, that Auden McKenzie would have set within the
6 commercial division as part of international generics,
7 the second blue box; is that right?
- 8 A. I am not sure exactly when this presentation was made
9 but yes, it would have fit into the international
10 generics box.
- 11 Q. Because you mention the Auden McKenzie business, if we
12 go to slide 29 {IR-H/646.1/29}. At the very bottom,
13 there the last bullet:
14 "Tuck-in acquisitions for ... the UK (Auden
15 McKenzie)"
16 So it clearly is suggesting that the deal has been
17 done by this stage; is that right?
- 18 A. Or in the process of closing.
- 19 Q. Or in the process, I am grateful, yes. If we go to
20 slide 32 {H/646.1/32} we can see a focus on the UK in
21 particular, the first three bullets, and the second
22 there says:
23 "Achieving #1 Gx posting post-Auden acquisition."
24 So although, as you said earlier, sir, it is
25 a relatively small deal from your global perspective, it

1 was sufficiently important for you to identify as
2 a highlight from the international perspective?

3 A. Well, we were just below -- we were the second, I think
4 largest at the time in the UK and by doing this small
5 tuck-in it added incremental revenue, and that flipped
6 us -- and volume and flipped us over the top so that we
7 were the number one at the time.

8 Q. The number 1, yes.

9 A. But that was a -- between number 1 and number 2 was
10 fairly small, so by doing the tuck-in that was enough to
11 be able to flip us to say that we were the number 1.

12 Q. You go on to explain a little more about the
13 significance of the Auden deal at slide 33 {H/646.1/33}.
14 You repeat the point about putting you in the number one
15 position, but it shows here that you were aware that
16 they had a portfolio of niche and semi-exclusive
17 products, we saw that earlier; that is right, is it not?

18 A. Yes.

19 Q. The upside to that, what you were telling investors, was
20 that it was delivering a robust profit margin, was it
21 not? So that was obviously a key rationale for this
22 deal.

23 A. Yes -- yes.

24 Q. I am grateful. Now I would like to move to the
25 AM Pharma period, which you deal with at paragraph 5.1

1 of your statement, which is at {B1/1/10}. Just to
2 check, the reason you give it this name, that is simply
3 because AM Pharma was the company selling Hydrocortisone
4 tablets in the UK? There is no other significance to
5 it, as I understand it?

6 A. Yes, not that I am aware of.

7 Q. You explain in your statement that AM Pharma continued
8 to sell Hydrocortisone in exactly the same way as it had
9 done prior to acquisition; that is right, is it not?

10 A. Correct.

11 Q. You are not suggesting, are you, that Actavis did not
12 exercise decisive influence over AM Pharma during the
13 AM Pharma period?

14 A. So when you are referring to the AM Pharma period, are
15 you talking about from the time that we announced the
16 acquisition to time of close, or you are talking about
17 from the time of close until the time of the
18 divestiture.

19 Q. So if we look at -- I am actually following your
20 statement, and I am following your words --

21 A. I just want to make sure that you and I aligned.

22 Q. Absolutely. I am referring to the period from the day
23 when the deal closed, 29 May 2015, to the end
24 of August 2015, which is essentially the day before
25 Actavis UK take over selling Hydrocortisone tablets.

- 1 A. Correct.
- 2 Q. The only point I was putting to you is that although you
3 call it the AM Pharma period you accept, do you not,
4 that Actavis, now known as Allergan, was exercising
5 decisive influence AM Pharma during this period?
- 6 A. Well, yes, and then -- but there is also another context
7 here, and that is that in between those two days we
8 entered -- those two dates we entered into the larger
9 transaction where we sold Actavis, including AM, to Teva
10 and so that was in July of 2015.
- 11 Q. Yes, sir. I am going to come on to deal with the deal
12 you did with Teva in a moment. But before we do,
13 I would like to just go through with you a particular
14 document relating to the Actavis UK period. So can we
15 go, please, to {H/791/1}. I am moving on now in the
16 chronology, and this is dealing with the period you
17 identify from 1 September 2015 until 10 March 2016.
18 I want to do that by reference to this document.
- 19 This is clearly an Allergan presentation; is it not?
- 20 A. Yes, we had just re-branded the company Allergan at that
21 time.
- 22 Q. Are you comfortable if I now use Allergan as the term
23 denoting the business from this moment onwards?
- 24 A. You can, but I can also say that the Actavis name
25 continued and we managed the Actavis -- the generics

- 1 business under the Actavis name.
- 2 Q. I understand. The date of the presentation you will see
3 is October 2015.
- 4 A. That is correct.
- 5 Q. The presentation was made to you, was it not?
- 6 A. It very well could have been. It could have been to
7 a few of us.
- 8 Q. If it might help, we can look at an email that suggests
9 that it was at {IR-H/789/1}. You can see that this is
10 an email sent by [REDACTED] to a number of people at
11 Actavis and Allergan, and I just invite you to read the
12 subject line:
- 13 "Copies of the presentations given at Budget
14 meetings with Mr [Redacted]" --
- 15 He was the president of International Brands, is
16 that right?
- 17 A. That is right.
- 18 Q. -- "and Bob Stewart". That is you, is it not?
- 19 A. That is me.
- 20 Q. Were you -- sorry, could we go back to {H/791/1},
21 please. Were you provided with a copy of this
22 presentation when you prepared your witness statement?
- 23 A. Yes.
- 24 Q. Yes. But you do not mention it in your statement.
- 25 A. Okay.

- 1 Q. No. Is that because you did not think it was --
- 2 A. I would not have had that before my witness statement,
3 I had it since, as I was preparing.
- 4 Q. So the chronology is you did not have it when you
5 prepared your witness statement?
- 6 A. Correct.
- 7 Q. But you have seen it and been provided with it since
8 giving your statement --
- 9 A. That is correct.
- 10 Q. -- before giving your evidence today?
- 11 A. Correct.
- 12 Q. Could we look at the executive summary, please, at
13 page 3 {H/790/3}. The first bullet is just reiterating
14 that the Auden deal has put you into the number one
15 spot. Do you see that?
- 16 A. Yes.
- 17 Q. If you scroll about halfway down, "Reflected Auden
18 acquisition", the ninth bullet. We can see that the
19 point is being made, it is actually made several times
20 in this presentation, that there was an upside from
21 delayed competitor entry on Hydrocortisone.
- 22 So by "upside" Allergan was saying that the
23 Hydrocortisone business had performed better than had
24 been expected; that is right, is it not?
- 25 A. Well, Actavis is saying to me that -- that yes, that

1 there was an upside in the numbers because of the
2 delayed competition.

3 Q. This point is picked up at page 5 {H/790/5}, the ones
4 looking at the 2015 performance, and if we look at the
5 comments box and in particular the second bullet, we can
6 see that:

7 "Auden significantly ahead of deal model ..."

8 Pausing there. The deal model, that is what we were
9 looking at in the Project Apple presentation; that is
10 right, is it not?

11 A. Yes.

12 Q. "... with delayed competitor entry on Hydrocortisone."

13 A. There could have been multiple deal models just
14 reflecting that, but -- so of the one you presented to
15 me, yes, that is -- I am sure that that is the case.

16 Q. I am grateful. If we look at page 9 {H/790/9} we can
17 then see what is meant by this upside and being ahead.
18 It is a summary of the profit and loss, and if we look
19 in the "Auden UK", which is the second column, and then
20 scroll halfway down we can see the net margins at that
21 time were \$118 million; do you see that?

22 A. Yes.

23 Q. Then if you go to the very bottom you can see that the
24 contribution that is being made is by far the highest,
25 it is at 83%; do you see that?

1 A. I do.

2 Q. If we go to the comment box, please, at the bottom of
3 the page, the third bullet:

4 "Auden's strong performance on Hydrocortisone has
5 increased overall GX margin %."

6 So the question is that Actavis was singling out the
7 performance of Hydrocortisone because it had contributed
8 by far and away the most to the profitability of the
9 business?

10 A. Correct.

11 Q. We can see again a further confirmation of how important
12 Hydrocortisone is at page 16 {H/790/16}. This is a list
13 of the top UK generics products in 2015, and in the
14 number one spot we can see Hydrocortisone; do you see
15 that?

16 A. I do.

17 Q. The comments at the bottom of this page, however,
18 explain in the first bullet:

19 "Hydrocortisone 10mg competitor launched in October
20 versus deal model assumption of March."

21 So, just unpacking that, where earlier on we saw
22 that there was delayed competitor entry do you agree
23 with me that what has actually happened is that Actavis
24 thought entry would occur in March 2015 but the reality
25 was it entered in October 2015?

- 1 A. That is correct.
- 2 Q. So in other words, it had six months more of its
3 monopoly position; that is right, is it not?
- 4 A. Correct.
- 5 Q. I am grateful. I would like to then just look at how
6 this was analysed as part of the budget. We can see the
7 2016 budget begins at page 27 {H/790/27}. That is just
8 to show you where I am in the slide deck, that is all.
9 Then page 28 is the executive summary {H/790/28}. We
10 can see that the budget, the first bullet integrates
11 Actavis and Auden; that is correct, is it not?
- 12 A. Correct.
- 13 Q. The fourth bullet there says:
14 "Top 5 molecules UK, represent 45% of Gross
15 margin ..."
16 And then:
17 "3 of the 5 [are from the] Auden portfolio."
18 One of those was obviously Hydrocortisone, was it
19 not?
- 20 A. I would imagine it was.
- 21 Q. It might help if we look at page 35 {H/790/35}. We can
22 see here is again "Top Products" and now in 2016, and we
23 can see that Hydrocortisone was expected to hold on to
24 the number one spot, was it not?
- 25 A. According to this, yes, and this is, again, a projection

1 of the budget.

2 Q. Yes, I mean, I agree, it is projecting what would
3 happen, what the business thought would happen in 2016.

4 Now, if we go to the comments box we can see now
5 that Hydrocortisone, it is the second bullet I am
6 referring to:

7 "Hydrocortisone assumes competition -- share loss in
8 range 25% to 33% for 10mg and 20mg (compares to deal
9 model loss of 60%)"

10 A. That is correct.

11 Q. So what this is showing is that actually Actavis was
12 paying close attention to the performance of
13 Hydrocortisone, was it not?

14 A. Well, this is a budget presentation that [REDACTED]
15 prepared for her cluster. I think it is important to
16 have some context around this in terms of how I am
17 reviewing this at this particular time. We had
18 announced the Teva transaction in July of that same
19 year. This is now a presentation that is being made
20 after that date. When I am looking at this I am
21 operating from the asset purchase agreement that we had
22 with Teva, which required me to have oversight of this
23 business as part of that contract so that we can hand
24 the business over that they've acquired.

25 So Teva entered into a definitive agreement in July.

1 They owned this business, effectively, contractually.

2 It was our job to make sure that we supported the
3 business and reviewed the business in its ordinary
4 course so that when Teva satisfied all the regulatory
5 conditions to get clearance to close the transaction,
6 that we handed the business over to what they've
7 purchased.

8 Q. Could I just pick up a couple of things you just said
9 there. One was you said that once the Teva deal had
10 been announced in July of 2015 it owned the business
11 contractually, but one of the condition precedents for
12 that to go ahead was to get regulatory approvals; that
13 is right, is it not?

14 A. Yes, Teva had the -- what is called the "hell and high
15 water" provision in that agreement, so they had to do
16 everything that was required in order to get the
17 regulatory clearance to close.

18 Q. Yes, and if they did not get that regulatory clearance
19 then of course it would not have closed?

20 A. Correct, but what we did in July of 2016, Allergan
21 effectively moved all of the Actavis performance into
22 discontinuing operations. So in the context of the way
23 I am looking at this business, I am looking at this
24 purely to keep the plants operating, people motivated,
25 that pipelines coming through, that we're operating the

1 business in its ordinary course. [REDACTED] prepared
2 a presentation based on what she thought was the reality
3 of the business in a forward look in 2016, and so -- and
4 that was part of the asset purchase agreement that we
5 had with Teva.

6 Q. You have mentioned the asset purchase agreement with
7 Teva.

8 A. Yes.

9 Q. So it might be useful just at this point to go to the
10 form 10-K that Allergan filed with the US SEC in 2015.
11 It is at {IR-H/646.2/46}, please. This is a filing that
12 you made with the US regulators. If we just pick it up
13 at the bottom, if we could expand that, please, to where
14 it says "Risks Related to the Pending Sale of our
15 Generics Business to Teva ..."

16 Perhaps it is easiest if I ask you first just to
17 read that paragraph, please. (Pause)

18 A. Okay.

19 Q. So the only point I really wanted to take from this it
20 clearly was not a done deal, because you are actually
21 telling the regulator that there are a number of risks
22 and uncertainties with this pending sale of your
23 generics business; that is right, is it not?

24 A. Yes, you have to be -- in this type of filing you are
25 highlighting every possible risk that there could be.

- 1 Q. One of those risks was that you would not get the
2 regulatory approvals and the deal would not go ahead?
- 3 A. But with the hell -- yes, and -- but with the hell and
4 high water provision in the contract it was our belief,
5 and ultimately was proved to be right, that the
6 transaction would conclude.
- 7 Q. What you are not saying here, though, is that Teva has
8 got control of the business. You are not saying that to
9 the regulator?
- 10 A. No, we are saying that we still operate the business but
11 we are operating it on behalf of Teva until they can
12 close.
- 13 Q. If we could go back, please, to {H/790/38}. So, now
14 I wanted to move on through the budget. It looks at
15 Auden and then it looks at Hydrocortisone specifically.
16 We can see in the comments that, again, a comparison is
17 being made between the deal model, and I take your
18 point, sir, that there may be more than one although it
19 is referring to it singular. The deal model estimated
20 a profitability of \$110 million but the delay in
21 competition, we are told, produced an upside of just
22 over \$50 million; that is right, is it not?
- 23 A. Relative to the deal model.
- 24 Q. Relative to the deal model, and "AOP", is that annual
25 operating profit?

- 1 A. I forget what we -- what the "AOP" stood for.
- 2 Q. We can see that, in the second bullet, that the product
3 margin for the business was ahead of the deal model and
4 actually here it makes the link that it was being driven
5 by delayed competition on Hydrocortisone; do you see
6 that, sir?
- 7 A. I do.
- 8 Q. What it is saying is that whereas the deal had assumed
9 a 60% market share loss, now the business thought it
10 would only lose 25-33%.
- 11 A. That is according to this.
- 12 Q. Yes, according to this. Actually this goes on to then
13 look at Hydrocortisone in a bit more detail. If we can
14 go to the next slide, please {H/790/39}. Here we see
15 that Actavis is looking at this product and it is
16 looking at it in quite some detail, so I would like to
17 go through it carefully with you, if I may. If we could
18 start, please, with the table in the right-hand corner.
- 19 What this is showing for each of the different
20 strengths, and we are only interested in 10 and 20mg in
21 the UK, we have 2016 volume, so that is the volumes that
22 were being predicted that Actavis would sell; that is
23 right, is it not?
- 24 A. According to this, yes.
- 25 Q. Then we have net sales, so in other words revenues for

1 2016?

2 A. Mm-hm.

3 Q. Then net margins or profits on those sales for that

4 year.

5 A. Yes.

6 Q. Just pausing there, if we look at, say, 10mg together

7 the figure for net sales is about \$53.8 million, and

8 I say dollars because there is a dollar sign on the

9 left-hand side of the diagram. So I assume that is the

10 currency that is being used?

11 A. Actavis had always consolidated in dollars.

12 Q. Because you are ultimately a US --

13 A. We were a US publicly traded company.

14 Q. Exactly. So you see the net sales figure, 53.8, and

15 then next to it the net margin figure, \$52.8 million;

16 yes?

17 A. Yes.

18 Q. So they are very close to one another, are they not?

19 A. They are.

20 Q. That basically is -- the difference between them is just

21 the cost of producing the good, is it not?

22 A. It also -- yes, that would be. Yes.

23 Q. So therefore Actavis was earning a very large profit,

24 was it not, on 10mg?

25 A. Well, Actavis plus there was an earn-out between -- with

1 the Auden McKenzie shareholders, but -- so some of that
2 was basically earned by them.

3 Q. I am not asking about the earn-out, I am just asking in
4 terms of the profitability of the product. Do you agree
5 with me that it was forecast in 2016 to be a highly
6 profitable product, because basically the difference is
7 negligible and so when you were selling you were
8 basically generating almost pure profit, were you not?

9 A. Correct.

10 Q. The same is true, the difference in the 20mg, it is 3.09
11 as opposed to \$3.1 million. It is a smaller product,
12 I grant you, but it is also basically pure profit, is it
13 not?

14 A. Yes, it is, a high margin.

15 Q. I am grateful, a very high margin. Now, if we look at
16 the assumptions, please. They appear in the bullets at
17 the bottom of this slide. If we just start with 10mg,
18 that is by far the largest Hydrocortisone product.
19 I would just like to go through these with you, if
20 I may.

21 We have 10mg and then in parentheses "(AMCo, Almus,
22 Actavis)".

23 So "AMCo", that is a reference to the 10mg tablets
24 that Actavis was supplying it, is it not?

25 A. Yes. Look, I was not involved in any of these separate

- 1 agreements that were with AMCo or Almus.
- 2 Q. Sir, I am not asking about the separate agreements, all
3 I am asking you is the reason why it is put on this
4 slide is that -- and I think you have -- is that at this
5 time Actavis was supplying AMCo. That is all I am
6 asking. That is why it is put in amongst --
- 7 A. I mean, that was clearly an assumption in this
8 presentation.
- 9 Q. Almus, that is the Boots own label product that was
10 being supplied by Actavis?
- 11 A. I do not remember.
- 12 Q. You do not remember, okay. Actavis, well, that is
13 self-evident, that is its own sales, is it not?
- 14 A. Correct.
- 15 Q. The reason why they are all in parentheses or brackets
16 is because they are all selling Actavis product. That
17 is why they have been grouped on the left-hand side.
- 18 A. I believe that is the inference.
- 19 Q. Yes, I am grateful. Then after the dash we have:
20 "... competitor from Nov 15 at 20% of share
21 increasing to 33% ..."
- 22 Do you see that?
- 23 A. Yes.
- 24 Q. Then we can actually see that there are some competitor
25 assumptions in the fourth bullet. I just want to go

1 through those with you, if I may.

2 In terms of marketing authorisations, we see that
3 the business knows that Orion has one, and Sovereign.
4 That is Waymade's brand, and Orion launched via Alissa
5 in October.

6 So would you agree with me that the way to
7 understand this is that the unnamed competitor in the
8 first bullet is clearly Alissa?

9 A. You are getting into a level of detail that I would not
10 have been really -- would not have fully appreciated.

11 Q. You would not have looked at this in any detail
12 yourself?

13 A. Not in that degree.

14 Q. Would you, looking at the graph, however, agree that
15 where one is looking at net sales, net margins it is
16 going up between second quarter 15, third quarter 15.
17 So at least during that time, before there is any
18 competition, sales and margins are going up; correct?

19 A. Correct.

20 Q. So even though they are supplying Almus and AMCo
21 nonetheless sales and margins are going up?

22 A. Yes.

23 Q. Yes, I am grateful. Can we go over the page, please, to
24 page 40 {H/790/40}. Now, this is a back-up so this is
25 a bit more detail, but I would like to go through it

1 with you if I may.

2 Just to tell you in broad terms, if we could just
3 perhaps enlarge the top half of the slide, please. In
4 broad terms what this shows is market shares for 10mg,
5 20mg, 2.5mg, and then it shows that over three-month
6 periods from October 15 to December 16, and then the
7 second thing it shows is the price as a percentage off
8 the drug tariff used in the UK. That is just to tell
9 you what this is showing. We can see, if we just look
10 at 10mg, that is the only one I am going to focus on --

11 A. Again, you could show this to me but I would not have
12 been presented a back-up.

13 Q. You would not have been presented the back-up, but --

14 A. I mean, I am not going to be able to answer.

15 Q. You are giving evidence -- at least let me check my
16 understanding of this slide with you, so that if there
17 is anything that you know about it that I have wrong you
18 can tell me that and you can tell the tribunal that.

19 So if we just start, please, with looking at the
20 market share for 10mg. It is showing AMCo and Almus in
21 yellow and that is separate from "competitor", and AMCo
22 is shown as having a 15% market share. I am not going
23 to ask you about this, but I can tell the tribunal that
24 equates to the 12,000 packs that it was being supplied
25 at the time.

1 You see that the projections from October 15 to
2 December 16 is that AMCo and Almus would keep the same
3 share; do you see that, sir?

4 A. Correct, that is what that says.

5 Q. Yes. Do you also see that when it comes to the price
6 off the drug tariff there is a difference that AMCo is
7 getting 97.9% of the drug tariff and that there is
8 a difference from that compared to the price that
9 Actavis itself was charging, which was 25% off the drug
10 tariff; do you see that?

11 A. I see it, but I would have had nothing to do with any of
12 this.

13 Q. Okay, in which case I am going to move on. It may be
14 that you cannot help us with this either, but can we
15 look at page 54, please {H/790/54}. This is looking at
16 risks and opportunities, would this be something that
17 would have -- you would have given some consideration
18 to?

19 A. Yes.

20 Q. When it was being presented to you?

21 A. Yes, this would have been presented to me.

22 Q. Okay, excellent. What this is doing is it is looking at
23 opportunities, which is like an upside case, for 2016
24 and then it is looking at risks which is, as you put it,
25 sir, a downside case.

1 If we look first at opportunities we can see that
2 the one in the second row that is being identified is
3 "No Hydrocortisone Competitor". So that means that
4 Actavis would retain a 100% share, does it not?

5 A. I am not sure that that is what it will assume but this
6 was modelling no -- I believe no additional
7 Hydrocortisone competitor.

8 Q. You think although it does not say "additional" you
9 think that it is modelling a second competitor to one
10 that is already launched?

11 A. That would be my interpretation of this.

12 Q. Okay. The implication of that is that it would generate
13 \$27 million worth of additional profit; correct? You
14 can see that in the column under "EBIT", in terms of
15 potential impact?

16 A. Versus what was planned in the budget.

17 Q. Exactly, what was planned in the budget, and what was
18 planned in the budget, for the tribunal's note, is at
19 page 35 {H/790/35} which was looking at a market share
20 loss of 25-33%.

21 Can we just turn then to the risk and the downside
22 case, and if we look at the third row and you can see
23 that actually the risk is that Hydrocortisone would have
24 an erosion of 60%; do you see that, sir?

25 A. I do.

1 Q. Then the impact on earnings before interest and tax
2 would be a \$19.5 million -- and that would be presumably
3 a loss, a reduction, because therefore it is a worst
4 case scenario; correct?

5 A. Correct.

6 Q. Then if you look at the comments it says, "retain 40%
7 share", so that is just saying the flip side, is it not?
8 That is just saying Actavis would keep 40% of the
9 market?

10 A. That was their assumption in terms of modelling.

11 Q. Then it also says "no AMCo". So you were not expecting
12 AMCo to launch its own product in 2016; that is correct,
13 is it not?

14 A. This is not my reflection. This is not my scenario.
15 This is the business scenario presenting it to us.

16 Q. But the business scenario being presenting to you is
17 saying no AMCo in 2016, is it not, even in a risk?

18 A. It is saying as -- in a risk.

19 Q. In a risk "no AMCo", correct?

20 A. Yes.

21 Q. Yes. It might help --

22 A. I think it is important, that when we are talking about
23 a budget review we are talking about risks and
24 opportunities. Where could there be upsides, where are
25 there downsides, give us a balanced kind of view. So

1 just like you have in a base case you have a upside
2 model, a downside model. So this is -- that is why you
3 see the numbers between the opportunities and the risks
4 being fairly balanced, because they are trying to, you
5 know, show yes, there may be some upsides, yes, there
6 may be some downsides, and then these are the
7 assumptions that would go on either of those.

8 Q. On the upsides and the downsides it might help if we try
9 and put some percentages on the low and medium
10 probability. We do not find them here but in
11 a subsequent presentation at {IR-H/820/1}, just to show
12 you the document. So this is a presentation made in
13 February 2016. It is very faint, and if we can turn to
14 page 15 {IR-H/820/15}, you see it is exactly the same
15 slide, risks and opportunities. Apart from the date, it
16 is obviously a few months later on, we can see now that
17 percentages have been given to the probabilities.

18 A. Yes, that was a change that we made in 2016.

19 Q. So now when you are making predictions you give it
20 a percentage figure; is that right?

21 A. Yes, just to try and put some qualitative figures around
22 the low, medium and high.

23 Q. Exactly. So for a low --

24 A. Which would not have been the case in 2015, so --

25 Q. There was a change in 2016?

- 1 A. Yes.
- 2 Q. I am grateful. So if one looks at the low probability
3 second row, for opportunities that is 0 to 20%. Do you
4 see that, sir?
- 5 A. Point that out to me again.
- 6 Q. If you go under "Opportunities", go two rows down,
7 limited Hydrocortisone competitor, singular, impact, and
8 it is put at 0-20%.
- 9 A. Yes.
- 10 Q. Then if we look at the risks, and it is the third one
11 down, Hydrocortisone 60% erosion. That is a medium
12 probability and that is 20 to 35%.
- 13 A. That is correct.
- 14 Q. So it is right that the business thought, whether it is
15 upside or downside or opportunity or risk, that it was
16 less likely than not, is it not? It was below 50%. You
17 did not expect this to happen?
- 18 A. Correct.
- 19 Q. If we go to page 9, please {IR-H/820/9}, just because it
20 gives a bit more update.
- 21 A. Again, this is [REDACTED] -- you know it was her view of
22 that risk in terms of percentage risk.
- 23 Q. She was the person who prepared the presentation?
- 24 A. Correct, that is correct.
- 25 Q. If we just look at page 9, at the fourth bullet we can

1 see, now we are in February 2016:

2 "Over-delivery of Auden products (esp.
3 Hydrocortisone) compared to deal model contributed
4 additional \$32M margin."

5 So we can see that again Hydrocortisone has beaten
6 expectations, has it not?

7 A. Yes.

8 Q. Can we go back to your witness statement, please, at
9 paragraph 6.1, it is {B1/1/11}. You say in the second
10 sentence:

11 "... decisions in relation to pricing and strategy
12 were taken on an arm's-length basis by Actavis UK
13 without any involvement from Allergan [but then you
14 clarify] (by which I mean the branded business)."

15 So it is fair so say, is it not, that Allergan's
16 generics business was closely involved in the pricing
17 and strategy of Actavis UK's Hydrocortisone business?

18 A. Allergan's generics business called Actavis, which was
19 sold to Teva, they are the ones who handled all of
20 the pricing, and all of this modelling and all of these
21 projections and all the scenarios that you are listing
22 around what could or could not happen with this market.

23 Q. Two things though, sir. We were looking at that 2015
24 update and the 2016 budget, and you accepted it was
25 an Allergan presentation because the logo of Allergan is

1 on every page.

2 A. The company name had changed, the parent company name
3 had changed to Allergan.

4 Q. Agreed.

5 A. I was that fault line between Allergan and Actavis.

6 Q. The presentation, you also accepted, had been made to
7 you. So you would have seen all of that detail as well?

8 A. I am not -- I would not have seen all of the detail that
9 you have just shared, but I would have seen the overall
10 performance.

11 Q. I am grateful. If we look at paragraph 6.2, you say
12 there:

13 "... Allergan had no interest in the marketing of
14 the hydrocortisone business ..."

15 Then you make the point you have made earlier:

16 "... this was a small part of the much larger global
17 generics business that had been earmarked for sale."

18 But I am going to put to you that is just not right,
19 is it, Mr Stewart, because we have looked at the 2015
20 update and the 2016 budget, and we can see that it was
21 looking at sales and margins and pricing and competitor
22 activities in great detail. So you have not mentioned
23 this document in your witness statement, but it is
24 right, is it not, that actually Allergan did have
25 an interest in marketing Hydrocortisone? That is why it

1 was looking at it in such detail?

2 A. Actually it didn't, and that is why I do not have it in
3 here in my statement because Allergan, again, we closed
4 the deal. Shortly thereafter we then sold the generics
5 business in July of 2015, and Allergan did not focus on
6 Actavis any more. I was the only one focusing on
7 Actavis because of the fact that I was required to
8 deliver the Actavis business to Teva. And so Allergan
9 really did not care about what was the actual
10 performance of the business. We actually excluded it.
11 Even in all of our SEC documents, if you see from 2015
12 or from July of 2015 on, we have reported the generic
13 business into discontinued operations. We did not even
14 talk about it to investors any more.

15 So Allergan truly was separate from this and Actavis
16 was contractually going to Teva, and so what my job here
17 in reviewing this budget is to make sure that [REDACTED] is
18 continuing to provide the oversight to that business and
19 that we are performing the business in the ordinary
20 course, because that was what we contractually committed
21 to Teva.

22 Q. But "in the ordinary course", that means they are going
23 to stick with Actavis. It clearly had an interest in
24 the performance of Hydrocortisone, did it not?

25 A. It -- Allergan did not. Actavis --

- 1 Q. I am sorry, I did not ask you about Allergan. I was
2 taking the point you made.
- 3 A. Okay.
- 4 Q. I asked you about Actavis. It clearly had an interest
5 in the current performance of Hydrocortisone, did it
6 not?
- 7 A. In the context of making sure that we were operating the
8 business in the ordinary course, we had -- it was not
9 just looking at Hydrocortisone. I am looking at 10,000
10 products. So we are talking about a massive portfolio.
11 UK is just one component of a very big transaction. We
12 had 8,000 employees, we had 40 manufacturing facilities.
13 All of that we needed to manage in a time period where
14 we are going through all of these regulatory clearances,
15 and it was my job to take that box. We took Actavis, we
16 dropped it into a box and then we sold that box off to
17 Teva, and it was my job to deliver the box.
- 18 Q. I am going to move on with the box and look at what you
19 refer to as the "Hold-Separate" period.
- 20 Can we just start with the deal with Teva. So, as
21 you said it was announced in July 2015, That is right,
22 is it not?
- 23 A. Correct.
- 24 Q. It brought together two of the largest suppliers of
25 generics in the UK and Ireland, did it not?

- 1 A. That is correct.
- 2 Q. The European Commission thought that the merger, if it
3 was not modified, would harm competition in various
4 generic markets in the UK and elsewhere?
- 5 A. That was the conclusion that they drew.
- 6 Q. So the Commission approved the merger on condition that
7 Teva sold a substantial part of Allergan's generic
8 business in the UK and Ireland, did it not?
- 9 A. That is correct.
- 10 Q. In preparation for that divestment Allergan and Teva
11 agreed a series of commitments to preserve the
12 divestment business, did they not?
- 13 A. It did.
- 14 Q. You, in your witness statement, summarised the
15 commitments at paragraph 7.5 which you can find at
16 {B1/1/13}. I would just like to compare what you say
17 there with the text of the commitments. If we start,
18 please, with paragraph 7.5.1, and you say:
- 19 "The Divestment Business was to be held separate
20 from Actavis Generics. This meant that Allergan's staff
21 and management were prevented from having any
22 involvement [and you underline "any"] in the Divestment
23 Business."
- 24 You cite for this proposition clause 37, so can we
25 just have a look at clause 37, please. It is at

1 {IR-H/986/9}. If we could just enlarge 37, please.
2 Just under the heading "Hold-separate obligations".

3 We can see the bit that you focus on which comes
4 after the Roman numerals, but you do not say in your
5 statement, do you, the bit that comes before (i), which
6 is that:

7 "... to ensure that unless explicitly permitted
8 under these Commitments:"

9 Do you agree that you did not reflect that in your
10 statement?

11 A. My statement was really in the context that when we had
12 the meeting around what the Hold-Separate period meant
13 and what that meant to us, it was -- using my box
14 analogy it was like we put the UK business in a vault
15 inside the box. So it even put further restrictions in
16 terms of what we were able to do and so I thought that
17 was clear in my witness statement.

18 Q. With your box analogy now turned into a vault, can we
19 just look at what the commitments were explicitly
20 permitting, or indeed obliging Allergan to do vis-a-vis
21 the divestment business.

22 Can we look at first of all commitment 36(b), so
23 that is on the previous page, please {H/986/8}. So this
24 is at the bottom, if we can just -- thank you very much.
25 We can see here that this is where the parties, that is

1 Allergan and Teva, and they are obliged to undertake:

2 "to make available, or procure to make available,
3 sufficient resources for the development of the
4 Divestment Business, on the basis and continuation of
5 existing business plans."

6 So, so far as it was a box or a vault, nonetheless
7 Allergan had to provide resources for it, did it not?

8 A. No, it was the people that were already named in that
9 particular vault, like [REDACTED] was appointed the person to
10 run and she would run the business, that she would have
11 the sufficient resources which she had.

12 Q. So you are saying that it already came with sufficient
13 resources and therefore this commitment was meaningless?

14 A. She had the resources that she needed to operate the
15 business.

16 Q. Where were the resources coming from?

17 A. In the UK.

18 Q. So you are saying that neither Allergan nor Teva needed
19 to make available sufficient resource, because that is
20 what is obliging them to do?

21 A. So it would, if she needed support, that she would have
22 to ask for it.

23 Q. Okay. So in that scenario if she needed support she
24 would ask for it, and therefore Allergan in that
25 scenario would provide sufficient resource in line with

1 its commitment?

2 A. Yes, if it was asked.

3 Q. I am grateful. If we look then at paragraph (c), again
4 we can see the parties undertake:

5 "to take all reasonable steps, or procure that all
6 reasonable steps are being taken, including appropriate
7 incentive schemes ... to encourage all IE-UK Key
8 Personnel to remain with [the business] ..."

9 So that is also requiring, is it not, Allergan to be
10 involved because you had to set up rewards or bonuses
11 and other incentive schemes to make sure people did not
12 leave the divestment business?

13 A. Well, I look at that and say that we would not have
14 taken away any of the typical compensation packages that
15 were available as some kind of a punitive means for them
16 to then wind up seeing a mass exit of employees. So
17 I look at this being that we need to keep the funding,
18 the incentive mechanisms in place that existed, and that
19 is what we did.

20 Q. You started that answer with, as if it was a negative
21 obligation, you could not take it away, but you finished
22 your answer by saying that you would continue funding
23 the incentive schemes because that is what you were
24 obliged to do. So in other words you were obliged to be
25 involved in the business in funding the incentive

1 schemes so that staff remained in the divestment
2 businesses; that is right, is it not?

3 A. I look at it and say that the compensation needed to be
4 set up in a way that employees were motivated during
5 this period of time so there was not any -- so that
6 there was no negative consequence to the fact that this
7 was being held in a Hold-Separate.

8 Q. My only single point to you is that Allergan is the one
9 that is committed to providing that funding and
10 therefore is involved in ensuring those incentive
11 schemes stay in place?

12 A. We actually had an incentive plan in each country
13 that -- that just continued. It is not that Allergan
14 had to intervene with yet another plan. That did not
15 happen. What this is doing is preserving, but instead
16 of the plan that was already in place, that it would not
17 get removed just because the business had been moved
18 into a hold-separate.

19 Q. If we go back to your statement, please, at 7.5.3, that
20 is at {B1/1/13}, you state there categorically:

21 "No confidential information was to pass from the
22 Divestment Business to the retained business and any
23 such information obtained prior to the Commitments had
24 to be destroyed ..."

25 You cite for that this proposition clause 40, and

1 just because elsewhere in your statement you are equally
2 categorical, at 7.13.4, which is to be found at
3 {B1/1/16}, you say there in terms that:

4 "... [REDACTED] was required not to share any
5 confidential information with Allergan and any such
6 exchange could have amounted to a breach of the
7 Commitments."

8 Then you refer again to clause 40.

9 Can we have a look, please, at clause 40, it is at
10 {IR-H/986/9}. In particular, I would like to just draw
11 your attention to the last sentence of that commitment.
12 So it is right at the bottom of the page:

13 "The parties may obtain or keep information relating
14 to the Divestment Businesses which is reasonably
15 necessary for the divestiture of the Divestment
16 Businesses or the disclosure of which to the Parties is
17 required by law."

18 So it is right, is it not, that there are actually
19 two gateways for information to pass to Allergan. The
20 first was in relation to information for the
21 divestiture; that is right, is it not?

22 A. Yes.

23 Q. In fact you describe a "clean team" in paragraph 7.11.3
24 of your statement which was set up for that purpose?

25 A. That is correct.

- 1 Q. It was also right that you could get information
2 required by law, and you say in your statement at
3 paragraph 7.11 {B1/1/15} that you did receive
4 information for what you refer to as "essential
5 reporting purposes"; that is right, is it not?
- 6 A. That is correct.
- 7 Q. So it is not quite right to say that there is no
8 information; there were those two gateways for which
9 information could be shared?
- 10 A. We had a fiduciary responsibility to still report the
11 business results, and as a publicly traded company there
12 was a clean team that was set up that was yet another
13 mechanism to be able to ring-fence whatever data could
14 be shared. But yes, there was de minimis information
15 that would come through but it was purely for
16 a reporting mechanism.
- 17 Q. When you were reporting business results that is because
18 where there were profits generated by the divestment
19 businesses they were going to you as the owner prior to
20 closing, were they not?
- 21 A. It was in discontinued operations. So Allergan was not
22 using that in any of our EPS calculations because it
23 was -- for the purposes of Allergan it was as if that
24 business was gone.
- 25 Q. Forgive me, sir, you said "EPS calculations", just for

1 the benefit --

2 A. Earnings per share.

3 Q. I am grateful. I just want to deal with one other
4 aspect of the commitments, if I may. Back to your
5 statement at 7.5.4, and here you refer to there being
6 a complete separation -- sorry, it is {B1/1/13}, please.
7 It is 7.5.4:

8 "A complete separation of the IT networks containing
9 any confidential information ..."

10 Unfortunately, again, I think there is a couple of
11 qualifications and nuances that you have omitted from
12 your description of this commitment. If we go to
13 {IR-H/986/9}. If we look at paragraph 40, please. We
14 pick it up halfway through the paragraph, beginning "In
15 particular". You see it says:

16 "... the participation of the Divestment Businesses
17 in any central [IT] network shall be severed [but then
18 it says] to the extent possible ..."

19 So it was not an absolute obligation, was it?

20 A. That was -- it was clear to us that we had to disconnect
21 people's access into these systems and being able to see
22 or have visibility to data.

23 Q. If we read on, it says that it should not compromise the
24 viability of the divestment businesses. So again, it
25 was not an absolute obligation to cut off IT networks;

1 it was only to the extent possible and only if it would
2 not undermine the viability of the divestment
3 businesses?

4 A. Yes, I mean the Hold-Separate period required the
5 business to continue to operate, but it prevented firm
6 people to be able to get in and see what was actually
7 happening in the business, other than what was going to
8 be statutorily required for reporting.

9 Q. Would you agree with me that your summary in 7.5 does
10 not fully and fairly reflect the precise wording of the
11 commitments?

12 A. I disagree with you. I think we -- like I said, we put
13 this business into a vault which kept it really separate
14 from the rest of this organisation --

15 Q. You do not --

16 A. -- including me.

17 Q. You do not mention the possibility that under the
18 commitments you could have sought a derogation from them
19 from the Commission?

20 A. There was no reason to, because the business was able to
21 function separately from the rest of the organisation.
22 So there was no need for us to intervene.

23 Q. But had you realised that the business had been engaged
24 in unlawful behaviour, that would have been a reason,
25 would it not?

- 1 A. We did not realise that that was the case.
- 2 Q. No, I am putting to you a hypothetical, had you
3 realised --
- 4 A. I am not going to answer a hypothetical.
- 5 MR BAILEY: So if we could move on --
- 6 THE PRESIDENT: Put the hypothetical, and I would like to
7 hear the question first and then we will see if the
8 witness can answer.
- 9 MR BAILEY: So, in circumstances where you were aware that
10 the vault, the divestment business was engaged in
11 illegal conduct, one of the ways that you could bring
12 that to an end would be to approach the
13 European Commission and ask for derogation from the
14 commitments to bring that behaviour to an end. That
15 would be a mechanism that would allow you to stop that
16 illegal behaviour.
- 17 A. The mechanism would have been available to us, but there
18 was nothing to suggest that that was a -- there was
19 a need to do that and activate that.
- 20 Q. I would like to turn, if I may, to the Hold Separate
21 manager and [REDACTED] role in this context. So, she
22 was the senior vice president of Actavis UK, was she
23 not?
- 24 A. She was.
- 25 Q. She was very familiar with the Hydrocortisone business,

1 was she not?

2 A. She was very familiar with the entire UK business.

3 Q. Her role under the commitments was to manage the
4 day-to-day business of the divestment businesses; that
5 is right, is it not?

6 A. That is correct.

7 Q. In doing that, can we just have a look, please, at how
8 she went about managing the business. I take it that
9 you will not have seen this at the time but it is
10 important just to see. Could we go, please, to
11 {H/868/1}, and in particular look at page 3 {H/868/3}
12 which helpfully is called a "Plan on a page for
13 Hydrocortisone".

14 This is from May 2016 during the Hold-Separate
15 period. We can see from the highlights, the first one
16 is that there has been another price rise, this time at
17 the end of 2015, and again another one in the first
18 quarter of 2016. But the bit I am interested in is
19 actually the strategies and goals. Can I just ask you
20 to have a look, please, at the various strategies and
21 goals set out in this slide. (Pause) Have you read
22 that?

23 A. Yes.

24 Q. Is it possible on Opus to bring up another document so
25 it can be looked at side by side? Could we bring up as

1 well, please, {H/815/3}. Just to tell you what this is,
2 this is the same document, key product summaries, but
3 this one was from February 2016. So on the left-hand
4 side you have the May 2016, that is during the
5 Hold-Separate period, and on the right-hand side you
6 have the one before the Hold-Separate period. Can I ask
7 you to read the strategies and goals on the February
8 version on the right-hand side as well, please. (Pause)

9 A. Okay.

10 Q. They are identical, are they not, except for the final
11 bullet point?

12 A. Correct.

13 Q. So the strategy pursued by the business during the
14 Hold-Separate period was exactly the same as it was
15 before the Hold-Separate period, was it not?

16 A. With, obviously, the wholesale support comment added.

17 Q. Yes, you are quite right, sir, but can you just answer
18 my question: the strategy was otherwise -- the first
19 four propositions, the strategies/goals, they were
20 identical, were they not, between February and May?

21 A. Yes.

22 Q. Yes. You are quite right, sir, to say that the last one
23 is different, and if we could start with the right-hand
24 side we can see that here what is being envisaged by the
25 Actavis UK is that wholesale support for the defence

1 campaign, which I think is referring to
2 Project Guardian, is agreed with --

3 A. I am not referring to anything here, so --

4 Q. Yes, I will just read out the wording. So it is talking
5 about seeking wholesale support for defence campaign,
6 agreed with various named wholesalers, AAH, Alliance
7 Phoenix, Mawdsleys and DE.

8 Then if we look at what happened in May we can see
9 that although the wording is different actually it is
10 more of the same, it is continuity, because it says:

11 "Continue to use the campaign to reinforce the
12 benefits of Actavis Auden's full label product."

13 So actually although those are worded differently in
14 fact it is consistent, is it not, that the strategies
15 and goals were exactly the same?

16 A. Yes. Again, this would not have made it up to me before
17 the hold period. So I understand your point in terms of
18 trying to say that it is the same, but I would not have
19 seen this even before the hold period, the Hold-Separate
20 period.

21 Q. What I would like to do is to turn to something you said
22 at the outset of your evidence, which was that you took
23 legal advice about how the Hold-Separate period was
24 meant to operate, and that was from the US law firm
25 Cleary Gottlieb, and you exhibit that advice to your

1 statement. It is all of a piece with the idea that
2 nothing changed during the Hold-Separate period.

3 I appreciate, sir, that you say in your statement
4 you did not liaise with Cleary Gottlieb, but you have
5 exhibited the advice and so I would like to ask you some
6 questions about it.

7 It is at {IR-C1/2/1}, please. This is a memorandum
8 and we can see it is addressed to Allergan Plc. Do you
9 see that, sir?

10 A. Yes.

11 Q. It is dated 26 February 2016. So it is just before the
12 commitments came into force on 10 March?

13 A. Yes.

14 THE PRESIDENT: It says "draft".

15 Q. It does, sir?

16 THE PRESIDENT: Does that mean anything?

17 MR BAILEY: This is the only document we have and I assume
18 therefore unless the witness is aware -- are you aware
19 of any further advice that was given or a final version?

20 A. I remember being verbally communicated around this and
21 that is where it was very clear in terms of how we had
22 to really keep this completely separate.

23 THE PRESIDENT: Let us be careful about -- I do not want you
24 until Mr Jowell has a chance to stand up to say anything
25 about any other advice apart from this letter because

1 I do not want there to be an inadvertent waiver of
2 privilege.

3 MR JOWELL: I think we have to accept, sir, that we have
4 waived privilege in respect of Cleary Gottlieb's advice
5 to Allergan in relation to the Hold-Separate period by
6 providing this document. The waiver does not go further
7 than Cleary Gottlieb's advice but I have no difficulty
8 with him expanding on any other advice that he got.

9 THE PRESIDENT: I am very grateful, Mr Jowell. I just did
10 not want to get to that point without having it
11 articulated.

12 Mr Stewart, sorry, I was just making sure that your
13 - or rather the appellants' - position was
14 appropriately protected but do go on with your answer to
15 the extent of any Cleary Gottlieb advice that might have
16 been accompanied or accompanying this document.

17 A. Great.

18 MR BAILEY: Just for the avoidance of doubt, that is the
19 only legal advice I am going to ask you about.

20 If we go down in this document under the "executive
21 summary" to the second bullet we can see that it is
22 pointing out:

23 "The parties will no longer directly hold management
24 rights in the Divestment Businesses. Instead [and
25 explains] that Teva must appoint managers to

1 independently run the day-to-day management of the
2 Divestment Businesses ... within the ordinary course of
3 business and existing budgets/business plans."

4 Just to explain, I am going to walk you through the
5 advice and then I am going to ask you some questions at
6 the end just so you can see the entirety of it.

7 A. Okay.

8 Q. If we look then at the third bullet we can see
9 reflecting the commitment we looked at earlier:

10 "The parties must make available sufficient
11 resources to the Divestment Businesses to ensure their
12 continued viability and marketability ..."

13 Then if we turn over the page, please, {IR-C1/2/2},
14 just at the bottom, effectively the last bullet at the
15 bottom of page 2 is effectively Cleary repeats this
16 point several times at the bottom of page 2. You can
17 see that, and it is referring to the appointment of

18 

19 Then if we go to the top of page 3, please.
20 {IR-C1/2/3}. We can see that the legal advice in the
21 first full bullet says:

22 "Hold Separate managers will have to run the
23 Divestment Businesses in the ordinary course of business
24 and typically on the basis of existing budgets and
25 business plans ..."

1 Then if we can go, please, to page 6 which is an
2 annex. {IR-C1/2/6} This is setting out granular
3 guidelines on the Hold Separate regime in the EU.

4 If we look at paragraph 7, please, in the second
5 bullet we can see again the message is the same:

6 "The Hold Separate managers [now it is in obligatory
7 form] must run the relevant Divestment Businesses in the
8 ordinary course of business based on existing business
9 plans and budgets."

10 Then at paragraph 8 at the bottom you see a nice
11 pithy explanation:

12 "The guiding principle is business as usual."

13 Then finally, if we just turn over the page, we can
14 see what that means:

15 "The chief executives of the Divestment Businesses
16 must continue to run their operations in the ordinary
17 course of business [again] within their existing
18 budgets/business plans ..."

19 The time bullet there is that Teva and Allergan --

20 MR JOWELL: My learned friend did not finish the entirety of
21 that bullet.

22 MR BAILEY: I apologise, yes. Quite right.

23 THE PRESIDENT: Why do you not read it to yourself,

24 Mr Stewart, and then you can have questions. That is
25 fair enough. (Pause)

- 1 A. Okay.
- 2 MR BAILEY: If we stand back from this Cleary Gottlieb were
3 advising Allergan Plc four key things. First, a Hold
4 Separate manager was going to run the day-to-day
5 management of the divestment businesses in Ireland and
6 the UK. That is right, is it not?
- 7 A. Correct.
- 8 Q. Second, the divestment businesses were to be run in the
9 ordinary course of business on the basis of existing
10 budgets and business plans, weren't they?
- 11 A. Correct.
- 12 Q. Third, the guiding principle for this was business as
13 usual, was not it?
- 14 A. Correct.
- 15 Q. Fourth, Allergan and after closing Teva were required to
16 provide sufficient resource for the divestment
17 businesses on the basis of existing business plans?
- 18 A. Yes, but the business plan contained everything it
19 needed to run the business, so there was not a need for
20 additional resource.
- 21 Q. Understood. I am going to come on to the existing
22 business plan now. So if we could turn, please, to
23 another document that you exhibit which is the first
24 monthly report of the monitoring trustee. That is at
25 {IR-C1/3/1}. We can see the date of this is

1 20 April 2016. So, as it says, it is just a month after
2 the Hold-Separate period began. If we go, please, to
3 page 9, {IR-C 1/3/9}. It is the third paragraph. This
4 is just, to explain what this is doing. We can see that
5 on April 11, 2016, the European Commission appointed
6 Duff & Phelps, which I think is now known as Kroll, as
7 the monitoring trustee and explained that:

8 "The trustee's role was to monitor both the
9 compliance of Teva and Allergan with the commitments and
10 to report to the Commission."

11 Do you see that?

12 A. Yes.

13 Q. You mention this report in your statement and I just
14 want to look at one section, if I may, dealing with the
15 Hold Separate manager and her approach.

16 That is at page 18. {IR-C1/3/18}. Could I ask you
17 to read to yourself, please, the first full paragraph
18 beginning "The trustee understands". It is about
19 employee communication. (Pause)

20 A. Okay.

21 Q. I realise, sir, that you were not involved with these
22 events and [REDACTED] is not here so I am going to ask
23 you that I have understood this correctly. This is
24 saying, is it not, that the Hold Separate manager sent
25 an email to all employees telling them about the

- 1 commitments. That is right, is it not?
- 2 A. That is what this says.
- 3 Q. It also says that there were briefings with the managers
4 telling them that one of the main elements of those
5 briefings was to remain focused on the 2016 plan. That
6 is right, is it not?
- 7 A. Yes, it is focused on the business and not worrying
8 about all the other distractions that could be
9 associated with the Hold Separate.
- 10 Q. Indeed. This execution of the 2016 plan, if we go to
11 page 20 of this document, {IR-C1/3/20}, we can see under
12 the heading "Appointment of Hold Separate manager",
13 which is explaining [REDACTED] experience and
14 credentials we see about halfway down:
15 "More in particular", and here it is explaining:
16 "... she developed a business plan and the strategy
17 for the UK Actavis (now UK Allergan Generics) business,
18 which became the market leader in 2015 following
19 a sustained period of growth."
20 So that is telling us, is it not, that [REDACTED]
21 was the person who developed a business plan for the UK
22 generics business. That is right, is it not?
- 23 A. I think it's saying that she's got the capability of
24 managing the business and Hold Separate.
- 25 Q. The reason she had the capability to manage the Hold

1 Separate business is because she was the person who
2 developed the plan prior to the Hold Separate. That is
3 right, is it not?

4 A. Not just the plan but she has an accomplished manager
5 for over 25 years, understood the industry, had the
6 relationships with the plant and her team and so she was
7 the most credible person to operate it.

8 Q. In addition to her experience and her credibility, she
9 developed the business plan prior to the Hold Separate
10 which she was then implementing during the Hold
11 Separate?

12 A. I think you are overemphasising the plan but she was the
13 one that could operate the business independently.

14 MR BAILEY: Sir, I do not know if that is a convenient
15 moment to take a break.

16 THE PRESIDENT: Yes, of course, Mr Bailey. We will rise for
17 ten minutes and resume at 20 to 4.

18 (3.31 pm)

19 (A short break)

20 (3.43 pm)

21 MR BAILEY: Just two more documents I would like to take you
22 to, Mr Stewart. The first of those is the contract of
23 employment between Actavis UK and [REDACTED]. That is
24 at {IR-H/858/2}, please. If we could go to the bottom
25 half of that page, please. If I could just ask you to

1 read the paragraph beginning "Under the commitments".

2 (Pause).

3 A. Okay.

4 Q. So this is her employer, Actavis UK, telling [REDACTED]
5 that her role was to ensure -- in the words of the
6 contract:

7 " ...to ensure the commercial efforts devoted to
8 their promotion and commercialisation remain
9 substantially unaltered".

10 That is right, is it not?

11 A. Yes, business as usual.

12 Q. Business as usual, indeed. Had the commitments expected
13 her to run the divestment businesses in any way she so
14 wished it would have said so, would it not, as opposed
15 to rather than business as usual, business as unusual
16 and she could do something radically different. It
17 would have made that clear that that was within her
18 remit?

19 A. Well, yes, I mean this is saying business as usual.

20 Q. I am grateful.

21 Then the last document is at {IR-H/882/3}. This is
22 a chain of emails and I would not have expected you to
23 have seen these before but I am showing them to you
24 because this is an exchange between Allergan and the
25 Hold Separate manager during the Hold-Separate period.

1 I am going to start with the email that starts the
2 chain which appears last and show you that and then I am
3 going to go up through the exchange.

4 It starts with an enquiry from a journalist from The
5 Times about Auden McKenzie. We can see if you look
6 halfway down the date of this is 31 May 2016.

7 "Urgent -- The Times."

8 I would just like to show you first of all a few
9 passages because this sets the scene for the emails that
10 come next. If we just pick it up in the third paragraph
11 The Times is saying:

12 "We have obtained evidence that a number of small
13 pharmaceutical companies, including Auden McKenzie, are
14 exploiting a loophole in NHS pricing rules, effectively
15 avoiding price controls. The result is that the cost of
16 some drugs have seen huge increases in recent years."

17 Then if we just turn over the page, please, although
18 do say if you wish to read.

19 A. I would like to read the whole thing if you do not mind.

20 Q. Of course. If you could go back a page so the witness
21 can read the ... (Pause)

22 A. Okay.

23 Q. Then over the page, {IR-H/882/4}. You see there is
24 a heading "Auden McKenzie" and it begins:

25 "Auden McKenzie has been responsible for a number of

1 dramatic price rises."

2 Then the next heading:

3 "Hydrocortisone 10mg and 20mg".

4 The only bit I wanted to draw to your attention is
5 under "10mg" it says:

6 "Since 2008, the price of 10mg tablets has risen
7 from 70p to more than £84 a packet -- an increase of
8 almost 12,500 per cent."

9 Just pausing there. On any view that is
10 a considerable price rise, is it not?

11 A. Yes, it is.

12 Q. Rather than go through an email that you will not have
13 seen I would like to look at how this is followed up.
14 So if we can go, please, to the bottom of page 1, top of
15 page 2 because that is the email is split. If we just
16 look at the bottom of page 1 you can see that there is
17 an email from an individual. We will see who she is in
18 a moment and we can see that it is sent to three
19 individuals, one of whom was the president of
20 International Generics. Then over the page you see it
21 is copied to the Hold Separate manager and also
22 Mr Wilson who was the managing director of Actavis UK.

23 If we can go to the next page, please, I just want
24 to show you who is writing this email. We can see that
25 it was the Vice President of Communications and PR for

- 1 International Brands, Allergan. Do you see that?
- 2 A. I do.
- 3 Q. Can I ask you to go back to page 2 and just read what
4 she writes in the first three paragraphs in blue.
5 (Pause)
- 6 A. Okay.
- 7 Q. So I think the VP for communications and PR Allergan is
8 making four points. The first is that the business
9 dealt with a similar enquiry in October 2015. Do you
10 agree with that?
- 11 A. It certainly suggested there had been a previous
12 enquiry.
- 13 Q. Yes. The second is that the planned response to the
14 journalist's allegations was going to be very similar to
15 the one that had been provided in October 2015. That is
16 right, is it not?
- 17 A. That is what this says, yes.
- 18 Q. The proposed statement by Allergan to The Times had been
19 reviewed by [REDACTED]. You can see that in the second
20 paragraph just a bit where there is a bit of red. It
21 says:
22 "The statement has been reviewed by Jonathan and
23 [REDACTED]
- 24 A. Yes.
- 25 Q. Then the fourth point under the heading "Further

1 actions", the VP was saying:

2 "We are going to monitor this story and advise ..."

3 That would be advise the recipients of this email.

4 That is correct, is it not?

5 A. Yes.

6 Q. "... on any next steps once we see the specific tone,
7 accusations or inaccuracies."

8 So what this shows, Mr Stewart, is that there was
9 a line of communication between Allergan and the Hold
10 Separate manager during the Hold-Separate period. Do
11 you agree with that?

12 A. That was certainly an email.

13 Q. The email was actually showing that they were willing to
14 discuss allegations about pricing of Auden products,
15 were they not?

16 A. Well, I was not privy to any of these conversations nor
17 have seen this correspondence before, so I really cannot
18 opine on what that communication was.

19 Q. Okay. Let us just finish off the email exchange granted
20 that you will not have seen it at the time. There is
21 a reply if we go to page 1, please, first of all, from
22 the director of corporate affairs, another Allergan Plc
23 employee. You can see that he has made various edits to
24 the response and we just note that he says:

25 "I also think we should remove reference to Actavis

1 not being a dominant provider -- we have made many
2 historical statements pointing to Actavis being
3 number 1, or number 2 generic company in the UK."

4 Then we finally have how the Hold Separate manager
5 dealt with this and we can see at the top of the page
6 she is forwarding this email to Mr Wilson, he is the
7 managing director of Actavis UK, asking about the
8 tariff, the drug tariff overview in June 2015
9 to June 2016. So she is promptly following up on that
10 query.

11 Would you agree with me that this is not her
12 responding by saying: this is a vault, hands off, I deal
13 with these things independently and autonomously, is
14 she?

15 A. I have no context of this so there could have been other
16 emails. I have no idea what [REDACTED] was thinking or how
17 anybody was communicating around this.

18 Q. Agreed there might be other emails but based upon this
19 email it is clear, is it not, she has not responded by
20 saying, this is none of your business, Allergan. This
21 is a business I am meant to be running independently.
22 Do you accept that proposition based on this email?

23 A. The email I see that you are highlighting here [REDACTED] is
24 sending to two people that I believe were on the Actavis
25 side.

- 1 Q. That is true. But you haven't seen any response from
2 [REDACTED] to the Allergan emails indicating that -- in
3 fact, actually on the contrary, if we go back to page 2,
4 please, we see that [REDACTED] had reviewed the
5 statement that was being made in response to The Times,
6 do we not, under "Our planned response"? So she had
7 cooperated with Allergan in relation to this?
- 8 A. Again, I do not have context to this enquiry coming into
9 Allergan or did it come into Actavis, I do not know.
- 10 Q. From everything we have seen Allergan knew the
11 Hydrocortisone business very well, did it not? I am now
12 moving off this email.
- 13 A. Again, Allergan did not know a lot about the
14 Hydrocortisone business.
- 15 Q. Under the commitments during the Hold-Separate period
16 the task of the Hold Separate manager was to run
17 day-to-day the divestment business according to business
18 plans that had been set during Allergan's ownership; is
19 that correct?
- 20 A. It was business plans that were set before Allergan even
21 owned it that continued after we had re-branded the
22 company Allergan.
- 23 Q. So those plans were the same before the Hold-Separate
24 period and during the Hold-Separate period, were they
25 not?

1 A. I would not know if anything really changed in the
2 Hold-Separate period because at that point that business
3 went into the vault.

4 Q. So it is right, is it not, that Allergan, before that
5 Actavis Plc, exercised decisive influence over
6 Actavis UK throughout the period from 29 May 2015 when
7 it bought the business to 1 August 2016 when it sold it
8 to Teva?

9 A. Again, when Actavis announced the transaction to sell
10 the business to Teva Actavis went into a different
11 reporting mechanism and it was reported as discontinued
12 operations and Allergan was not exerting any real
13 influence, was not setting new goals, new targets. It
14 was the Actavis business was sold and it was our job to
15 hand it over to Teva as is.

16 Q. It was not setting new strategies, new goals but on the
17 contrary, what it was doing is it was continuing the
18 goals that were already in place and pursuing the
19 strategies that were already in place, correct?

20 A. Because the agreement with Teva required us to handle
21 the business in its ordinary course and we had disclosed
22 what the business was to Teva and then that was what
23 ultimately what we sold.

24 Q. So you agree with me that the business in the ordinary
25 course was consistent through -- once the Teva deal had

1 been announced in July 2015 it was consistent through to
2 when you sold it in August 2016?

3 A. The underlying performance was similar.

4 Q. I am grateful. I have no further questions, sir.

5 THE PRESIDENT: Just a few questions, Mr Stewart.

6 Let us start with terminology because I want to be
7 very clear what we are talking about. You were at the
8 relevant time the COO of what I am going to call
9 Allergan?

10 A. Correct.

11 THE PRESIDENT: I mean I know names change but can we agree
12 that we will use Allergan to refer to the entity where
13 you were COO.

14 A. That is correct.

15 THE PRESIDENT: Just I want to avoid confusion.

16 A. The title changed after we had announced -- so you have
17 to remember at the time I was running all of operations
18 for the combined company and then we sold off -- and
19 then I also had the responsibility for the generic P&L.
20 When we sold off the Actavis business I was the person
21 who stayed back at Allergan. I should have technically
22 gone with that business to Teva. I was held back and
23 then I became the chief operating officer of Allergan.
24 But I was running the Actavis business at the time that
25 we sold it to Teva.

1 THE PRESIDENT: Indeed.

2 A. Yes.

3 THE PRESIDENT: I am going to start at the other end of the
4 telescope if I may. We will come to Teva in a moment.

5 I just want to make sure when we are talking about
6 acquisitions and divestments we are not getting our
7 terms confused.

8 In terms of your area of expertise, and clearly you
9 are very senior in the organisation, you are not
10 a lawyer I think you said?

11 A. That is correct.

12 THE PRESIDENT: But you do have fairly significant
13 acquisition and divestiture experience in the course of
14 your career. Would that be fair?

15 A. Yes, that is fair.

16 THE PRESIDENT: When you were being asked about the
17 acquisition of what I am going to call, let us discuss
18 what we are going to call it, do you want to call it
19 Auden or Actavis, the company that you are buying that
20 was producing and selling Hydrocortisone? Shall we
21 agree that we will call that Actavis?

22 A. Yes.

23 THE PRESIDENT: Okay. So we will use those terms. It is
24 Allergan buying Actavis and that is what we mean for the
25 purposes of these questions.

1 A. Okay.

2 THE PRESIDENT: You said, I think when you were being asked
3 about the data that was being investigated by amongst
4 others PwC, you took a forward looking approach.
5 I think that is the term you used.

6 A. Correct.

7 THE PRESIDENT: So in a sense, the past does not really
8 matter unless it can affect the future.

9 A. That is correct.

10 THE PRESIDENT: So when you had PwC investigating or
11 auditing, as I think you said, the figures, you were
12 really looking for errors that would be material in
13 terms of your future projections.

14 A. Yes, and also because of the fact that once you do
15 announce an acquisition like this you do have to
16 ultimately provide the historical, so that any time when
17 you are doing pro forma things in the future you need to
18 show what that look back could be. Also what we are
19 buying the business and valuing the business based on
20 that forward projection.

21 THE PRESIDENT: Yes, you need to be assured that any
22 reporting of the past by you in the future is accurate.

23 A. Correct.

24 THE PRESIDENT: That is one of the risks you seek to close
25 out going forward.

1 A. Yes, correct.

2 THE PRESIDENT: Is one of the risks arising out of past
3 conduct the risk of future litigation?

4 A. Sure, if the diligence uncovered that it could be a risk
5 that would have been included in the deal model
6 assumptions. But in this case that was not highlighted
7 and if there was, we would have never done the deal.

8 THE PRESIDENT: I am very grateful for the specific
9 response. But in general terms let us talk
10 hypothetically about a hypothetical acquisition. You
11 would expect your adviser, obviously it would not be you
12 because you are at the top of the tree and you have
13 people who do this for you, but you would expect those
14 kicking the tyres of any acquisition to identify the
15 risk of past conduct triggering future litigation and
16 you would want that, if spotted, dealt with?

17 A. Sure.

18 THE PRESIDENT: How you deal with it would be a matter of
19 the nature of the risk that had been identified.

20 A. Yes, hypothetically if that risk had been identified
21 there is ways of dealing with it contractually or in
22 valuation or in just -- yes, there is ways of dealing
23 with it.

24 THE PRESIDENT: Indeed, I think you mentioned three. So one
25 is just walking away not doing the deal.

1 A. Sure.

2 THE PRESIDENT: The other is to say, well, what I thought
3 was worth £100 is now worth 75.

4 A. Mm-hm.

5 THE PRESIDENT: Or you put in place a warranty that protects
6 you if it is a kind of contingent risk that you cannot
7 really price in.

8 A. That is correct.

9 THE PRESIDENT: You may not be able to answer this and if
10 you cannot please say so, I quite understand if you
11 could not.

12 Is there generally a warranty in place regarding
13 unknown prior litigation that manifests itself after the
14 acquisition is completed on your watch? Is that
15 something which is common, uncommon or you do not know?

16 A. Very uncommon.

17 THE PRESIDENT: Very uncommon.

18 A. Yes.

19 THE PRESIDENT: So you would normally only have a warranty
20 which is in place in respect of an identified risk that
21 you would want to cater for.

22 A. That is correct.

23 THE PRESIDENT: Thank you. Of course, when you are selling
24 on, and I am now moving to the other end of the
25 telescope, the sale to Teva you of course are on the

1 receiving end of all that due diligence, you have to
2 make sure that you have answered all questions and dealt
3 with any queries appropriately, data rooms, all that
4 sort of stuff you would have to do.

5 A. That is correct, and that was going on at the same time
6 that we were integrating Auden, closing Auden.

7 THE PRESIDENT: In terms of maintaining the business that
8 you are selling in the ordinary course, and again, tell
9 me if you cannot answer this because it is verging on
10 the legal, but presumably in the ordinary course does
11 not mean continuing business that is unlawful.

12 A. That is correct.

13 THE PRESIDENT: I am not saying you knew. I am saying
14 hypothetically speaking if you spot something that is
15 not right you would shut it down.

16 A. That is correct.

17 THE PRESIDENT: Would you tell the potential acquirer that
18 this was happening or would it be just regarded as
19 a part of the ordinary course of business?

20 A. Certainly if we had identified something that was
21 unlawful we would have disclosed that and Teva would
22 have seen not only what our acquisition model looked
23 like for Auden, they also saw our press release
24 announcing the transaction but they would have also saw
25 our forward projection where we were signaling a decline

1 in Hydrocortisone.

2 THE PRESIDENT: So it would not have been quite the same but
3 we have seen, and we will not go to them, we have seen
4 various documents that in the most general level
5 Allergan would have seen regarding the company it was
6 acquiring. You would have had variants of those to
7 reflect the movement in time which would be provided to
8 Teva which they would have looked at.

9 A. But this happened so quickly.

10 THE PRESIDENT: There may have been less of a gap.

11 A. We were in diligence with Teva, I am going to say
12 six weeks after we had closed Auden McKenzie, so nothing
13 would have been really adjusted from what you saw in our
14 presentations.

15 THE PRESIDENT: That is a fair point. I understand what you
16 are saying. I mean, you would want to take account of
17 changes. You are saying there would not have been very
18 many.

19 A. Yes.

20 THE PRESIDENT: Now, we have established that you are
21 operating at a high level here, so you cannot, as was
22 fairly acknowledged in the questions, you cannot see,
23 you will not have seen a lot of the documents that were
24 put to you in the course of cross-examination. That is
25 entirely understandable, and you have done your best

1 answering those.

2 Can I just ask you about your expected practice of
3 those who are reporting to you in an acquisition. Can
4 I sort of put it to you this way and you can tell me how
5 far I have wrongly predicted what your best practice is.

6 Essentially when you are acquiring something you
7 have got problems and you have got virtues. Good and
8 bad if you like. As regards both, you are going to want
9 to know the broad picture, you are going to want to know
10 in bullet point form the good and the bad. You are
11 going to want to know much more about the significant
12 risks than the good bits.

13 In other words, would it be fair to say that your
14 interest when you are looking at an acquisition is much
15 more in the vulnerabilities than in the benefits. Would
16 that be fair?

17 A. Looking at both. You want to know what the benefits are
18 and how this could be accretive but you also, to your
19 point, are looking at where are the risks and where
20 could there be value destruction or value leakage. So
21 generally on balance you are looking at both. You want
22 to be convinced that you can pay a valuation or
23 a multiple for a business but then you also want to
24 understand what the potential risks of being able to
25 deliver that are.

1 THE PRESIDENT: Fair enough. What informs your expectation
2 of more granular reporting up? Clearly you only have
3 24 hours in the day to look at things. You cannot read
4 everything that has been produced. What is it that you
5 want to see and have drawn to your attention in the
6 context of an acquisition?

7 A. In this case there was a lot of reliance on the
8 operators of the business. [REDACTED] was a highly regarded
9 operator within the company. She had a history of solid
10 performance and so there was not a tremendous amount of
11 oversight needed or at least the belief was that because
12 we had a very seasoned, very capable operator that was
13 saying here is what we think is going to happen with
14 this business going forward.

15 So in terms of the granularity I was getting more
16 high level summaries around just the typical performance
17 of the business but again, this was a very, very small
18 part of my overall scope of responsibility and so I have
19 spent more time on this review here than I would have
20 actually in practice.

21 THE PRESIDENT: That is often the case with litigation, I am
22 afraid, Mr Stewart.

23 A. Yes.

24 THE PRESIDENT: But I think we are in agreement, but let me
25 unpack it so I can check that we actually are.

1 If it is all as expected you have got someone you
2 can rely on and it is a business plan that you feel is
3 reliable or indeed those lower down the tree who you
4 trust to look at this think it is reliable, then you
5 would not expect that to be pushed up to your level.
6 The story all is well, you do not really want to know
7 more than that.

8 But if there is something which is problematic, to
9 go back to the example of, let us say, a risk of
10 litigation arising out of the past that is material, you
11 know, not a nuisance claim but something which is
12 significant in the consequent transaction that is
13 something you would expect to be flagged to you and
14 drawn to your attention?

15 A. Absolutely.

16 PROFESSOR MASON: Just one further question, if I may,
17 following on from the question the president to you. If
18 you are able to say, did, and I am going to struggle to
19 get the labels correct so you will correct me if I use
20 the wrong ones, but did Allergan offer any warranty of
21 any nature to Teva?

22 A. I do not recall what was in that agreement. I know
23 there was a number of changes to that agreement over
24 time with working capital adjustments, things like that,
25 but I do not recall specifically if there was any

1 warranty.

2 PROFESSOR MASON: Okay, thank you.

3 THE PRESIDENT: Any questions arising out of that,

4 Mr Bailey?

5 MR BAILEY: No, sir.

6 THE PRESIDENT: Mr Jowell.

7 Re-examination by MR JOWELL

8 MR JOWELL: I would just like if I may to go back briefly to
9 a couple of the presentations that you were shown.

10 Could I show you first part of Mr Bailey's
11 cross-examination on page 128 of today. You will see at
12 the top of the page Mr Bailey said:

13 "Can we draw a distinction between the product at
14 the time of this presentation and the product when it is
15 being modelled as to its future prospects. In terms of
16 the product Hydrocortisone at the time of this
17 presentation we can see Actavis is describing it as
18 a near term cash-cow. That is a metaphor. That is
19 saying, is it not, that Hydrocortisone tablets were
20 highly profitable and will continue be so in the short
21 term.?"

22 And he says to you:

23 "That is right, is it not?"

24 And you replied?

25 "Answer: Yes, because we were modelling that the

1 profit would decline and the volume would decline."

2 I am not sure that the answer quite answers the
3 question that was being put. The question that was
4 being put was whether the Hydrocortisone tablets were
5 highly profitable and would continue to be so in the
6 short term.

7 Could I show you the expression "near term cash-cow"
8 which I do not think you were actually taken to. It is
9 in the same presentation. If we could go to it. It is
10 in {IR-A1.1/7/2}. Forgive me, I am looking at a
11 different -- it is the same presentation but it is
12 different. Do you see under "Executive summary,
13 background", and could I just ask you to refresh your --
14 you will see that it features in the sixth bullet but
15 could I just invite you to the read the fifth bullet and
16 the sixth bullet. (Pause)

17 A. Okay.

18 Q. If we could go forward, please, to page 5 of the same
19 document. {IR-A1.1/7/5} we see at the top:

20 "Base case: profit and loss projection.

21 Hydrocortisone erosion -- 2015 competitor entry;
22 revenue reduced by 90% in three years."

23 Then you see the first line of the
24 table: Hydrocortisone sales. You will see the third
25 column is full year 2015. The next column is full year

1 2016 and the next column is full year 2017.

2 I just wonder in light of that if you could comment
3 on the time horizon in which you were in fact expecting
4 this cash-cow to continue?

5 A. Very short term.

6 Q. I am grateful. Could I ask you next about another
7 matter that -- another presentation that was put to you
8 which is -- I think we can find it at {H/790/35}.

9 Mr Bailey asked you a number of questions about what he
10 called the high absolute profit margin and the high net
11 margins of Hydrocortisone, and you see here the
12 Hydrocortisone profitability projections along with the
13 other top ten products of Actavis in the United Kingdom.

14 He did not show you I think the right-hand column
15 which are the net margins of each of these products that
16 were predicted. I wonder whether you would like to
17 comment on how Hydrocortisone compares in its net
18 margins to the other products there?

19 A. Similar, and that is why Hydrocortisone did not get
20 flagged as a bit of an issue because it was in the
21 margin profile of other products that we had in our UK
22 business.

23 Q. Thank you. One final question, you were asked about
24 [REDACTED]. What happened to [REDACTED]?

25 A. It is my understanding she retired after the Teva

1 transaction was completed.

2 MR JOWELL: Thank you. I have no further questions, sir.

3 THE PRESIDENT: Mr Jowell thank you very much.

4 Mr Stewart, thank you very much for your time. Safe
5 trip back to the United States and you are released from
6 the witness box. Thank you very much.

7 A. Thank you very much.

8 (The witness withdrew)

9 Housekeeping

10 THE PRESIDENT: That concludes the evidence, as I understand
11 it. You are now haring off to produce some closing
12 submissions. Good luck with that. I have three short
13 housekeeping points to raise and if any of you have
14 housekeeping points, then now is the time I think to
15 raise them.

16 First off, Mr Jowell, you were not here this morning
17 but I went through, using the professor as a sounding
18 board, a series of what I called oddities which is
19 probably not a phrase that we will carry on using in the
20 market but areas where we would think we need to be
21 particularly careful in finding the facts. There is an
22 additional one which is the evidence that we have heard
23 regarding the fixed capacity in the market, that there
24 were only a certain number of products sold per month of
25 10mg Hydrocortisone. So that I just add to the list so

1 that you know what is going through our minds about
2 things that we are going to pay particular attention to
3 on the facts.

4 Secondly, we mentioned this before the evidence
5 began, but it is particularly stark in the context of
6 the witness evidence that we have just heard which is
7 the significance of the moving in and out of an entity
8 that was, if the CMA are right, infringing competition
9 law but was doing so unknown and perhaps uncontrolled by
10 the parent organisation.

11 I did say before the evidence began that that was
12 something which struck us as quite unusual in terms of
13 the way in which computing penalties normally is
14 assessed and it is something on which I think we would
15 be greatly assisted by the parties' submissions and
16 I think the evidence that we heard from Mr Stewart made
17 that point particularly stark. It arises at a number of
18 points in the history and it is the explanation of why
19 we have so many counsel teams dealing with an entity
20 that shape shifts over time.

21 It may be that has been dealt with before in which
22 case please do tell us but it seem to me this is quite
23 a stark example of that and, in a sense, it raises the
24 question of whether one can have a regime of static as
25 opposed to dynamic or dynamic as opposed to static

1 penalties as well as a competition.

2 So that is the second point. The third point arises
3 in relation to the figure which one finds in the
4 Decision. It is figure 1.4 on page 22 of the Decision.
5 One of the things that we have been considering is just
6 how the educated passenger, not an economist, on the
7 Clapham omnibus would want us to explain the outcome of
8 our judgment, whatever that outcome might be.

9 If you look at the graph on figure 1.4 -- why do we
10 not put it on the screen, yes, indeed. I do not have
11 the --

12 PROFESSOR MASON: {K/60/1} is the revised figure.

13 THE PRESIDENT: Let us go to the Decision. I mean it has
14 been corrected, but for the purposes of this point it
15 does not matter. So can we go to whatever the reference
16 to the Hydrocortisone Decision is.

17 PROFESSOR MASON: {IR-A/12/22}.

18 THE PRESIDENT: Do you all have in some shape or form this?
19 I mean, I think I can make the point without having the
20 document up on screen. It is figure 1.4, prices and
21 costs of Hydrocortisone tablets between January 2006
22 and April 2021. It has been corrected but it is
23 figure 1.4 in the Decision.

24 In one sense, this graph could actually be a graph
25 of the face mask analogy that we have used a couple of

1 times. What you have got is a perfectly low price
2 pre-Covid when no one really wants face masks. You have
3 got a period where suddenly demand for face masks shoots
4 up and everybody wants one but very few people can
5 supply them. So the price shoots up. You then get an
6 increase in supply and the price goes down, so that you
7 hit the prior price that existed here.

8 So the layman on the Clapham Common Omnibus any bus
9 would be able to understand literally in a sentence why
10 we have this mountain between book ends to low valleys
11 where the price is far lower.

12 What I think the person on the Clapham omnibus would
13 expect us to be able to say in our decision is in
14 a sentence or two why we have this graph here because we
15 do not have Covid or anything like that and it seems to
16 us that that is something that we are quite keen to
17 encourage the parties to assist us on. We anticipate
18 that the point is not going to be capable of
19 articulation by reference to a couple of sentences
20 because of the complexities of the regime that we are
21 talking about and we suspect that is the answer.

22 But we are very keen to deal with the mountain, as
23 I call it, between the two low points because it seems
24 to us that unless one has got an explanation for why it
25 occurs you do not actually need to worry about the

1 competition from skinny or anything like that. You
2 simply have got a very large series of spikes,
3 book-ended by two low prices and that in and of itself,
4 it seems to us, is something that is requiring of
5 explanation.

6 So that is a point for you to think about because it
7 is on our minds and since it is on our minds, it seems
8 to be only fair that we articulated it for better or
9 worse for you to come back on, and that is really the
10 point of our raising that now.

11 We do not yet know, I think, exactly what structure
12 the rail strikes next week will have. Do you have any
13 firm views about 10 o'clock versus 10.30 because we will
14 do our very best to accommodate.

15 MR JOWELL: My understanding is I think we are all content
16 with 10.30.

17 THE PRESIDENT: That is very helpful. We will obviously try
18 to accommodate really in the short adjournment any extra
19 time but I think the problem is it is going to be 10.30
20 and 4.30 without really any prospect of extension after
21 4.30 but thank you for that indication. We are really
22 very grateful and I know the CAT staff will be thankful.

23 Are there any other points that you need to raise?

24 Mr Jowell you are on your feet.

25 MR JOWELL: Not from our side, sir, and we are very grateful

1 for the tribunal's time and we will certainly be looking
2 forward to next week to addressing you on all of these
3 issues. Thank you.

4 PROFESSOR HOLMES: May I raise just two other practical
5 points in relation to the closings. One is I am sure
6 you have been discussing amongst yourselves the order of
7 batting amongst the appellants, and I recall Mr Brealey
8 mentioned that he would be addressing us on Friday. If
9 you could give us indication of that.

10 MR JOWELL: Certainly. Ms Ford will start. She will be on
11 Tuesday and Wednesday. I will follow on Thursday
12 addressing you on the Allergan specific issues. Then
13 I think it is Mr Brealey on Friday and the beginning of
14 Mr O'Donoghue and then we have Mr Palmer on Monday.
15 Mr Palmer and Mr O'Donoghue on Monday.

16 THE PRESIDENT: That is very helpful. The other practical
17 point, speaking personally, if it was possible to
18 produce hard copies of the closing submissions and we
19 gave you appropriate details, I would be grateful if
20 those could be sent to us.

21 MR JOWELL: Yes, I think there is already a deadline for
22 those.

23 THE PRESIDENT: Saturday I think.

24 MR JOWELL: Is it Saturday, yes?

25 PROFESSOR HOLMES: Exactly.

1 MR JOWELL: We will certainly provide hard copy. How shall
2 we get those hard copies to you?

3 THE PRESIDENT: We will communicate through the registry to
4 the parties and give you addresses to send them because
5 it will not clearly be the tribunal address that will be
6 the relevant one but I will ensure that you have that
7 information.

8 PROFESSOR HOLMES: That is the only reason why I raised it,
9 thank you.

10 MR JOWELL: In the case of my client of course we have
11 already put in officially a closing submission. We will
12 put in an additional, if we may, with your permission
13 a very brief document purely addressing the evidence
14 that you have heard today.

15 THE PRESIDENT: Of course.

16 MR JOWELL: That will be a very short document.

17 THE PRESIDENT: I see no one else rising to their feet.

18 Thank you all very much and we look forward to
19 seeing you on Tuesday. Thank you.

20 (4.30 pm)

21 (The hearing adjourned until Tuesday, 13 December at
22 10.30 am)

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