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IN THE COMPETITION
APPEAL TRIBUNAL

Case Nos. 1275/1/12/17
1276/1/12/17

Victoria House,
Bloomsbury Place,
London WC1A 2EB

22nd November 2017

Before:

PETER FREEMAN CBE QC (Hon)
(Chairman)
PAUL LOMAS
PROFESSOR MICHAEL WATERSON

(Sitting as a Tribunal in England and Wales)

BETWEEN:

FLYNN PHARMA LTD AND FLYNN PHARMA (HOLDINGS) LTD Appellant

- and -

COMPETITION AND MARKETS AUTHORITY Respondent

- and -

PFIZER INC. AND PFIZER LIMITED Appellant

- and -

COMPETITION AND MARKETS AUTHORITY Respondent

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HEARING – Day 11

APPEARANCES

Kelyn Bacon QC, Ronit Kreisberger and Tom Pascoe (instructed by Macfarlanes LLP)

Mark Brealey QC, Robert O'Donoghue QC and Tim Johnston (instructed by Clifford Chance LLP)

Mark Hoskins QC, David Bailey, Hugo Leith and Jennifer MacLeod (instructed by CMA)

1 Wednesday, 22 November 2017

2 (10.30 am)

3 Closing submissions by MS BACON

4 THE CHAIRMAN: Ms Bacon, good morning. No more footnotes
5 for us, I hope.

6 MS BACON: No more footnotes. Sir, I am not going to repeat
7 the contents of my written closings, I am going to take
8 those as read. What I propose to do today is to go
9 through the CMA's closing submissions, broadly in the
10 order in which those submissions are made in the CMA's
11 document, and set out our answers to those points.

12 Can I start with a general point. There are
13 obviously many issues on which we disagree with the CMA
14 on the interpretation of the evidence, and that is to be
15 expected and you will be hearing submissions from
16 everyone and you will come to your own view on that.

17 What troubled us is that there are numerous points
18 in the CMA's written closing submissions where the CMA
19 has simply got facts wrong, or made propositions that
20 are squarely contradicted by witness or expert evidence
21 that was not challenged in cross-examination, or has
22 mis-stated what the witness said, or has selectively
23 cited from the witness's evidence in a way that gives
24 quite a false picture of what the witness actually did
25 say.

1 I am not merely making that as a forensic point.
2 Of course it is to be expected in litigation that
3 the parties will come to the court and highlight bits of
4 the evidence that advance their case. But this is not
5 normal commercial litigation, the CMA is a competition
6 regulator, it has imposed fines of many millions of
7 pounds on my clients and Pfizer and it is
8 a quasi-criminal penalty.

9 So those features, in our submission, make it all
10 the more important that the CMA is scrupulously fair and
11 objective in its presentation of the evidence throughout
12 the process and it is troubling to my clients that that
13 was not the case in the decision and it seems not to be
14 the case now.

15 That is of particular importance at this stage
16 because despite the chairman's request for brevity last
17 week, the CMA's document is 133 pages long, or 147 pages
18 if you include the two annexes, and there are a total of
19 I think 843 footnotes. We had three days to review all
20 of that before we came into court yesterday morning and
21 we have only a day to make our submissions now.

22 I am sure the tribunal is going to review very
23 carefully all of the parties' submission but the
24 tribunal might be excused if it does not necessarily
25 follow up every single citation and every single

1 footnote among those 843 to see if what the CMA said
2 about the facts and the evidence is actually
3 corroborated by the reference that they have given.
4 That makes it particularly concerning to us that the
5 CMA's closing submissions have those errors.

6 What we have done is to set out in a short note the
7 main instances that we found where the CMA's closing
8 submissions are, we say, clearly and obviously
9 inaccurate, whether as a matter of fact or because they
10 have misdescribed or selectively described the evidence.
11 And I have not put on that our submissions, I really have
12 only put on the note the points where we say the error
13 is obvious from the face of the document or the face of
14 the evidence. We have not tried to do a comprehensive
15 survey of everything, but it will I hope save me from
16 going through some of the points in detail today and
17 hopefully it will save the tribunal from chasing up all
18 of the transcript references on those points. So
19 Mr Pascoe is going to hand that up.

20 I am going to refer to most but not all of the
21 points as I go through my submissions today. There are
22 a few points that are smaller points of detail which the
23 tribunal can read. (Handed)

24 THE CHAIRMAN: Ms Bacon, I think there is one set of issues
25 as to whether you and your clients have sufficiently

1 covered the evidence.

2 MS BACON: Yes.

3 THE CHAIRMAN: There is another set of issues as to whether
4 we are in a position to do so. Would it help you if
5 I said we are not going to give judgement on Friday
6 afternoon?

7 MS BACON: Yes, obviously I am not expecting that. But
8 there are points of detail there. The point is I just
9 do not have time to go through all of them today.

10 THE CHAIRMAN: This is homework.

11 MS BACON: It is partly homework, and I will refer to some
12 of those today in an attempt to shorten what I need to
13 say orally but I am not going to go through all of them.

14 THE CHAIRMAN: We have quite a lot of homework.

15 MS BACON: I apologise for giving you even more.

16 What I am going to do today is mainly be looking
17 at two documents, the CMA's written closings and I will
18 refer to our written closing submissions, and in passing
19 I will be referring to that note that I have just handed
20 up to make some of my points more shortly.

21 THE CHAIRMAN: Very good.

22 MS BACON: I am going to start with market definition and
23 dominance which I will broadly take together.

24 As you will have seen, it is common ground now that
25 it is necessary to look at the evolution of the market

1 over time. But what I think the tribunal can usefully
2 do is to break down that period of time into different
3 subperiods when one can observe that different things
4 were going on. I am not saying that one should define
5 different product markets for different periods. What
6 I am saying is that as an analytical tool, we can
7 recognise that there was an evolution in a proper sense
8 of the word rather than an identical pattern of
9 competition throughout the period and we can look at how
10 the evolution occurred.

11 So for the purpose of my submissions on market
12 definition, I am going to break the relevant period into
13 four distinct periods. First of all the period before
14 NRIM entered the market, so that is September 2012 until
15 April 2013. Secondly, April to November 2013, so that
16 is the period before the MHRA guidance. Thirdly, the
17 period just after the MHRA guidance, November 2013 to
18 May 2014. And then May 2014 onwards. You will see why
19 I have done that when I -- well, it is probably obvious
20 to you already.

21 The first period, we can take that quite shortly.
22 That is the period when only Flynn and parallel imports
23 are on the market. The two points to note about that
24 period were that NRIM had got its marketing
25 authorisation by then, it had got it in September 2011,

1 and Flynn fully expected there to be generic
2 competition. We have given the references to that at
3 paragraph 50A of our closing submissions and footnote 67
4 so I do not need to take you to those references. So
5 that is, if you like, the prequel or the lead in to the
6 competition that we know did occur in period number two.

7 So period number two is April 2013 to November 2013
8 and that is the period when NRIM first launched and
9 there is no doubt at all that NRIM's product was
10 substituted for Flynn's during that period. The two
11 biggest pharmacy chains in the UK, Boots and Lloyds,
12 switched the majority of their customers to NRIM's
13 product. You can get an idea of how quickly Boots'
14 purchases of NRIM's product ramped up from looking at
15 the Alliance data. The Alliance data, for your note, is at
16 bundle I1, tab 21, but it is one of those spreadsheets
17 which is very difficult to read so I am going to hand
18 you up an enlarged version of it, an A3 version.

19 I do not think we have looked at this before. You
20 will have seen in my closing submissions that I referred
21 to the Alliance top 20 data because there was a set of
22 a number of spreadsheets and that only went up to, as
23 you will have seen from my opening submissions, around
24 June/July 2014. But what we also have which I do not
25 think I referred to in opening was this top 10 data set,

1 and these data only concern NRIM's sales, so Alliance's
2 sales of NRIM's product, but helpfully they do cover
3 a longer period of time. So they go from the
4 point at which just after NRIM launched, so June 2013,
5 and this data set goes up to February 2016. So unlike
6 the top 20 data set we do have an idea of what was going
7 on after May 2014 and I think it is very instructive to
8 look at that. I am going to come on to that for my
9 period four.

10 But for the purposes of period two, you just need to
11 look at the top line of that which is the Boots data.
12 So just to remind you, period two is April to
13 November 2013 and you can see how quickly Boots switched
14 to NRIM in that period and the kind of volumes that were
15 being purchased of NRIM's product through Alliance.

16 The various tables and graphs that I took you to in
17 opening also show during that period NRIM's market share
18 shooting up and Flynn's plummeting. That is, taken with
19 these purchasing data, we say, crystal clear evidence of
20 substitution during that period. In fact, Flynn's sales
21 of the 100mg capsules declined from an average of
22 I believe around 35,000 packs a month before NRIM's
23 entry to around 12,000 packs a month in the first half of
24 2016. Just for your note, I am not going to take you
25 to the documents, but those figures can be derived from

1 the documents at J1/13 and J2/70.

2 In the entirety of the CMA's closing submissions the
3 only acknowledgment of this very significant switching
4 is a few words in paragraph 60 where they say, and
5 I quote:

6 "Whilst some switching did take place in this
7 limited period ..."

8 That is it. But it was not just "some switching",
9 it was the wholesale switching of the majority of the
10 customers of the two largest pharmacy chains in
11 the country. You can see that from looking at the
12 figures that I believe you have already been taken to of
13 Lloyds' purchase data up to July 2014, because we have
14 that, and that is just for your note at I1/30, and then
15 the Boots' purchases of NRIM and Flynn in this
16 spreadsheet that I have just shown you.

17 We also have the top 20 spreadsheet which shows
18 exactly Flynn and NRIM during that period. This
19 spreadsheet I have just shown you only has NRIM.

20 So you can see there the switching of product from
21 Flynn to NRIM so there is no doubt that NRIM was being
22 substituted for Flynn on a huge scale in this period.
23 Yes, it was two major customers, but they were the two
24 largest pharmacy chains in the country. So in our
25 submission there is no doubt that during that period

1 Flynn and NRIM must be regarded as having been
2 substitutable and on the same product market.

3 Moving on then to the third period, so November 2013
4 to May 2014, and that is then after the MHRA guidance.
5 There are three main things to note during that period
6 and I am going to go through them in turn just to say
7 what they are. First of all it is going to be volumes,
8 secondly price changes, and thirdly evidence of pharmacy
9 purchases, so again back to the Alliance data.

10 So in terms of volumes, maybe you could look at the
11 graph that I handed up in opening at N6. This shows
12 volumes of 100mg doses, so the period is essentially
13 between the two vertical lines that have been drawn on
14 the graph. You can see during that period that there
15 was still considerable volatility of volumes both in
16 terms of Flynn's volumes and NRIM's volumes of sales.

17 The CMA has not come up with any explanation for
18 that that would fit its case that after November 2013
19 pharmacies suddenly stopped switching. So the market
20 data alone, just looking at the volumes, showed that for
21 at least six months after the NRIM guidance -- this is
22 my period three -- market shares were continuing to
23 change back and forth, and that is only consistent with
24 NRIM being substitutable and substituted for Flynn and
25 the reverse during that period, because one of the

1 things is we see Flynn has a spike in around April 2014
2 when it reduced its prices.

3 So that brings me on to the second of the features
4 of that period which is the price change. The CMA says
5 that Flynn actually increased its prices for a short
6 period at the start of 2014 and that is actually the
7 first time that the CMA has ever made that point and we
8 have dealt with it at paragraph 2, number 2 of our
9 errors note.

10 The apparent price increase then actually relates to
11 a credit, in other words, a reduction or reimbursement
12 granted by Flynn to one of its customers at around that
13 time. We have gone back to see what caused it, and what
14 happened was the way that the credit was recorded on the
15 system of Flynn' pre-wholesaler, UDG, made it look like
16 Flynn's sales volumes to that customer had been reduced
17 by 1700 packs. I saw the data yesterday and we can
18 provide that to you if you need it. But there is
19 a reduction going through of 1700 packs. Of course it
20 is a nominal reduction, we did provide those packs to
21 the pre-wholesaler, but that is the way that the
22 reduction in price, the rebate, was accounted for on the
23 UDG system. So because it made it look like we sold
24 them 1700 packs less, that had the effect of inflating
25 the ASPs, and that is the reason why it looks like

1 Flynn's prices increased during that time. In fact the
2 actual selling prices did not change at all. So that is
3 why there is that apparent price raise. It was not that
4 we put our prices up, it was actually caused by
5 a reduction in price.

6 The reason why none of this is in the evidence is
7 because the point was not put to us until the CMA's
8 closing submissions. What we have seen is graphs where
9 we see prices going up and down, and I will come to the
10 general kind of wiggleness in a minute. But the CMA
11 never said and did not ask Mr Walters, it never asked us
12 during the administrative procedure "Why does it look
13 like your ASPs went up at that point in time when you
14 say you were under price constraint from NRIM?" But
15 that is the answer and that is why I am giving it to you
16 now on my feet.

17 So we can leave this point about the apparent price
18 rise aside and we then turn to our actual price
19 reduction in April 2014. Now, there is no dispute that
20 the initial talks with Pfizer were sought on the basis
21 of the prior agreement with Pfizer. We said that in our
22 closing submissions and Mr Walters was quite candid in
23 accepting that during his cross-examination. But the
24 question is why Flynn passed on that price reduction to
25 its customers by reducing its price.

1 We know that Pfizer's price was not tied to Flynn's
2 resale price, and Mr Poulton said that in
3 cross-examination. It is also a point that was made
4 yesterday. They did not know what our resale price was
5 and they did not influence it. We set the resale price.
6 So there was no reason why in principle, having got the
7 price reduction that had been essentially pre-agreed, we
8 couldn't if we had wanted to, and if we really were in
9 a market of our own, Flynn could have simply kept the
10 extra profit. But what it did was to implement
11 a substantial reduction across the two strengths where
12 its product directly competed with NRIM, so the 100mg
13 and the 300mg.

14 Just for your note, the references to the reductions
15 for those two strengths are at paragraph 3.169 of the
16 decision.

17 There are two competing explanations or, if you
18 like, theories as to why that happened. Flynn's
19 position is that that was due to competitive pressure
20 from NRIM, and Mr Walters' evidence in his witness
21 statement was unequivocal. In paragraph 53 of his
22 witness statement he said Flynn's price reduction was in
23 response to the launch of NRIM's capsules. That is our
24 explanation. The CMA's theory is that it was not due to
25 competitive pressure from NRIM; it is not really clear

1 what they say was the reason, but they say it was not
2 competitive pressure from NRIM because there was not
3 sufficient competitive pressure. And they make various
4 points to say why they think there was not sufficient
5 competitive pressure from NRIM at that time.

6 So we now take up their closing submissions, and
7 I am going to go through the points in the order that
8 they are made in the closing submissions. This section
9 is the source of a number of points in my errors note so
10 it might be helpful to have the errors note to hand as
11 well.

12 The first point: 47(d) makes a short point about
13 an email from Pfizer to Flynn. That is inaccurate for
14 the reasons given at number 3 of my errors note. I do
15 not need to spend any time on that now.

16 More significantly 47(e) and (f) say that at the
17 time the price reduction was sought from Pfizer, NRIM
18 was not a significant concern to Flynn. That is correct
19 but only as far as it goes because Mr Walters said two
20 other things. The first was that -- sorry, are you up
21 with me?

22 THE CHAIRMAN: Yes.

23 MS BACON: So Mr Walters said he did say at the time that
24 the reduction was sought from Pfizer, NRIM wasn't a
25 significant concern. But he gave two further points.

1 The first was that there was a reason why he was not
2 initially concerned about NRIM and that was that he
3 expected NRIM to go after a certain amount of market
4 share, which he put in his first witness statement at
5 around 30 to 50 per cent, and after that they expected
6 NRIM to essentially back off. They would bank the
7 market share again and then they would sit tight because
8 it was not in their economic interests to have a price
9 war after that point.

10 He made that point -- I am just giving you the
11 transcript references -- he made that point twice in his
12 cross-examination. The first point was on Day 4,
13 page 104, and the second time he said it was at page 134
14 and that second reference is also on my errors note, it
15 is in response to another point later in the CMA's
16 submission. It is number 10.

17 So number 10, the bit that was not in the CMA's
18 submissions was the words:

19 "We expected to lose some market share to them and
20 our intelligence told us their usual habit was to take
21 it to a certain level and then basically desist."

22 So that was the first point, that was why initially
23 he was not that concerned about NRIM. But his second
24 point that he made in response to Mr Hoskins' questions
25 about this was that by the time the price reduction was

1 actually agreed with Pfizer, which was the start of
2 2014, Flynn had realised that NRIM was more of a concern
3 because they had become aware of NRIM's deal with
4 Auden Mckenzie.

5 Paragraph 47(g) of the CMA's closing submissions
6 says that Mr Walters' evidence on this point was not
7 credible because the acquisition of NRIM by
8 Auden Mckenzie was not until later. This is quite
9 an important point and it is number 4 on my note. It is
10 an important point because the CMA is basically accusing
11 Mr Walters of lying. But as we have set out in our
12 note, his evidence on that point was completely truthful
13 and corroborated by the contemporaneous evidence.

14 It might be good to just go and see what he said
15 first. That is Day 4 of the transcript, page 136, lines
16 15 to 21. Mr Hoskins asked.

17 "Question: You have just told the tribunal that NRIM
18 was not a significant concern to you in these
19 negotiations."

20 Then he says:

21 "Answer: That is correct. But it became obvious to
22 us in that period, interim period, which is a couple of
23 months, basically, that we were beginning to lose more
24 sales, and once we investigated it thoroughly, this
25 started to relate to the deal that was done with

1 Auden Mckenzie. So this the start of our problems with
2 Boots."

3 So that is the point that the CMA is referring to
4 and they say it is not truthful. But Mr Walters was
5 actually talking about the deal between NRIM and
6 Auden Mckenzie for NRIM to supply Boots through
7 Auden Mckenzie. And the reason why he did not give more
8 detail at that point was he already mentioned this a bit
9 earlier in his cross-examination at page 124.

10 On page 124, lines 12 to 15, he said:

11 "Answer: And then secondly, Auden McKenzie, when
12 NRIM started supplying their products to Auden McKenzie.
13 Then ultimately, of course, they sold the product to
14 Auden McKenzie."

15 So he is making two points. The first of those
16 sentences, "when NRIM started supplying their products
17 to Auden Mckenzie", that was the deal where NRIM
18 supplied to Auden Mckenzie and Auden Mckenzie would then
19 have the supply route to Boots. Then he said, "Then
20 ultimately, of course, they sold the product to
21 Auden Mckenzie." That is talking about the acquisition.

22 So he had already made that point. And we know
23 about the deal between NRIM and Auden Mckenzie for
24 Auden Mckenzie to supply into Boots because we have
25 three Section 26 notices which refer to the point and

1 I have set out the references to those. We have NRIM
2 Section 26 response, Auden Mckenzie Section 26 response
3 and Boots Section 26 response, all corroborate this
4 point. And we also know when Flynn found out about it
5 because we have an internal Flynn email from
6 December 2013.

7 So Mr Walters' statement in cross-examination was
8 completely correct and it was corroborated by the
9 evidence on the CMA's file.

10 PROFESSOR WATERSON: Could you remind me, Ms Bacon, who is
11 Auden Mckenzie? At what stage are they in the picture?

12 MS BACON: They come in at several stages but for this
13 purpose NRIM was using them to supply to Boots. But
14 they are another pharmaceutical company.

15 PROFESSOR WATERSON: Are they a wholesaler?

16 MS BACON: No, they are not a wholesaler. But I think the
17 point was, and it is in the Section 26 responses, that
18 Auden Mckenzie had an established relationship with
19 Boots and so NRIM realised that it would need some way
20 of getting into the Boots pharmacy. So it used
21 an arrangement with Auden Mckenzie that it would supply
22 into Boots through Auden Mckenzie, and that was borne
23 out in the Section 26 responses, and that was what
24 Mr Walters was talking about.

25 THE CHAIRMAN: So it was a different deal.

1 MS BACON: It was a different deal, and it was a different
2 deal that he had already referred to in his evidence.
3 But in cross-examination Mr Hoskins did not say "What
4 deal are you referring to?" If he had asked that
5 question, Mr Walters could have answered it.

6 MR HOSKINS: Or in re-examination.

7 MS BACON: I do not think I needed to re-examine on the
8 point because I did not know it was going to be put
9 against me that he was lying on a point which -- we knew
10 what he meant by the deal with Auden Mckenzie. As
11 I said, he had already referred to it earlier in his
12 cross-examination.

13 That deals with 47(g). 47(h) says that Pfizer's
14 later letter, this is a point that made a comment about
15 competition, was after the parties had become aware of
16 the CMA investigation. As you will recall, Mr Hoskins
17 did put that point to Mr Walters and his response was
18 robust. He said:

19 "We didn't have a clue where the CMA were going at
20 that stage."

21 So that is 47(h). Then 48. 48 -- still going
22 through the CMA's submissions -- makes a delay point and
23 claims that the delay in implementing the price
24 reduction showed that Flynn's price decrease was not
25 a result of competitive pressure from NRIM. That is

1 another non-point, it has been addressed in evidence.
2 The agreement with Pfizer was in February 2014.
3 In March 2014, just over two weeks after the agreement,
4 Flynn notified the Department of Health of the price
5 decreases, and the price reductions were ultimately
6 implemented on 1 April. It is a pretty short period of
7 time.

8 Mr Walters did explain that fully in his first
9 witness statement and his account was not challenged in
10 cross-examination. Mr Hoskins did not put it to him
11 that in some way Flynn delayed unreasonably in passing
12 on the price reduction to its customers. So the CMA's
13 argument on this is therefore contradicted by
14 Mr Walters' evidence that was not challenged.

15 I am obviously not taking the point that Mr Hoskins
16 had to put each and every paragraph of the witness's
17 evidence to them in cross-examination, but this is not
18 a peripheral point because it is being used against
19 Flynn to say: you delayed, therefore there was not
20 sufficient price constraint from NRIM. And that is an
21 issue that goes to the heart of the case on market
22 definition and dominance.

23 So that is paragraph 48.

24 49 says that Flynn's pricing behaviour was not
25 consistent with competitive pressure from NRIM. And 49

1 then goes through the prices of the different strengths
2 over the period after April. That is another non-point.
3 The first point to note in response is that the price
4 reductions, as I have said, were for the 100mg and 300mg
5 capsules and those were precisely the capsules that did
6 face competition from NRIM.

7 PROFESSOR WATERSON: I am a bit puzzled about the 300mg capsule here.

8 MS BACON: Because if you have a Flynn 300mg capsule you can
9 substitute that by three NRIM 100mg capsules, but you cannot do
10 that so easily with, say, 50mg capsules unless you can break the
11 100mg capsule in two. That is why.

12 So it was the two strengths. The two strengths
13 where the price was reduced were precisely the ones
14 where Flynn faced direct competition from NRIM and that
15 in itself is telling. But the other issue here, and
16 this is the point that is being made in paragraph 49, is
17 the price variations.

18 Can you look at the CMA's graph at N18. This is the
19 graph that plots the price variations against the drugs
20 tariff. There is a letter and then behind the letter
21 there is the actual graph. It is just a convenient
22 point to pick up the average selling prices.

23 I am not going to refer to the actual figures
24 because these are confidential, that is why the entire
25 diagram is blue. But what you can see is that Flynn's

1 ASPs for the 100mg, they did wiggle around a bit after
2 April 2014 but they remained considerably below the
3 previous price. And then you will see that by about
4 August or September of 2014 they had stabilised at below
5 the pale grey line that you can see just above Flynn's
6 blue line. I am saying that because I cannot read out
7 the figure. But you will see there is a pale grey line
8 which represents a figure on the chart and Flynn's ASPs
9 had stabilised at below that by around August/September
10 2014.

11 What Mr Hoskins did was to take Mr Walters through
12 the ASP figures and say, "Do you agree those were the
13 figures?" And Mr Walters unsurprisingly said, "Yes,
14 those were the figures on the page." But what
15 Mr Hoskins did not ask him was why there were
16 month-on-month variations in ASPs for the different
17 strengths. Again, that is something the CMA has never
18 asked Flynn. If it had asked, we would have been able
19 to explain that the variations in the ASPs, so the
20 wiggleness if you like, occur mainly because of two
21 things. The first is that Flynn supplies into two
22 channels, wholesalers and hospitals.

23 MR HOSKINS: I am concerned we are venturing in evidence.

24 Because Ms Bacon can make what comments she likes about
25 what we have done, she can make what comments she likes

1 on the way I have cross-examined, she had a chance to
2 re-examine, but it is not appropriate now to stand up
3 and try and fill in the gaps at this stage of the case.

4 THE CHAIRMAN: I rather agree.

5 MR HOSKINS: I do not know where she is going so I am sorry
6 if I am pre-empting but you will understand my concern.

7 THE CHAIRMAN: You did say: had this evidence been put you
8 would have been able to explain.

9 MS BACON: No, had the question been put.

10 THE CHAIRMAN: Had the question been put. That does sound
11 like more evidence, doesn't it?

12 MS BACON: The point is that all Mr Hoskins put to
13 Mr Walters was "Do you agree that those were the ASPs?"
14 What he did not say was "Why did the ASPs move around
15 and do you not think that that showed there was not
16 a price constraint?" That is not something that has
17 ever been said. It has never been said against us that
18 because the ASPs were wiggling up and down, that shows
19 that there was not a price constraint. He just put
20 a series of numbers to my client.

21 THE CHAIRMAN: I think you are allowed to make the point
22 that it has not been said but I am not sure you are
23 allowed to take us to evidence of --

24 MS BACON: No, I was going to explain -- okay, I can make
25 the point it was never put to my client that this was

1 because Flynn was raising its prices and lowering its
2 prices and that showed there was not a price constraint.
3 There is an explanation which could have been given and
4 it had nothing to do with Flynn raising and lowering its
5 prices. If the tribunal does not want to hear the
6 explanation then that is fine, but the point is this was
7 not put to my client, all that was put to him was series
8 of numbers. I did not know where Mr Hoskins was going
9 with this point.

10 MR LOMAS: But it is not in Mr Walters' evidence.

11 MS BACON: No.

12 MR LOMAS: In his witness statement.

13 MS BACON: No, no, it is not there. We know why there was
14 wiggleness. If you will let me explain why there
15 was wiggleness -- it was not the case that Flynn was
16 actually putting its prices up and down, they are ASPs.

17 THE CHAIRMAN: I think it is sufficient if you tell us that
18 you have an explanation and we will give that
19 appropriate weight.

20 MS BACON: Yes, we do have an explanation.

21 So the fact that the prices, the ASPs, that's the
22 average selling prices across the whole mix, go up and
23 down on this graph does not mean that Flynn was changing
24 its prices. And we weren't asked about that and
25 Mr Walters was not asked about that.

1 So that is paragraph 49.

2 Paragraph 50 is the reduced wholesaler model point.
3 That is paragraph 5 on my errors note. Again, this is
4 a point that was explained comprehensively in
5 Mr Walters' witness statement. He explained there why
6 this would not have weakened the attractiveness of the
7 product and he was not challenged on the point in
8 cross-examination.

9 Paragraph 51 claims that Mr De Coninck's evidence
10 was presented on a false basis. That is number 6 on my
11 errors note. Mr Hoskins tried to put that to
12 Mr De Coninck and got absolutely nowhere because
13 Mr De Coninck said he had not assumed anything about
14 the reasons for the price increase, his evidence simply
15 was put on the basis of the observed price movements and
16 that was also clear from the face of his report.

17 Paragraph 52 says that NRIM had to reduce its ASPs
18 to below Flynn's ASPs, and that is just not correct.
19 That is number 7 on my errors note. NRIM did have to
20 reduce its prices to below the drug tariff price because
21 otherwise its prices to the pharmacies would have been
22 above what they would be being reimbursed. But it did
23 not have to reduce its prices to below Flynn's, that was
24 a commercial decision taken by NRIM. And the only
25 plausible reason for NRIM going in below Flynn was that

1 it wanted to remain below Flynn to remain price
2 competitive.

3 So if I can then summarise on the price change
4 point, the CMA bears the burden of proof and none of its
5 arguments about the price change go anywhere. So there
6 is nothing of substance that undermines our evidence
7 that the price change, and indeed NRIM's subsequent
8 price change, were the result of price competition
9 between Flynn and NRIM.

10 Putting it another way, if you look at the totality
11 of the evidence, the only plausible explanation for the
12 fact that Flynn reduced its price, in other words it
13 passed on the price reduction that it got from Pfizer,
14 and NRIM then followed suit by going below Flynn, the
15 only plausible explanation is that there was price
16 competition between them. If there was not any price
17 competition and Flynn was in its own market it could
18 have kept the profit from the Pfizer reduction, and NRIM
19 equally could have pitched its price at the same level
20 as Flynn's; as long as it was below the drug tariff,
21 that is all it had to do, but it actually went in below
22 Flynn and stayed below Flynn.

23 You can see, going back to the graph at N6, the
24 result of the price changes. That is a point I made in
25 opening, that Flynn's volumes spiked precisely when it

1 reduced its prices. And then NRIM's volumes recovered
2 and Flynn's plummeted once NRIM had responded by
3 reducing its prices. That was also most likely at that
4 point partly in response to Flynn moving to a reduced
5 wholesaler model which I am going to come on to.

6 So there were three main things going on during this
7 third period: volumes, prices, and the third main thing
8 that we can see is the purchasing data.

9 So we can see from the Alliance data, that is
10 the top 20, that in around May, Morrisons and
11 Superdrug -- we can say those names now -- started
12 buying significant quantities of NRIM's product and
13 I have addressed that in our written submissions.

14 The CMA's main response to this is a de minimis
15 argument and that is at paragraph 35 of their closing
16 submissions. That paragraph is a cut and paste from
17 their skeleton argument. It was a bad point then and it
18 is a bad point now. The reason why the figures for the
19 total purchases of the products do not look large is
20 that all of Alliance's customers, other than Boots, were
21 dwarfed by Boots. Boots was by far the largest. And
22 you can see that from our top 20 table that we handed up
23 in opening at N/4 where we have the total volumes
24 purchased by Boots and the other pharmacies in
25 Alliance's top 20. And we know that Boots had already

1 switched the majority of its customers to NRIM.

2 So the relevant question is not what proportion of
3 the total Alliance sales was made up out of the trio of
4 Morrisons, Superdrug and Walter Davidson, the relevant
5 question is what proportion of the remaining sales they
6 made up. If you like, the contestable sales. What
7 proportion of the Alliance contestable market was made
8 up by Morrisons, Superdrug and Walter Davidson. And the
9 figure for that is set out at paragraph 37(a) of our
10 written closings. I will not read that figure out in
11 open court because it is likely to be confidential.

12 It is the last sentence of the big paragraph under
13 37(a):

14 "Put another way, these three customers
15 represented ..."

16 And then X per cent:

17 "... of the non-Boots purchases of 100mg capsules
18 from Alliance during that period."

19 MR LOMAS: But you do accept they are a tiny percentage of
20 the total market.

21 MS BACON: Of the total. Of the total. But the point is
22 that Boots was massive and everyone else was small in
23 comparison.

24 MR LOMAS: Understood.

25 MS BACON: But Boots had already switched. So if we are

1 saying, well, what else was happening? A whole chunk of
2 the market had switched. It is relevant to look at what
3 happened with the rest of the market because we already
4 have had the switching, it has happened in relation to
5 Boots. The question is what did everyone else do after
6 November 2013? And what we see here is that three
7 customers who made up X per cent of the rest of
8 Alliance's sales, and X per cent being a large figure,
9 did switch.

10 Before Mr Hoskins jumps up as he did yesterday and
11 says, well, okay, what happened in May 2014 was that
12 Flynn switched to a reduced wholesaler model and stopped
13 supplying directly to Alliance. We have dealt with
14 that, I have anticipated the point and that is dealt
15 with at the very next paragraph of our closing
16 submissions. It is entirely right that the fact that
17 Flynn's sales through Alliance go down to zero around
18 May 2014 is due to Alliance not directly supplying
19 Flynn's product after then. So that is why the Flynn
20 figure plummets.

21 What that does not explain is that the fact that the
22 NRIM purchases from those customers went up to almost
23 the same levels as their previous Flynn purchases had
24 been. So we know this is a declining market, so it is
25 not that NRIM was going up and they were buying the same

1 quantity of Flynn from somewhere else. So what the
2 figures suggest, given that we know it is a declining
3 market, is that the customers, they were probably
4 getting some Flynn from somewhere else, one of the other
5 wholesalers that would supply it, but because of the
6 quantity of NRIM that they were purchasing that very
7 much suggests that the sum that they were buying of
8 Flynn was not very much because the delta between their
9 NRIM purchases and their previous Flynn purchases is not
10 very large.

11 That is why we say that on their face, and we do not
12 presume to say these data are complete but this is the
13 best we have. On their face the data do indicate
14 substantial switching by those pharmacies of the
15 majority of their customers from Flynn to NRIM. That
16 should have put the CMA on notice that there was still
17 switching by major pharmacy customers many months after
18 November 2013, because Morrisons and Superdrug switched
19 in May 2014, six months after the MHRA guidance. And
20 that is prima facie evidence that the continuity of
21 supply principle was not being followed by major
22 pharmacies representing, as I said, X per cent of the
23 remaining market for Alliance's sales in May 2014.

24 Now, as I said, we know the data are not complete.
25 It would not have been difficult for the CMA to get

1 exactly those figures from the other wholesalers. It
2 just had to ask. It could have asked "Give us the same
3 data that we have just had from Alliance. Give us
4 a spreadsheet with all of your sales of NRIM and Flynn
5 for the whole of the relevant period". That would have
6 enabled the CMA to corroborate the Section 26s with
7 actual hard data of what the pharmacies were purchasing.

8 So they could have seen if, say, Morrisons and
9 Superdrug did actually switch to buying loads and loads
10 of Flynn from one of the other wholesalers, or whether what
11 was actually happening, as I suggest from the figures,
12 is that they probably got some Flynn from somewhere else
13 but not nearly as much as they were previously buying
14 from Alliance.

15 In the grand scale of things, asking a few
16 wholesalers for a few spreadsheets would not have been
17 a very difficult exercise. But it is an exercise the
18 CMA can carry out. We cannot. We are limited to what
19 the CMA did get, and all we have is the Alliance data,
20 so we have to do the best we can from the evidence we
21 have.

22 So drawing all of that together, what conclusions
23 can be drawn about this third period, November 2013
24 to May 2014? Number one, we know that volumes were all
25 over the place and that indicates substantial switching

1 both ways. Number two, we know that there were price
2 reductions from Flynn and then NRIM and the CMA has not
3 shown that those reductions were caused by anything
4 other than price competition between the parties.
5 Number three, the market share data and the volumes data
6 indicate that the price reductions caused spikes in
7 first Flynn's sales when it reduced its price and then
8 NRIM's when it followed suit, so it indicated that
9 the market was responsive to the price change. We also
10 know that major pharmacies such as Morrisons and
11 Superdrug started switching to NRIM from as late as
12 May 2014.

13 That all, in our submission, indicates that during
14 that period, that is my period number three, NRIM's and
15 Flynn's products were still very clearly being
16 substituted for each other and were competing on price.

17 Then we come to the fourth period which is May 2014
18 onwards. There is some common ground there. All
19 parties agree that from around May 2014, sales volumes
20 converged and converged increasingly. That is why from
21 that point, if you draw your trend line, the trend line
22 looks flat. So from around May 2014 onwards, Flynn's
23 and NRIM's sales were broadly the same in relation to
24 the 100mg on around a third of the market each.

25 There are two possible explanations for that. Our

1 explanation is that having got to around a third of
2 the market, it was in NRIM's economic interests to stick
3 at that point rather than provoking a further price war.
4 That is why NRIM's price remained broadly the same.
5 Flynn's price also remained broadly the same. Volumes
6 also remained broadly stable. That does not mean NRIM
7 was not substitutable for Flynn anymore, it just means
8 that the market stabilised. And that is absolutely
9 consistent with what we and Flynn knew -- what we know
10 now and what Flynn knew -- about NRIM's strategy from
11 what NRIM itself had said in its Section 26, it makes
12 that point and I put it in our closing submissions. And
13 it is also consistent with what Mr Walters said in his
14 evidence, in his witness statement and in his
15 cross-examination about NRIM's strategy. It is also
16 consistent with Mr Davies' evidence of competition
17 dynamics in generic markets.

18 So that is Flynn's explanation: the market had
19 stabilised but there was still competition between it
20 and NRIM, albeit not a price war for the reasons I have
21 given.

22 THE CHAIRMAN: I was going to ask you, that situation of
23 a stabilised market with some kind of guessing going on
24 as to each player's motivation and how far they would
25 wish to go and whether they would want to compete on

1 price. That in your submission is a competitive market,
2 is it?

3 MS BACON: It is not a market where Flynn is dominant. It
4 is not an intensely competitive market, and of course we
5 would not say that. It is not a market where there are
6 so many people in the market that the price rushes to
7 the bottom.

8 THE CHAIRMAN: Is it "sufficiently" competitive, to use the
9 CMA's terminology?

10 MS BACON: Well, there are two issues. The first is was
11 NRIM's product substitutable during that period? And we
12 say it was substitutable. I am going to come on to
13 evidence of more substitution. It was still going on.
14 We see that from the graph that I have handed up.

15 THE CHAIRMAN: I think the question is: is NRIM with its
16 approach to competition -- we do not know anything about
17 that more than what we have been told -- is that
18 applying sufficient pressure on Flynn's prices? That's
19 the question.

20 MS BACON: Yes. So that is why I say there are two issues.
21 One is it is substitutable enough to be in the same
22 product market, so for the purposes of market definition
23 we say yes. The second is could Flynn still be
24 dominant -- and I think this is a question you have
25 raised at several points during the hearing. Could

1 Flynn still be dominant even if NRIM was in the market?

2 And that is a point I am going to come on to. But we
3 say it was not still dominant, there was still
4 sufficient price pressure on it during that time --

5 THE CHAIRMAN: But the way you get to it is through looking
6 at price pressure --

7 MS BACON: I am going to get -- yes, there was sufficient
8 price pressure.

9 MR LOMAS: Before we do that, if you look at your fourth
10 period from May 2014 onwards and look at the Boots total
11 sales as an example, they stabilise and in fact they
12 decline by about 20 per cent over that --

13 MS BACON: Yes, it is a declining market --

14 MR LOMAS: There was a decline in total market of about
15 4 per cent a year but Boots declined by about
16 20 per cent across that period.

17 MS BACON: Yes.

18 MR LOMAS: But the NRIM product is 5 to 10 per cent cheaper
19 than the Flynn product.

20 MS BACON: Yes.

21 MR LOMAS: Boots are a profit-maximising quite
22 sophisticated, presumably, organisation with lots of
23 people running the numbers. They stood to make rather
24 greater profit from NRIM rather than Flynn, did they
25 not?

1 MS BACON: Yes.

2 MR LOMAS: So why is their NRIM purchasing declining?

3 MS BACON: It may be, and we don't deny this, it may be that
4 continuity of supply and the MHRA guidelines had some
5 effect. But it was not that it had sufficient effect to
6 put the product suddenly in their own market after that
7 point.

8 MR LOMAS: Was not Mr Walters writing to Boots making fairly
9 strong reference to the guidelines at this time?

10 MS BACON: I think that was a mainly earlier period. What
11 he was saying was they found out that Boots had suddenly
12 switched to NRIM, and indeed, as far as I understand,
13 there seemed to be some evidence that they were
14 switching patients who were coming with prescriptions
15 for Flynn's product. So it was not only that they were
16 switching patients with open prescriptions, but they
17 were switching patients who had Flynn prescriptions.
18 And one of the points he made in his evidence was that
19 they were being told that Flynn's product just was not
20 available, which Flynn was saying, well, that is not the
21 case, it is available.

22 So it is true that the Boots purchases were slightly
23 declining in that period. What you do see -- and I was
24 going to come to this also -- is that the non-Boots
25 purchases leapt up in a sort of middle period from

1 around May 2014 to around January 2015, or even
2 March 2014, and then after that there was a gradual
3 decline.

4 What this is not consistent with is the idea that
5 suddenly, either in November 2013 or at a short period
6 between then and, say, May 2014, something happened to
7 put two products that were clearly competing with each
8 other up until then into their own markets.

9 So I think it is right to say that there may have
10 been, I think as Mr Brealey said, some stickiness, but
11 it was not sufficient stickiness that two products that
12 were competing vigorously became in their own markets.
13 You can see, and I am going to take you to, the
14 non-Boots purchases because that did leap up.

15 The CMA's explanation is that the market -- I think
16 they would have to accept that the market was volatile
17 up until around May 2014. What they have to say is that
18 around that time it effectively ossified because of the
19 MHRA guidance and that NRIM's product ceased to be
20 substitutable for Flynn's. And they bear the burden of
21 proof on that point and, in our submission, they have
22 not met that burden of proof.

23 One reason why they have not met the burden of proof
24 is that they have no hard evidence of what was being
25 purchased by and dispensed by individual pharmacies

1 after mid-2014, what they have is individual purchasing
2 data from a small number of pharmacies up until around
3 that point. So there are in the Section 26 responses
4 details of what individual pharmacies purchased from
5 both Flynn and NRIM in total, as in from all of their
6 wholesalers, but only up until about 2014. We just do
7 not know what happened after mid-2014 and I do not have
8 comprehensive purchasing data from all of the
9 wholesalers who supplied NRIM's product.

10 So that goes partly to answer your point: you do not
11 know how much Boots was purchasing of Flynn's product
12 from other wholesalers, you just know they were not
13 purchasing -- there comes a point at which the NRIM
14 product starts to tail off but you do not know whether
15 that is because people were not buying from Boots, or
16 whether it was because people were still buying from
17 Boots and they were buying lots of Flynn from one of
18 the other two wholesalers because we only have
19 an incomplete picture of what is going on.

20 THE CHAIRMAN: Can I be clear, you are not putting to us
21 that you can prove that the market was competitive, you
22 are putting to us that you can see enough movement to
23 indicate somebody should have looked at it in more
24 detail?

25 MS BACON: Yes. So I am saying we have put forward

1 a plausible explanation, and the CMA has not proven the
2 opposite, and it bears the burden of proof.

3 THE CHAIRMAN: That is the same as -- we put that to
4 Mr Brealey yesterday and your answer is the same?

5 MR BREALEY: Yes. And we say --

6 THE CHAIRMAN: A competitive answer.

7 MS BACON: -- if anything the evidence indicates that our
8 explanation is right. But we accept that there is not
9 a full data set. The evidence should have put the CMA
10 on notice, they could have gone away and got full
11 wholesaler purchasing data, if necessary, then full data
12 from the pharmacies. But actually once you have full
13 wholesaler purchasing data you know exactly who is
14 purchasing what from whom.

15 THE CHAIRMAN: And of course that data might show the market
16 is not competitive.

17 MS BACON: Yes -- well, what you have then is purchasing
18 behaviour, you do not know dispensing behaviour, but
19 dispensing behaviour is probably very difficult to look
20 at because you do not know what an individual pharmacist
21 is doing.

22 MR LOMAS: There must be something between the two,
23 otherwise you have massive stock build ups.

24 MS BACON: Exactly. Exactly. But what you do not know,
25 for example, is you do not know whether the fact that

1 a pharmacy buys X amount from Flynn and X amount from
2 NRIM is because patients are being switched from one to
3 the other, or whether that is just because those
4 patients were already stabilised on Flynn's product and
5 already stabilised on NRIM's. That is why I say there
6 is a slight difference but you can extrapolate what is
7 going on reasonably well.

8 So what we do have in terms of the data is, as I
9 say, the Alliance data, and we know that Alliance did
10 account for a lot of NRIM's total sales and we have
11 given the figure at paragraph 39 of our closing
12 submissions.

13 THE CHAIRMAN: Where does the Kantar survey fit into this?

14 MS BACON: That is not our evidence. I am not making any
15 submissions on that.

16 THE CHAIRMAN: Okay.

17 MS BACON: Our closing submissions set out a flavour of what
18 you can see from the top 10 document which goes beyond
19 mid-2014. So this is the one piece of data we do have
20 of what happens from May 2014 onwards. What you can see
21 is there are various customers who started buying
22 significantly more of NRIM's products in 2014. That is
23 why I say you do not look at just what Boots is doing,
24 you can look at what the others are doing. So we know
25 now that actually it was not just Morrisons and

1 Superdrug, but other customers around that time, and
2 presumably because of the reduced wholesaler model, then
3 started buying more of NRIM's products. We have given
4 a few examples in our written closing submissions, but
5 you will see from the big spreadsheet that the few
6 examples that we have given, and these are confidential
7 names, they were not the only ones.

8 What you can also see is that there was a marked
9 increase in the purchases by other customers. The one
10 alteration that we have made to this document is to
11 insert a red line underneath the volume table and the
12 red line is the non-Boots sales. So that was not on the
13 original table, my solicitors put that on. So what you
14 can see is the combined effect of the non-Boots
15 customers. So that is the nine non-Boots who are listed
16 here and all of the other customers.

17 What you see is that from May onwards, when Flynn
18 stopped supplying through Alliance, sales of NRIM's
19 product leapt up. That indicates in our submission
20 quite clearly that instead of just going to another
21 wholesaler for Flynn's product at that point a lot of
22 the Alliance customers just switched to NRIM, which is
23 what Morrisons and Superdrug had done, because you see
24 such a huge jump in NRIM's sales in May 2014.

25 That continues to about the end of the year and then

1 there is a slight decrease which would be consistent
2 with the generally declining market. But what this
3 indicates --

4 MR LOMAS: It is a 4 per cent erosion per year and this is
5 a 10 per cent drop in one year.

6 MS BACON: Yes, there is a decrease. But what this shows is
7 that even in May 2014, this is at a time well after the
8 point when the CMA says the market had effectively then
9 ossified into a Flynn market and an NRIM market. This
10 is six months after the guidance, suddenly a whole lot
11 of customers of Alliance are switching large quantities
12 to NRIM in May, June, July, August, all the way through
13 to the end of that year.

14 So the CMA's case has been, and has to really be,
15 that the effect of the MHRA guidance was that at some
16 point after November 2013, maybe not immediately but by
17 a few months later, Flynn and NRIM were in separate
18 markets, and what we have is six months later there was
19 a big switch from a lot of customers of Alliance which
20 indicates the opposite, that at that point,
21 notwithstanding the MHRA guidance, they were still
22 willing to switch customers from Flynn to NRIM. So
23 looking at the hard data that we have, none of that
24 supports the CMA's explanation of NRIM being in its own
25 market from around the end of 2013 or the start of 2014.

1 So the CMA then falls back on essentially two
2 remaining arguments. The first is to say that Flynn's
3 prices were continually higher than NRIM's -- and this
4 is the 5 to 10 per cent and I did say I was coming on to
5 it. I have now come on to it. They say the 5 to
6 10 per cent shows the two products were not competing on
7 price. That is at number 8 of my errors note.

8 CRA did not say that the price differential was
9 between 5 and 10 per cent during the period. What CRA
10 said in their report was that it dropped to "around
11 5 per cent". And they referred to their detailed
12 diagram in their report, and perhaps we ought to just go
13 to that. That is CRA 3, this is bundle D, we all know
14 where it is by now, bundle D, tab 3, paragraph 15.

15 It is a bit difficult to read because you probably
16 need a ruler or something, but if you put a pen or
17 a pencil around the 95 per cent line, the diagram shows
18 the ratio of Flynn's and NRIM's average selling prices,
19 and what you can see is that from around July 2015 the
20 differential was consistently below 5 per cent. So from
21 around that time the differential was too low, even if
22 you were going to apply a sort of classic kind of SSNIP
23 test analysis, to suggest that people should have been
24 switching from Flynn to NRIM.

25 And Mr De Coninck also went further than that. He

1 said even at the sort of around 5 to 10 per cent level,
2 differences of that order of magnitude are not material,
3 he said. And more importantly, he also said that as
4 a matter of competition economics it is not the
5 difference in the price level in the abstract but the
6 changes to the price levels that were informative of
7 whether products are in the same relevant market.

8 So he said looking at the data that he had and his
9 correlation of the prices and the differentials and when
10 they changed, he thought that it was not material enough
11 that it ought to have provoked sufficient switching,
12 that the fact that there was not huge switching would
13 put them in different markets.

14 PROFESSOR WATERSON: How do you react to the point though
15 that of course these prices, which are the average
16 selling prices, these will be the prices that the
17 wholesalers pay and then the products will go to the
18 pharmacies, and then of course the pharmacies get the
19 drug tariff. So the difference between the drug tariff
20 and these two respective prices will be quite
21 significant. They will be significantly more than 5 or
22 10 per cent.

23 MS BACON: What you see is that pharmacies have established
24 relationships with particular wholesalers and you get
25 that from the Section 26 notices. So what we see from

1 the Alliance data is Alliance was supplying NRIM, so
2 when it could not supply Flynn people then just switched
3 to NRIM. And the same, one presumes, happened in
4 the opposite direction: if a wholesaler continued to be
5 able to supply Flynn then many pharmacies will just have
6 been able to continue with the wholesaler that is
7 supplying them at that time. We know from the
8 Section 26s that pharmacies often have established
9 relationships with particular wholesalers and you have
10 to surmise that is what is happening from the Alliance
11 data that we have.

12 So it is not a pure question of the price
13 differential, and that was also Mr De Coninck's
14 evidence.

15 PROFESSOR WATERSON: It also depends on whether pharmacies
16 have relationships with several wholesalers.

17 MS BACON: Yes. And we know that some of them really only
18 had relationships with one or other. And we also know
19 that there are established relationships between
20 the individual suppliers and individual pharmacies.

21 So there is more going on in this market. It is
22 a more nuanced market than just a price market. It is
23 not just the case -- because of this chain of supply it
24 is not just the case that a pharmacy will say, "Product
25 X supplied by NRIM at this, product Y supplied by Flynn

1 at that. I am just going to go and get the cheapest
2 product so I can get the maximum on the drug tariff".

3 MR LOMAS: Just picking up that point because it is
4 something that has troubled me a bit. If you take Boots
5 as a very well organised let us assume large buyer,
6 perhaps the largest player in the market, the relevant
7 differential to them, which is the point that has just
8 been made, is not between Flynn and NRIM's price, which
9 is somewhere between 10 and let us say 3 per cent across
10 the period, it is the difference between the profit they
11 make driven by the reimbursement price's comparison with
12 the price they pay, whether it is Flynn or NRIM, and
13 that 3 or 4 per cent differential in the Flynn to NRIM
14 price translates into a much, much bigger differential
15 in terms once you have taken account of the
16 reimbursement price.

17 MS BACON: Yes.

18 MR LOMAS: So the incentive on Boots to switch to NRIM is
19 a very significant profit driver indeed --

20 MS BACON: Yes.

21 MR LOMAS: -- if the market was price competitive in the way
22 in which, or at least there was switching in the way
23 which you seem to be suggesting.

24 MS BACON: But in order to make that point the CMA would
25 have had to go much further than it has done. It would

1 have had to find out exactly what Boots was purchasing
2 after the period that we have data for, because actually
3 we see that Boots was purchasing a lot of NRIM's product
4 even up until about May 2014. It was later than that
5 that it started to -- as you say, there started to be
6 some kind of a decline.

7 MR LOMAS: So they have crossed that barrier and the
8 incentive would suggest they ought to buy more.

9 MS BACON: We do not know what exactly the drop off was. We
10 do not exactly know what Boots' arrangements were with
11 Alliance and any other wholesalers. As I said, it is
12 more than just a straight pricing. And that is
13 the point that NRIM makes in its Section 26. It was
14 saying "We found it really hard to get into Boots".
15 Remember, this was a point in time that NRIM had come in
16 and it had launched much below Flynn's price. One would
17 have thought that if that was all that was going on,
18 Boots would have simply said "Obviously we will switch
19 everyone to NRIM". But NRIM required Auden Mckenzie
20 with their prior relationship with Boots to get into the
21 Boots market and that is what NRIM said.

22 So this is evidence that there is more going on in
23 this market, even for large customers like Boots, than
24 simply a price differential.

25 MR HOSKINS: There is evidence of Boots' purchases at

1 page 230 of the decision, figure 4.3.

2 THE CHAIRMAN: Thank you, Mr Hoskins.

3 MS BACON: I am not sure what point is sought to be drawn
4 from this in relation to the points that I have just
5 been making, that it is a more nuanced market, as we
6 know, than just saying we will go with the cheapest
7 price.

8 MR LOMAS: But just to complete the point, those nuances
9 seem to suggest that the reason is in the marketplace
10 why you do not get the switching that the pricing would
11 lead you to anticipate.

12 MS BACON: The market is a more subtle market than just
13 a price market and therefore established relationships
14 may play a part. We do not know what Boots was doing
15 elsewhere and we do not know whether there were
16 discounts going on that, for example, caused Boots to
17 buy more or less of one product than other. All we have
18 is data showing that from some point their purchases
19 were not quite as high as they had been before.

20 But as I said, the main point here is that we have
21 seen that a long time after the MHRA guidance there was
22 a lot of switching in around May, and that indicates
23 that at least at that point there was not sufficient
24 stickiness to prevent a lot of people from switching and
25 regarding NRIIM's product as being substitutable.

1 But going back to Mr De Coninck, the point is that
2 there is only one expert before the tribunal who looked
3 at the materiality of the price difference and that was
4 him. Mr Ridyard did not look at that particular point,
5 nor did Mr Harman because he was not addressing market
6 definition. So the only expert who has looked at this
7 and has been asked, well, is this price differential
8 actually in competition terms a significant one? The
9 only expert was Mr De Coninck. And the CMA did not
10 challenge that evidence, it has not challenged that
11 evidence head on in its closing submissions, and
12 Mr Hoskins did not challenge that bit of Mr De Coninck's
13 evidence in his cross-examination.

14 MR HOSKINS: Sorry, that is just not correct.

15 MS BACON: What Mr Hoskins put to Mr De Coninck was that he
16 was assuming that there was a particular reason for the
17 initial price reduction and Mr De Coninck, as I have
18 told you, said "No, I am not assuming anything".

19 So in our submission the argument about the
20 difference in Flynn's and NRIM's prices on the basis of
21 the economic evidence actually supports our explanation
22 which is that the price just was not significant enough,
23 taken together with what else was going on in the
24 market, to provoke significant further switching to
25 NRIM. That is what is consistent with what we have

1 already said about NRIM's strategy.

2 So the only other piece of evidence that indicates
3 what was actually going on in the market is the
4 Section 26 responses and Mr Brealey has made submissions
5 on those. Our point, the basic point is that taking all
6 of the hard evidence that we have, the CMA has to place
7 a lot of weight on the Section 26s. And for the reasons
8 that we have given in our written submissions, and for
9 the reasons that Mr Brealey gave yesterday, those
10 Section 26 responses are not sufficiently compelling to
11 show that the explanation for what was going on was that
12 NRIM's products stopped being substitutable for Flynn's
13 at some point in that fourth period because it has to be
14 really in that fourth period.

15 So what we do know is that there has been switching
16 during that period by numerous other pharmacies and not
17 only Boots and Lloyds. All of that reinforces the point
18 that continuity of supply is a difficult argument that
19 is not really corroborated by the hard evidence that we
20 do have of the pharmacy purchases.

21 Taking the period as a whole then, so I have broken
22 the period down for the purposes of analysis, now let us
23 bring it all back together and I can summarise our case
24 shortly. Our submission is that this was a market that
25 did plainly include NRIM, it was on the market during

1 the second, third and fourth periods, and there is clear
2 evidence of active substitution going on in all of those
3 periods. The only real question mark is what happened
4 at some point during the fourth period, and certainly
5 not at the start of the fourth period, at some point
6 during the fourth period, so at some point after
7 May 2014, perhaps towards the end of 2014, perhaps in
8 2015, it is not very clear, but at some point during
9 late 2014 or early 2015 at a point at which one sees,
10 for example, the Boots purchases started to tail off.

11 What is happening on that, and there is no evidence
12 that suggests that what is happening is that say
13 in January 2015 the market is suddenly at that point
14 changing. And why would it change at that point? There
15 has not been anything different that has occurred.

16 Our case is that on all of the available evidence,
17 what has happened during the entirety of the period is
18 NRIM has done what it said it intended to do in its
19 Section 26 response. But it gave evidence: we had
20 intended that in relation to Pfizer's product we were
21 going to enter, we were going to compete, we were going
22 to get up to this particular market share. That is what
23 they said in their section 26 which I provided in the
24 closing submissions. We thought that was what was going
25 to happen, that is what they did do. They got up to

1 market share parity with Flynn and then they essentially
2 rested on their laurels at a price point which was
3 eventually less than 5 per cent below Flynn's.

4 So our position is that from that point on, although
5 the market stabilised, it was a market on which they
6 were both present.

7 What the CMA has to say is that something changed at
8 a point when the market stabilised, or after that, to
9 essentially kick NRIM out of the market in which it had
10 until that time been competing fairly vigorously and in
11 a market where we can see that market shares or volumes
12 were still going up. And for the reasons that I have
13 given, we say that the Section 26 notices which then
14 have to carry all the weight of explaining that are not
15 really adequate.

16 So that is all I wanted to say on market definition.

17 Can I move --

18 THE CHAIRMAN: Is that a good moment to stop?

19 MS BACON: Yes. I was going to go on to dominance, I only
20 have a couple of minutes on dominance. Can I just
21 finish on dominance?

22 THE CHAIRMAN: A couple of minutes?

23 MS BACON: Yes, less than a page.

24 So if I am right, suppose I am right on market
25 definition, if the market includes NRIM for the whole of

1 the relevant period the question is then what that means
2 for the dominance assessment. In our submission, the
3 answer to that is clear because the CMA does not
4 actually have a case. Its assessment in the decision
5 and in all of the subsequent pleadings -- the pleadings
6 and skeleton arguments and all the written closings --
7 put their case on two alternative hypotheses and only
8 two hypotheses. Number one, NRIM was not in the market
9 at all. Hypotheses number two, it was in the market but
10 only for what I have called period two.

11 So that must be deliberate. They must have decided
12 that if both of hypotheses failed then they cannot
13 succeed on dominance, otherwise they would have put
14 forward the third alternative, ie what if NRIM was in
15 the market for the whole time, do we still think Flynn
16 was dominant? But they do not say that.

17 So in our submission, if the tribunal does find that
18 NRIM was in the market for the whole period, which is
19 our case, then the matter stops there and the decision
20 has to be set aside.

21 We say that in any event that is right for all of
22 the reasons I have given in our closing submissions, but
23 I am just emphasising the point now that the contrary
24 point is not pleaded. If we are wrong about the market
25 definition then we rely on the other points in our

1 closings, including the buyer power point, but I am not
2 going to go to that further now.

3 So that really was all I had to say about dominance.

4 Is that a convenient point, sir?

5 THE CHAIRMAN: Your case is that NRIM was within the
6 relevant market for the whole period and that that is
7 sufficient to get you off the dominance hook.

8 MS BACON: Yes as a matter of pleading and yes as a matter
9 of fact for the reasons we have given in our written
10 closings.

11 THE CHAIRMAN: That is your case.

12 MS BACON: Yes.

13 THE CHAIRMAN: Okay. Thank you. Ten minutes.

14 (11.45 am)

15 (A short break)

16 (11.55 am)

17 MS BACON: So we are on to abuse, sir. This is where I take
18 a break from marking Mr Hoskins' homework. In this part
19 of my submissions I am just going to actually answer the
20 tribunal's questions, because you have seen what our
21 position is in general from our pleadings and our
22 skeleton and our written closings, so I thought it would
23 be most helpful if I just run through your questions and
24 give our answers to those questions.

25 So I think it would be helpful if you were to turn

1 up United Brands. I am sorry to go back to this yet
2 again and I hope this will be the only time we have to
3 look at it today. It's authorities bundle C1, tab 3.

4 THE CHAIRMAN: I apologise for such a venerable case.

5 MS BACON: The first question is about United Brands so I
6 thought I could not really answer it without looking at
7 it now. The relevant paragraphs are 249 to 252/253,
8 I am sure you have them highlighted and marked up
9 already.

10 Question 1: is United Brands the starting point? A
11 short answer and a long answer. Short answer: yes.
12 Long answer: United Brands does two things and that is
13 why I have asked you to turn up the relevant page. The
14 first thing it does is to set out an overarching
15 principle of whether a price is excessive, so that is
16 paragraphs 249 to 250. Then it sets out at 252 a way of
17 testing for that. And the reason to emphasise that
18 distinction is that when we are looking at the two-stage
19 test in 252, if that is the method used in a particular
20 case, it still has to be applied having regard back to
21 the overarching principle in 249 to 250.

22 The reason that that is important is that the
23 overarching principle is the bit which says that
24 the price, if it is excessive, it is excessive by
25 reference to something. And the something is the price

1 that would have been obtained under normal and
2 sufficiently effective competition.

3 So in other words, it is 249 which provides the
4 benchmark by reference to which excessiveness is tested
5 and you do not get that from 252. 252 just refers to
6 a question of whether the difference between cost and
7 price is excessive but it does not offer the reference
8 point for deciding what excessive means. So that is why
9 you have to go back to 249 and 250.

10 At paragraph 60 of our closing submissions I set out
11 what I think is the correct expression of the overriding
12 principle taking 249 to 250 together, and that was the
13 reason for my somewhat pedantic correction to the
14 footnote because paragraph 60(a) comes from paragraph 81
15 of our opening skeleton.

16 MR LOMAS: Can I just check. Does that mean if you are
17 looking at 49 and 50, you would equate the economic
18 value of the product with the price that would be
19 achieved in normal and sufficiently effective
20 competition or do you think they are different prices?

21 MS BACON: Economic value could be something else.

22 MR LOMAS: It could be something else.

23 MS BACON: There are two separate points being made here.

24 There is a point about excessiveness and how
25 excessiveness is to be measured and that is 249, and

1 then there is a point about economic value, and we have
2 made submissions on economic value and I will come back
3 to that. But I am not saying it is just equating one
4 with the other.

5 As I will develop a bit later on, it could be that
6 in a particular case it is very difficult to determine
7 economic value other than by looking at comparators for
8 normal and sufficient competition. That is what
9 Mr Ridyard said was this case. And respectfully we
10 agree that this is one of those kind of cases in which,
11 to look at economic value, one does look at comparators.
12 So the two in this case might come down to the same
13 thing. But of course one takes on board Mr Brealey's
14 points yesterday about economic value and having to do
15 with the intrinsic value of the product as well. So we
16 do not disagree with any of that.

17 THE CHAIRMAN: In this paragraph 250, what do you think the
18 three words at the beginning mean, "In this case"?

19 MS BACON: It is making a contextual point in this
20 particular case, in the context of this case.

21 THE CHAIRMAN: So it does not mean what is said in 249, it
22 means what is going on in United Brands.

23 MS BACON: Yes. That is one of the reasons why I think 249
24 and 250 are making different points, although in
25 a particular case they might come down to more or less

1 the same thing.

2 So that is why I say there are two distinct things
3 going on in United Brands. There is the overarching
4 principle in 249/250 and then the two-stage test in 252.
5 And 252 is what the CMA has applied in this case and we
6 do not object to that as a matter of principle. But
7 what we have said, apart from the point that you have to
8 read 252 with the overarching principle in mind, the
9 other thing about 252 is you cannot read it as if it
10 were a statute. And our position is that in that
11 respect the Latvian Copyright case does give you some
12 useful guidance as to how a court or competition
13 authority should approach the analysis of whether
14 a price is excessive.

15 We are not suggesting that United Brands is in any way
16 superseded or replaced by the Latvian case. What we are
17 saying is since the Latvian case is the most recent
18 consideration of United Brands by the CJEU, it is right
19 for the tribunal to have regard to it insofar as it is
20 relevant. And we have already set out in our written
21 submissions various ways in which we say it is relevant.
22 In other words, where some of what is said in
23 the Latvian case can directly be taken to the
24 interpretation of United Brands in this case even having
25 regard to the fact that the facts in the Latvian case

1 were different. So that is our answer to question 1.

2 Question 2A: is a benchmark price necessary? We say
3 that at least one benchmark is necessary but it does not
4 have to be a benchmark price as such, it could be
5 a benchmark profitability level. But there has to be
6 one or more benchmarks that serve as the reference point
7 for the paragraph 249 test of whether the price is
8 excessive by reference to what would have been obtained
9 under normal and sufficiently effective competition, or
10 put another way, you cannot determine what is normal and
11 sufficiently effective competition in the abstract.

12 That, it seems to us, is a major point of principle
13 between us and the CMA. Because the CMA thinks
14 for example that you can look at Flynn's absolute
15 profitability in pounds terms and say, "Well, that looks
16 like a lot, it is more than they needed to cover their
17 cost of capital, and therefore Flynn's price is
18 excessive". The short answer to that is paragraph 249.
19 By referencing in that paragraph what the undertaking
20 would have got under normal and sufficiently effective
21 competition the court is setting out what, in our
22 submission, is an empirical benchmark, it is not
23 a theoretical exercise. It requires some empirical
24 evidence of what normally goes on in the market or in
25 a sufficiently comparable market which, as we have set

1 out in paragraph 65 of our written closings, does not
2 mean a perfectly competitive market. And that point was
3 made in Albion.

4 So we are not looking at what would happen in
5 a perfectly competitive market where there is
6 superintensive competition and price descends to the
7 marginal cost, we are looking at a normal market where
8 there is sufficiently effective competition; there is
9 not no competition but there is at least some
10 competition, and that is the comparator.

11 MR LOMAS: You would say the price needs to be excessive by
12 reference to the real world market, not the theoretical
13 market.

14 MS BACON: Yes. As you will see, we dispute the theoretical
15 concept in this case anyway because it is all built on
16 Mr Harman's ROCE WACC analysis. But even leaving that
17 aside, the basic point is exactly that one: it is a real
18 world market, not a theoretical market.

19 Of course we should not lose sight of the fact that
20 in the decision the CMA does rely on a benchmark and the
21 benchmark is the PPRS. I will come to that shortly
22 after I have dealt with my question-answering period,
23 but it is the PPRS that supplies the CMA with the
24 6 per cent figure. The figure does not come from
25 anywhere else. And without that figure, without having

1 had the source of that benchmark, the CMA could not have
2 done its ROS analysis, and that is the foundation of its
3 case against Flynn in the decision, so even the CMA in
4 the decision is relying on a benchmark.

5 So that is why I say you do need one or more
6 benchmarks but they do not need to be price benchmarks.
7 It could be, we say it is not this case, but it could be
8 that in a particular market you do not have a good price
9 comparator but you have got profitability comparators,
10 and in our submission profitability benchmarks would
11 also do the trick. And actually that is essentially
12 what the court in United Brands is referring to because
13 they are talking about profitability comparators in
14 their two-stage test.

15 So question 2B. So I said you need a benchmark.
16 2B: how is the benchmark price to be ascertained?
17 I will read that as saying how is the benchmark to be
18 ascertained, because I say you do not need a price, you
19 can have profitability. And the answer is that there is
20 not likely to be any single benchmark for either price
21 or profitability, rather the Competition Authority or
22 the court should look at all of the available and
23 informative benchmarks of either profitability or price
24 and see if a comparison of those against the disputed
25 price or disputed profit margin points clearly in

1 the direction of there being excessive pricing.

2 That does not mean, and I need to make this clear,
3 it does not mean that we say the Competition Authority
4 has to proactively go out there and seek out every
5 single benchmark that might possibly exist. We do say
6 that Advocate General Wahl's point that there should be
7 a "sufficiently complete and reliable set of elements
8 which point in one and the same direction" is the
9 right approach. So you need to have enough.

10 MR LOMAS: In terms of that -- I hesitate to use the word
11 "basket", but basket of comparators, the treaty talks
12 about unfair prices and the measure is about stopping
13 consumers being exploited by pricing techniques. It
14 does not talk about excessive profits and should not
15 perhaps seek to control the profitability of commercial
16 entities.

17 So in those baskets, do you not need to look quite
18 closely at the pricing factors and perhaps profit only
19 insofar as it is a guide to what the appropriate price
20 might be?

21 MS BACON: Yes, I use profit as a guide to what the price
22 might be. What I am saying is you might not have
23 an actual end price comparator. You might not have
24 a sufficiently -- a product where you can say this price
25 is the exact price comparator, and you might be in

1 a market where you only --

2 MR LOMAS: A synthetically derived price, in a sense.

3 MS BACON: Yes, you derive the price from the profits. As I
4 said, in this case we do say there is a price
5 comparator. But we would go further and say let us
6 suppose you did not have the Teva tablet price
7 comparator and all you had was information about
8 the profitability of generic products, if that was the
9 only information available to you then you could look at
10 that as a guide.

11 But going back to my point, do you have to go out
12 and actually find -- does the CMA have to go out and
13 find a certain number of apples to put in its basket?
14 No, it does not. It needs to have a sufficiently
15 complete and reliable picture. That means if the
16 undertaking that is being investigated, in this case
17 Flynn, puts forward a number of benchmarks that
18 the Authority has not considered, and if those
19 benchmarks get over the hurdle of being informative and
20 meaningful, so if they get in the basket in the first
21 place, then the Authority cannot, in our submission,
22 simply disregard them because it has found another
23 benchmark that it says makes its case.

24 So my threshold for being in the basket is: is it
25 informative? It need not be perfect, but it is

1 informative so that you at least give it some weight.
2 And if something is informative and it should be in
3 the basket then it should be considered and given weight
4 alongside the other benchmarks that have been put
5 forward or come up with.

6 So that is how we say the benchmark price is to be
7 ascertained. It is not a single benchmark, but you look
8 at the totality of the evidence and you then take a view
9 as to weighting those, is the price excessive, because
10 everything points in the same direction according to
11 Advocate General Wahl.

12 Question 2C, I have essentially answered that, but:
13 is cost plus the only way of doing it? Obviously not.
14 United Brands itself did not set out a cost plus test.
15 What it set out was a comparison between cost and price
16 which just means a profitability analysis. And even if
17 you are only looking at profitability tests --

18 THE CHAIRMAN: It depends what you mean by cost, doesn't it?

19 We have had cost as cost, cost as cost plus a reasonable
20 margin.

21 MS BACON: I am not saying it excludes cost plus, I am
22 saying a cost price comparison could be just gross
23 profits, it could be product contribution, it could be
24 cost plus. But United Brands does not say cost plus is
25 the metric, it says a cost price comparison. We say

1 that there are a number of different profitability tests
2 which are relevant and can be used in this or other
3 cases.

4 Gross margins seem to be an obvious measure. They
5 were used in Napp where the issue was, like this case,
6 the profitability of a pharmaceutical product. There
7 are two gross margins comparisons done in Napp, gross
8 margins of Napp's other products and gross margins of a
9 suitable comparator company. So those were the gross
10 margin comparisons done there.

11 At a more granular analysis, the Authority could
12 also look at the gross profit margins of individual
13 comparator products. That would of course require
14 information-gathering powers that would be available to
15 a body like the CMA. An individual company like Flynn
16 would not be able to get that kind of granular
17 commercial information from its competitors. So that is
18 what the CMA could have done, we cannot do that.

19 I do accept that gross margins are not a perfect
20 measure in that they might give an incomplete picture if
21 you have a sector where there are high directly
22 attributable costs, using that term in the sense that
23 I used it in Mr Harman's cross-examination, so costs
24 such as sales and marketing which are directly
25 attributable to particular products. There are two

1 possible solutions to that. One is to look at a product
2 contribution analysis, which Mr Harman calls direct
3 margins, and that does take into account directly
4 attributable costs. Again if that is going to be done
5 for companies other than the company under investigation
6 it would require information-gathering powers that
7 the CMA would have. We would not be able to do that.

8 The other solution is to investigate whether the
9 particular sector is one where there are likely to be
10 high directly attributable costs, as in: is this
11 a sector where this problem with gross margins is likely
12 to be a significant issue distorting the comparison. If
13 it is a sector where that is likely to be an issue, then
14 that would go to the weight to be given to a gross
15 margin analysis as compared with other kinds of
16 benchmarks.

17 In this case, Mr Harman, when we discussed this
18 point, accepted that he had no empirical evidence
19 showing that generic pharmaceutical products do incur
20 high directly attributable costs. Certainly if you look
21 at Flynn's portfolio we have seen that all of the
22 generics in that portfolio incur little or no directly
23 attributable costs. So on that basis, on the basis of
24 the evidence that we have, there is no obvious reason to
25 discount the weight of a gross profit comparison. But

1 as I said, if that was really an issue and the CMA
2 thought that was an issue the answer then is to do
3 a product contribution analysis, which we have done for
4 Flynn because we know our directly attributable margins.
5 What we do not know is what they would be for other
6 generics, and the CMA has the tools to find that out.

7 So that is the two other types of profitability
8 analysis which we say are relevant, can be done, could
9 be done in this or any other case.

10 Then there are price benchmarks. The most
11 informative price benchmark is likely to be the price of
12 comparable products in the same geographic market. So
13 in this case that would be either other Phenytoin
14 products, tablets, or potentially other AEDs, and that
15 is Pfizer's point.

16 MR LOMAS: Sorry, those are not technically in the same
17 market in the sense that we use it --

18 MS BACON: I said in the same geographic market, I did not
19 say the same product market.

20 MR LOMAS: Geographic market, yes.

21 MS BACON: So other comparable products sold in the UK where
22 one can assume that at least at a broad level the
23 conditions of competition are broadly the same.

24 If the undertaking sells the exact same product in
25 different segments of the market you could also look at

1 that, and that was Napp but it is not this case.

2 In principle we accept it might be valid to look at
3 prices in other geographic markets. The problem with
4 that is because the economic and regulatory conditions
5 are likely to vary from country to country, a comparison
6 with prices in other countries is likely to be much less
7 informative than a direct comparison with home country
8 prices and would have to control in some way for the
9 differences in the regulatory frameworks and that is
10 a point that was very much a point that was being made
11 in the Latvian case.

12 So if you do have in-country benchmarks those are,
13 in our submission, likely to give a far better
14 indication of what is the relevant benchmark, what is
15 the normal price.

16 Again, as a matter of principle, a historical price
17 comparison might be relevant if you can use that to get
18 an indicator of what is a normal price right now. It
19 might be said that for different reasons the historic
20 price was not a normal competitive price. I am just
21 making points in the abstract now, I will come on to the
22 exact points later on. But in principle there could be
23 a whole variety of reasons why historical price does not
24 give you an indication of what is now the normal
25 competitive price and in those circumstances, if that is

1 the case it would not be relevant for the United Brands
2 test in paragraph 249.

3 Just to foreshadow what I am going to say, and you
4 know the point in our case, we say the reason why in
5 this case the historic price does not tell you what is
6 a normal competitive price is that it was loss-making
7 but you know that already.

8 So question 2D: must or could other ways of
9 ascertaining the benchmark price include consideration
10 of comparators? I have essentially answered that. Any
11 benchmark has to turn on a comparator. A cost plus
12 analysis has to do the same because you still have to
13 find something to find your plus in the cost plus.

14 So it comes back to the point that you cannot apply
15 the United Brands test in abstract. Fundamentally the
16 requirement to benchmark against the normal and
17 sufficiently competitive price means you have to find
18 a comparator; benchmark and comparator are, in my
19 submission, essentially synonymous. And even if you are
20 looking at a historical price that is still
21 a comparator.

22 If the question is do you always have to look at
23 comparators that are other products or other companies?
24 Then the answer would be this: if there are such
25 comparators and they are informative, so they get over

1 the threshold of being put in the basket, and they are
2 put before the Authority or the court then they should
3 be taken into account. If there are no informative
4 comparators in other products and other companies, then
5 the court or Authority will have to do the best that it
6 can using the benchmarks that relate to the product
7 itself. But the bottom line is that the burden of proof
8 lies with the Authority. If you are doing the best you
9 can you still have to have sufficiently compelling
10 information, a sufficiently reliable set of information,
11 that it can without any doubt be resolved in favour
12 of -- well, CMA's position, if there is not that
13 sufficiently compelling set then you cannot say: we have
14 done the best and we have got this one scrappy
15 benchmark, we accept it is not very good but that seems
16 to suggest there is an excessive price. In our
17 submission that just would not meet the burden of proof
18 and it would not meet Advocate General Wahl's test for the
19 general approach.

20 THE CHAIRMAN: The point against you, if I may say so, and
21 I know we are talking abstract theory, not the actual
22 application of the case. But the point against is you
23 that the Authority has a certain margin of discretion in
24 deciding how it approaches this, it was aware of
25 possible comparators, indeed you and Pfizer told them of

1 some. It looked at them, it did not find that they met
2 the test of sufficiency and informative and objective
3 criteria and so it did not take the analysis any
4 further. They are saying that is their entitlement.

5 MS BACON: So the answer --

6 THE CHAIRMAN: What is your comment?

7 MS BACON: The answer to that is you are deciding this on
8 the basis of a merits review, you can decide if the
9 Authority was wrong in either rejecting the
10 comparators -- in our submission, what they did was they
11 actually chucked the comparators out of the basket, they
12 said we do not need to look at them. But even if they
13 fall back on a more moderate position, they were in
14 the basket but we did not give them weight, you can still
15 decide if that is right as a matter of principle, should
16 they have been given more weight than they were?

17 THE CHAIRMAN: We are not able ourselves to investigate the
18 characteristics of the comparators beyond what you tell
19 us.

20 MS BACON: You have the evidence before you and you can
21 decide whether on the evidence before you the Authority
22 had sufficiently proved that, say, a particular
23 comparator was not informative or should have been given
24 little or no weight.

25 Let us take gross profits, for example. You have

1 seen the economic evidence on that, you have heard the
2 witnesses, and you will need to decide if, on the basis
3 of the information in front of you, the CMA has
4 sufficiently proved to the required standard of proof,
5 and it is a high threshold, that the gross profit
6 comparisons should either have been chucked out of the
7 basket, ie not informative at all, or should be given
8 little or no weight. And if you consider that that is
9 not the case, then the answer should be that whatever
10 margin of discretion and judgment they had they
11 exercised it the wrong way. That is the answer to that.

12 And of course we do say for lots of reasons that
13 they were wrong. Either they were wrong to chuck the
14 gross profit out of the basket altogether, or if what
15 they did was put it in but say it has little or no
16 weight that was wrong too for the reasons I put to
17 Mr Harman and we have put in our closing submissions.

18 So question 2E, if I may: how do you measure the
19 excess? The answer is you do not have to measure it.
20 Our position is that a difference between the benchmark
21 price and the actual price or a difference between the
22 benchmark profit and the actual profit is an indicator
23 that there may be an excess, what you or the
24 decision-maker has to do is consider two things: first
25 of all consider how much of a difference there is, ie is

1 it material? Then that raises the question of what is
2 material, and that is not something that can be measured
3 in the abstract but it really turns on context.

4 If you have a true commodity product and the average
5 gross profit margin is, say, around 3 or 4 per cent, and
6 you know that the variation around that average is no
7 more than a percentage point. So intense competition in
8 the market, lots of competitors, very low profit margin,
9 not much variation, and the disputed product has
10 a profit margin of, say, 9 per cent, I am just putting
11 it 5 per cent above, then you might be able to conclude
12 from that that 5 per cent difference in a market where
13 everything is pretty low and everything is pretty samey
14 indicates excessive profitability.

15 THE CHAIRMAN: And you would look over time as well.

16 MS BACON: Yes, and you look over time, exactly. But if you
17 have a sector where the products are quite heterogeneous
18 and the average profit margin is, say, 25 per cent but
19 with some significant variation around that, then you
20 might not be able to conclude that a profit in that
21 sector with 5 per cent more, say 30 per cent, was
22 excessively profitable.

23 So in my submission, materiality is an empirical
24 question. That was why I put the point to Mr Harman.
25 It is not just an abstract question, it is an empirical

1 question looking at the sector in question and the
2 variability. And of course you can do all kinds of
3 statistical analyses, you can do standard deviation
4 analysis or whatever on that sector. But you need to do
5 some kind of proper analysis on the sector before you start
6 concluding that a difference of X or Y is actually
7 material. And I do not need to spell out where this is
8 going in this case.

9 The other thing that the decision-maker will need to
10 do after looking at materiality is the
11 Advocate General Wahl point: do all the benchmarks point
12 in one and the same direction? So that is how you
13 measure or assess the excess. It is not something to be
14 measured in precise terms, in our submission.

15 THE CHAIRMAN: I was going to ask you generally, you make
16 points in your written closing paragraph 63 about what
17 the Advocate General in the Latvian Copyright case says,
18 whether the court follows in every respect. I think
19 Mr Hoskins is going to put something similar to us.

20 What weight are we meant to attach to the
21 Advocate General's survey of the law on unfair pricing
22 which is given to us in the context of a case about
23 geographic comparisons and copyright figures where cost
24 analysis is really quite difficult, where the court
25 obviously picks up some of his general survey and does

1 not pick all of it, and there are arguments about what
2 he meant, whether it changes United Brands or whether it
3 simply gives effect to it.

4 Do we regard this as an authority that we must have
5 regard to under Section 60, closely?

6 MS BACON: It obviously does not carry the same weight as
7 would a judgment of the court saying the same thing, but
8 of course a judgment of the court would never say the
9 same thing.

10 THE CHAIRMAN: You would never get a judgment with that sort
11 of --

12 MS BACON: No, you don't get a judgment with that kind of --
13 what the Advocate General was trying to do was clearly
14 to bring together two strands of case law, the Tournier
15 strand of case law and, if you like, the United Brands
16 strand of case law. He was trying, as Advocates General
17 sometimes do, to bring this under one general framework
18 that could be applied to everything.

19 The court does not clearly say if it is adopting all
20 aspects of that framework. It does adopt some of them,
21 and Mr Brealey took you yesterday to the bit where the
22 court says in substance as said by Advocate General in
23 paragraph whatever, and Mr Lomas' comment was, well, was
24 that a limb one point? And it clearly was a limb one
25 point in the Advocate General's opinion.

1 So the court is taking on some of what the
2 Advocate General says, so much of it as is necessary to
3 decide that case in front of it. It clearly does not
4 adopt all of the rest. What we say is that obviously
5 the tribunal is not bound by all of the stuff that
6 the Advocate General says which is not picked up by the
7 court and clearly relates to the specific facts of that
8 case. But what we do say --

9 THE CHAIRMAN: But we have not got a case like that case.

10 MS BACON: No. But what we do say is that a lot of what he
11 says is actually not very unusual, and he refers back to
12 cases like Napp. So this point about the basket of
13 benchmarks, he is referring back to Napp to make that
14 point. This is not groundbreaking novel stuff. The
15 value of the opinion is that it actually brings together
16 lots of the case law --

17 MR LOMAS: It's a synthesis.

18 MS BACON: Yes. Well, it is a bit more than a synthesis
19 because he applies his own conceptual framework and he
20 actually has a slightly different way of looking
21 at limb one and limb two. He says he is applying
22 United Brands but what he actually does is to slightly
23 conflate the two. That is what he is trying to do, he
24 is trying to bring it all together.

25 So his limb one and limb two are slightly different

1 from what one would regard as the classic United Brands
2 limb one and limb two, and we say you do not have to
3 go down that route. But for the bits where he does
4 make points that are clearly relevant to this case,
5 things like the benefit of the doubt, that is an
6 established proposition. Things like looking at the
7 basket of benchmarks, he is referring to Napp, he is
8 referring to the OFT. Things like saying you have to
9 have a sufficiently compelling set of evidence. That is
10 really making a general point based on his point that as
11 an economic analysis it is quite difficult to prove
12 excessive pricing and there is a risk of type 1 errors.

13 So in those respects one can look at the
14 Advocate General's opinion as a useful guidance, as
15 a useful synthesis or conceptual approach to investigate
16 how United Brands is to be applied in this case.

17 THE CHAIRMAN: Presumably we attach some weight to the fact
18 that it is recent.

19 MS BACON: Yes, very recent. Yes.

20 THE CHAIRMAN: Competition law has moved on a bit since
21 United Brands.

22 MS BACON: Yes, recent. And he certainly was not trying to
23 say this is only applicable to this case. He was trying
24 to say this is what you do in the generality of cases
25 because there is a generality of problems, there are

1 a number of problems that will arise in all cases.

2 MR LOMAS: I think his opening paragraph is: is there such
3 a thing as excessive pricing? He is setting a general
4 proposition out there.

5 MS BACON: Yes. But it is not off the wall, he is not off
6 with the fairies. He is making --

7 THE CHAIRMAN: That is a great relief. I will tell him.

8 MS BACON: One does get Advocate General opinions that take
9 their own view of ... I am being very careful in what
10 I am saying. My point is a lot of it is not
11 particularly novel or surprising.

12 Can I move on to question 3(a). We are now on to
13 unfairness. I am going to take (a) and (b) together.
14 So are the criteria of unfair in itself and unfair when
15 compared to competing products genuine alternatives?
16 Does the decision-maker have unfettered freedom to
17 choose one or other?

18 You will know my answer to that, it is no and no.
19 If you have a meaningful comparator product, so it jumps
20 into the basket and gets over that hurdle, then we say
21 it has to be taken into account. The Authority cannot
22 prove an abuse by cherry-picking.

23 If a comparison with competing products indicates
24 that a price is not unfair, then in our submission the
25 CMA cannot simply disregard that and find unfairness by

1 saying the price is unfair in itself. That means in our
2 submission that a decision-maker can only find that
3 a price is unfair in itself without regard to comparator
4 products if there are genuinely no meaningful and
5 informative comparator products to be considered.

6 THE CHAIRMAN: And the assessment of those comparator
7 products is the same kind of assessment as should take
8 place at limb one.

9 MS BACON: Yes.

10 THE CHAIRMAN: No different.

11 MR LOMAS: So technically the limbs may be alternatives in
12 the sense that either could be satisfied and that is
13 sufficient.

14 MS BACON: What do you mean by limbs?

15 MR LOMAS: Sorry, the two versions of limb two, two parts of
16 limb two, unfair in itself and unfair with comparators,
17 are alternatives in the sense that either could be
18 satisfied and the CMA or the NCA only has to satisfy
19 one. But you would say they are in a sense sequential
20 in that you would look first at limb two and ask if
21 there were comparators. If there were not any
22 comparators you could go to limb one and see whether you
23 could make a finding just on unfair in itself, but you
24 should not go to --

25 PROFESSOR WATERSON: Alternative one.

1 MR LOMAS: Let us call them alternatives. You should not go
2 to alternative one if alternative two gave you
3 an answer.

4 MS BACON: Yes. You can just see why that should be the
5 case because it would be manifestly unfair to
6 an undertaking if you said we are going to look at
7 limb one, say it is unfair in itself. But there we have
8 an ex hypothesi perfect comparator. I know the CMA says
9 it is not a perfect comparator --

10 MR LOMAS: Theoretically.

11 MS BACON: A theoretical perfect comparator which would, if
12 you looked at it, show the price was unfair. And it
13 would be very wrong for the decision-maker to say we are
14 going to completely shut our eyes to that. We have
15 reasons for saying we think it is unfair in itself
16 because the price is high or whatsoever.

17 MR LOMAS: Are we having an intellectual discussion here or
18 is there authority that supports the idea that these two
19 alternatives should be applied in a particular order?

20 MS BACON: I think it is -- yes and no. There isn't any
21 authority that suggests the CMA's position. What we
22 have is some cases where -- like Albion, where there is
23 no alternative two.

24 MR LOMAS: That de facto satisfies one of your variants.

25 MS BACON: Exactly. What we do not have is any authority

1 which suggests that they are genuine in practice
2 alternatives in the sense that you can have a perfect
3 comparator under alternative two and yet find there is
4 unfairness in relation to one.

5 What you do have is the Scippacercola case. We made
6 submissions on that in our written submissions. The
7 interesting thing about that is in that case what was
8 said is it was sufficient if the Commission looked at
9 alternative two, found that by reference to comparisons
10 there was no unfairness, and stopped there --

11 THE CHAIRMAN: I think the court in that case also said the
12 meaning of paragraph 252 of United Brands is clear.

13 MS BACON: Yes.

14 THE CHAIRMAN: And I think it follows from what you are
15 saying that it needs elaboration if it is to be --

16 MS BACON: And we are not aware of any case where a national
17 competition authority, certainly not the CMA, certainly
18 not the Commission, has said that if there is
19 a meaningful comparator for the purpose of alternative
20 two, that can be ignored and the case can simply be
21 decided on the basis of alternative one. This is the
22 first case where that has been done.

23 MR LOMAS: You would say Scandlines does not help us in
24 whether these are true alternatives or, if you like,
25 sequential alternatives?

1 MS BACON: I do not think there is a case which actually
2 addresses this theoretical point, whether it is
3 sequential or true alternatives. We have cases where it
4 is suggested they are alternatives but in a case where,
5 as in Albion, there was not a true alternative two.

6 And Scippacercola, what I was going on to say was if
7 the CMA's position was right then the court would have
8 been wrong. If it's the CMA's position that you can
9 ignore alternative two and just look at alternative one,
10 unfair in itself, then the court would have been wrong
11 when it said the Commission can simply look at
12 alternative two, give the undertaking take the thumbs-up
13 under alternative two because the comparator showed that
14 the prices were not unfair, and then stopped dead.

15 MR LOMAS: It would have had to have considered alternative
16 one.

17 MS BACON: Yes, and that was my point on Scippacercola.
18 That is the one case which suggests that we are right
19 because of the order in which the point was considered
20 there, and of course there we are looking at a decision
21 where the Commission said the opposite; there wasn't
22 unfairness.

23 THE CHAIRMAN: I do not quite understand why you have to say
24 that the order has to be sequential, looking
25 at comparators --

1 MS BACON: I was happily adopting Mr Lomas' main conceptual
2 framework. But actually our position is quite a simple
3 one: if there are comparators under alternative two,
4 they cannot be ignored and the case just decided under
5 alternative one.

6 THE CHAIRMAN: So they could be looked at at the same time.

7 MS BACON: Yes.

8 THE CHAIRMAN: They could be looked at afterwards as
9 a cross-check.

10 MS BACON: And in the round, yes. But they cannot be
11 ignored and with the CMA saying: I do not need to go
12 there. But actually this is all a rather theoretical
13 debate given that actually I think we are all ad idem
14 that, in any event, one would look at price comparators
15 also under limb one.

16 THE CHAIRMAN: I would not assume we are all ad idem. That
17 is always dangerous.

18 MS BACON: That is a dangerous proposition. On this side of
19 the bench I believe that we are ad idem that price
20 comparators are also relevant under limb one. In my
21 submission, I accepted your proposition that the kind of
22 analysis you would do under alternative two of limb two
23 is the same or similar to the analysis that you do under
24 limb one.

25 THE CHAIRMAN: And Advocate General Wahl does not actually

1 address this question of --

2 MS BACON: No.

3 THE CHAIRMAN: -- alternatives.

4 MS BACON: No, because his limb two is a bit different.

5 MR LOMAS: What does alternative two add if you do the same

6 comparator test for alternative two as you do for limb

7 one.

8 MS BACON: United Brands obviously had in mind -- it was

9 only looking at profitability comparisons under

10 limb one. So that is why -- I think that is why it must

11 have regarded the price comparisons as coming in under

12 limb two.

13 THE CHAIRMAN: Because that was the issue in United Brands.

14 MS BACON: That was the issue there. Once you move on --

15 and, as you say, time has passed, competition law has

16 moved on, it now seems to be clear that under limb one,

17 one is not confined to a profitability analysis but also

18 it is relevant to look at price benchmarks. Once that

19 is the case, it sort of merges into one.

20 MR LOMAS: So limb one and limb two start to flow together.

21 MS BACON: They start to flow together but there is the

22 possibility of justifying what is done by reference to

23 broader considerations of unfairness, let us say, under

24 limb two. That might be a separate issue. And also

25 there is the separate point about economic value, which

1 may well be slightly more of a limb two argument than
2 a limb one argument. That is the discussion we had at
3 the start about 249/250; are they the same? So I am not
4 going to say that they all merge into one, but I think
5 it is right to say that conceptually it is -- the kind
6 of comparator analysis you might do under alternative
7 two is likely to be the same sort of analysis that you
8 do under limb one.

9 THE CHAIRMAN: Perhaps we might move on from the abstract.

10 MS BACON: Yes. I am still just going through your
11 questions and I have a couple more pages on your
12 questions. I will try to go through these quite fast.
13 What are the criteria to judge unfairness? Question 3C.
14 Our position is it does not arise in this case, but we
15 have set out our position on the sorts of factors that
16 could be taken into account at paragraph 179 of our
17 closing submissions. Question 3D. How does the
18 comparison with competing products relate to comparators
19 as discussed in question 2? I have just answered that.

20 Question 4. What is economic value? I think I have
21 answered that. There is no easy answer. It depends on
22 the product or service being investigated. What I think
23 it is trying to capture is that in some markets it might
24 not be the case that every meaningful benchmark would --
25 sorry, in some markets it might be that, if you look at

1 all the meaningful benchmarks, those do suggest a price
2 far below the disputed price. But, for example, the
3 product or service in dispute might be far superior to
4 the rest and, therefore, has an economic value that is
5 recognised in the higher price.

6 So it is trying to capture I think the point that
7 you might look at benchmarks but that is not necessarily
8 the end of the analysis.

9 THE CHAIRMAN: I think our question was intended to flush
10 out the issue of whether economic value is some kind of
11 overarching concept which embraces all of the analysis
12 in the United Brands test or whether it is some separate
13 thing that fits into one part of it.

14 MS BACON: Yes, and I answered that at the start by saying
15 it is an overarching point. But insofar as it comes
16 in -- if you are trying to pigeonhole this in limb one
17 or limb two, it is probably more of a limb two point.
18 But I would say fundamentally it is in paragraph 250;
19 249/250 are the overarching principles, so it does apply
20 to everything.

21 PROFESSOR WATERSON: So from what you have just said,
22 economic value incorporates some idea of value to the
23 consumer or consumers --

24 MS BACON: Yes, exactly. And that is Mr Brealey's point.
25 The last question then: is it a separate free-standing

1 test or part of the analysis under one or both? I put
2 the point round the other way. I would say economic
3 value is part of the overarching question in 249/250
4 which I have encapsulated at paragraph 60A of our
5 closing submissions and the two limbs of United Brands
6 are in essence a way of assessing whether my synthesised
7 test, which includes economic value, is met.

8 In the present case, descending to the particular,
9 what I think we say, and it was Mr Ridyard's answer was
10 that the best indicator of economic value is looking at
11 comparator products. In that kind of case then looking
12 at economic value in the abstract and looking at
13 comparators under either limb one or limb two
14 essentially boils down to the same thing.

15 So I think, sir, I have answered the questions on
16 the tribunal's homework sheet. Unless you have further
17 questions, I would move on to this case.

18 Since our position is that comparators are relevant
19 for both limbs one and two, we have taken the approach
20 in our written closings of just going through the
21 relevant comparators in turn, and you will have seen
22 that. But since what I am doing today is saying why
23 I think the CMA's analysis is wrong, I think it is most
24 helpful if I follow broadly the structure of the CMA's
25 closing submissions. So we can now take up Mr Hoskins'

1 homework again, and we can start at 178.

2 So the first point they make is the absolute margins
3 point. This point boils down to saying two things:
4 number one, Flynn makes more money in absolute terms on
5 Phenytoin than its other products, number two, Phenytoin
6 would still be a valuable product to Flynn if the
7 profitability was lower. Both true. Both irrelevant.
8 Nothing in United Brands or in any subsequent case that
9 we have found suggests that excessiveness should be
10 measured in terms of whether a product makes a lot of
11 money in absolute pounds terms or whether it makes a lot
12 of money compared to other products sold by the company
13 in pounds terms or whether the product would still be
14 valuable to the company at a lower profit point.

15 The reason why none of the cases suggests that kind
16 of metric is it just does not work in the real world.
17 A product that is very profitable for a small company
18 like Flynn, and by comparison with the other products in
19 Flynn's portfolio, might be absolutely small fry if it
20 were in the portfolio of another company like, say,
21 Pfizer or Novartis. And the fact that a product might
22 still be attractive to sell at a lower price point says
23 nothing about whether its price or profit are excessive
24 by reference to the overarching test in paragraphs 249
25 or 250 or, as I have synthesised it, at paragraph 60A of

1 my closing submissions whether the price exceeds what
2 would have been obtained under normal and sufficiently
3 effective competition to such a degree that it bears no
4 reasonable relation to economic value.

5 That is why 249 of United Brands requires
6 a benchmark. If the CMA agrees that 249 and 250 of
7 United Brands are the starting point, which I think they
8 do, then they cannot get away from the requirement for
9 a benchmark, and that rules out an approach that simply
10 says that a price is excessive because it produces lots
11 of profit in pounds terms and in the abstract.

12 That is why we said in our closing submissions that
13 the high absolute margins point actually comes down to
14 essentially the same point as the conceptual ROCE WACC
15 analysis, because it is the ROCE WACC analysis that
16 turns this point, which is just about lots of money,
17 into a benchmark and the benchmark is the WACC.

18 MR LOMAS: But it could go to unfairness rather than just
19 excessiveness.

20 MS BACON: Yes, I accept that. If you got past
21 excessiveness --

22 MR LOMAS: Once you got there. Yes, I agree.

23 MS BACON: Then it is one of the kind of noise arguments
24 that you can put into the unfairness basket. It is
25 a kind of contextual factor that can be taken into

1 account. But it does not go to excessiveness, and they
2 put this under the excessiveness limb. They say, well,
3 makes a lot of money, ergo excessive. My point is it
4 does not tell you anything because you do not have
5 a benchmark. You only turn this absolute profits point
6 into a benchmark through Mr Harman's analysis, and that
7 analysis says ROCE turns to WACC in the long-term in
8 a -- he said even in a not perfectly competitive market
9 but he had said in his reports in a competitive market.
10 And really turns on whether that is correct and whether
11 that is a correct way of looking at a benchmark for the
12 purposes of 249. But, as I said, he turned that into
13 a benchmark by saying the benchmark is the WACC and so
14 you benchmark against WACC over the long-term looking at
15 volumes and costs, your return on capital will turn to
16 your WACC and you should set your price by reference to
17 that. You heard what I said about that to Mr Harman in
18 cross-examination and you heard his answers. I will
19 come to that later on because the CMA deals with that
20 particular point later on in their analysis.

21 That is our answer to the absolute profit pounds
22 point which is made at paragraph 178 and following.

23 So the next point that the CMA makes is at 185,
24 which is Flynn's activities and risks. Essentially the
25 same can be said about that, which is that saying

1 Flynn's activities and risks are limited in relation to
2 Phenytoin does not provide a reference point because the
3 question is always limited by: comparison with what?

4 So, in other words, looking at what Flynn does can
5 tell you whether a particular postulated benchmark or
6 comparator is a good comparator or whether it might be
7 too high or too low but it cannot tell you in the
8 abstract where the price point or the profit point
9 should be.

10 So the real question is: what do Flynn's activities
11 and risks in relation to Phenytoin tell you about the
12 comparator or comparators that should be chosen? And
13 once you have chosen the comparators, what do you know
14 about where Phenytoin should be placed relative to those
15 ie should it be higher or lower in terms of the price?

16 Taking the first of those, what do those risks tell
17 you about choosing the comparator set, and looking at
18 the CMA's own list of points at paragraph 187 of their
19 submissions, they say Phenytoin is an existing drug with
20 an established track record. That would tell us that
21 the best comparator is another generic. So if we are
22 looking at Flynn's portfolio, the generic drugs rather
23 than the branded drugs are probably better comparators.
24 If we are looking outside Flynn's portfolio, then we
25 should probably be looking at companies selling generics

1 rather than branded products.

2 THE CHAIRMAN: Generics do not have captive user bases,
3 generally speaking.

4 MS BACON: What has been said about this by the experts that
5 have addressed this from an industry perspective, which
6 is Mr Williams and Mr Davies, is that there are
7 different types of generics, and Flynn is a niche
8 generic. That is what they have said.

9 MR LOMAS: I thought they got to the point where it was
10 regarded as an off-patent branded drug, at least in
11 terms of its economics.

12 THE CHAIRMAN: Quasi-branded.

13 MS BACON: That is Mr Ridyard.

14 THE CHAIRMAN: And Mr Harman I think.

15 MS BACON: Yes. But our experts do not say that. They say
16 it should be regarded as a generic. Yes, it is
17 off-patent but it is a generic. It is actually
18 a generic. It is not a quasi-brand, it is actually
19 a generic. It is outside the PPRS. As you have seen
20 from the evidence, we asked whether it might stay within
21 the PPRS with a price increase and the answer came back
22 "no". So our evidence is it is actually a generic and
23 Mr Davies and Mr Williams both say it is a niche
24 generic.

25 So if one starts from that basic proposition and you

1 look at the fact that it is an existing product with
2 an established track record, generics are a better
3 comparator than a branded product set. And that makes
4 Mr Williams' and Mr Davies' comparator sets as a starting
5 point better than the PPRS, which is for branded
6 products only.

7 We can also say that, since Flynn does not do its
8 own manufacturing, then the best comparison is with
9 generics that do not do their own manufacturing, and
10 that is what Mr Williams' sample set of
11 non-manufacturing generics does.

12 MR LOMAS: But even on your case those are not all niche
13 generics. That is generics wide sense, is it not?

14 MS BACON: And he has not done a granular analysis of
15 looking at all of the products in their portfolios.
16 What is recognised is that, within each company's
17 portfolio, there will be some products that are more or
18 less profitable. He cannot get from those companies
19 confidential data about whether there are some products
20 that are more or less subject to competition and,
21 therefore, have higher or lower profit margins or
22 whether their profit margins are higher or lower for
23 other reasons entirely. We have a flavour of that in
24 Mr Davies' evidence where he does, on the basis
25 of anonymised data, look at generics with leading

1 products and finds that there are a number of companies
2 with leading products whose percentage of their total
3 profitability is comparable to Phenytoin and Flynn. But
4 if one wanted to drill down into the comparisons, the
5 CMA could have got that information. But of course what
6 we are trying to do is say, on the totality of the
7 evidence we have, okay we do not necessarily have
8 a perfect comparator but are the comparator sets
9 meaningful? Are they sufficiently good to put into the
10 basket? Are they informative? And looking at it at
11 that level, which is necessarily a high level on the
12 basis of the information we have before us, we have the
13 PPRS, which is, as I will come to, the source of the
14 benchmark, and we have generic comparators. They are
15 all baskets.

16 MR LOMAS: But is not one of the dangers here, Ms Bacon,
17 that your experts pick this term of a "niche generic"
18 but we have not actually really had very much clarity of
19 what it means to be a niche generic. Then, in
20 terminological terms, you very easily slip into saying
21 it is a niche generic, drop the "niche", call it
22 generic, compare it with generics. The reality is that
23 the Flynn product had its supply structure set in place,
24 a defined user base of people already stabilised on it.
25 It did not need to re-register, it just needed a name

1 change. It picked up the brand and the credibility of
2 the Pfizer product and its risk profile was very
3 different from generics itself and it was branded. So
4 without being very clear about what we mean by this
5 category of "niche generics", we need to be very careful
6 that we do not end up comparing, back to apples
7 and kumquats, things that do not carry the same
8 economics.

9 MS BACON: Can I just unpick what you said. So you said at
10 the end it was branded. No, it was not a brand. It had
11 an identifier on it. It was not a brand.

12 THE CHAIRMAN: An identifier on it.

13 MS BACON: It was sold as a generic. It was in a part of
14 the drug tariff that was for generic products. It was
15 actually -- that is why I say, it was actually in terms
16 of the classification of drugs a generic product. It
17 was, we have seen, subject to competition from NRIM.

18 Now, if we are at this point, you will have decided
19 that there was not sufficient competition, but what you
20 will have seen is that Flynn lost a huge amount
21 of market share to NRIM. And that is the point that
22 Mr Davies makes and he says, well, actually let us break
23 this down, what are the activities and risks of Flynn
24 compared to a generic product? If you are a generic
25 product on the market, whether or not you genericise

1 a brand or whether you just come in behind a brand, you
2 have got a user base which is there, a user base of
3 people taking that drug. If you genericise a brand,
4 what happens is that you hope that you will pick up
5 quite a lot of that, but you are still going to be then
6 subject to competition. So a brand that just switches
7 and goes generic, the expectation will be that there
8 will be a rapid loss of market share because it has been
9 genericised and, as soon as it is genericised, then
10 everything else just piles in. If you are a new
11 generic, you are expecting that you will increase the
12 market share and you will then be subject to competition
13 from other generics. Mr Davies says, looking at the
14 risks of a generic, any generic, that enters the market,
15 Flynn's risk was no different in substance to that of
16 another generic entering a market, and he puts them all
17 together. He is an industry expert, and what the CMA do
18 not have is an industry expert who comes in and says:
19 no, actually niche generics are different. So this
20 comes back to the point it is quite a complicated
21 market. It has particular market dynamics and one has
22 to look at the dynamics of this sector. It is not
23 something that can just be extrapolated from looking at
24 how other markets work. It requires industry expertise
25 and that is why we have two industry experts among our

1 experts, Mr Davies and Mr Williams, and they both say this
2 should be treated like other generics. The best
3 comparator -- okay, maybe not perfect comparator, but
4 the best comparator is looking at other generics.

5 PROFESSOR WATERSON: What is the meaning of the word "niche"
6 here? Does it have any meaning or can we drop it?

7 MS BACON: Mr Williams has defined it. I think it is in
8 Williams 1, and someone is going to tell me the relevant
9 paragraph. Yes, Williams 1, paragraph 32. He says at
10 paragraph A:

11 "There are some classes of generic drugs where ..."

12 And he gives an example:

13 "... multiple suppliers, large volumes, easily
14 accessible manufacturing capabilities ... where the
15 returns are likely to be diminishing. The specialist
16 generic sector has, in my experience, attracted a number
17 of entrants to this category."

18 Then he says:

19 "Specialist generics may attract high margins for
20 a number of reasons."

21 And these could include difficulty of manufacture
22 and so on:

23 "... niche markets where the cost of development of
24 the generic presentation have only a limited market over
25 which they can be recovered, declining markets due to

1 the lack of new patients being prescribed the therapy or
2 unusual characteristics in the prescribing regime."

3 PROFESSOR WATERSON: So it is something to do with the size
4 of the market relative to development --

5 MS BACON: Size of market, difficulty of manufacture,
6 limited source of API, declining markets. So that is
7 his description and Mr Davies' evidence was also that
8 this is a niche generic. The other reference is
9 Mr Davies, so D5, paragraph 14C. At page 5 of D5 he
10 makes a similar point:

11 "Launching niche generics which are typically
12 products with some initial barriers to entry eg lack of
13 API supplier, specialised manufacturing process, patent
14 or regulatory hurdles ..."

15 Then he says:

16 "Those products might have a higher than average
17 margin until the arrival of additional competitors."

18 So it is a long-term/short-term point.

19 MR LOMAS: One of my concerns with this paragraph 14C is
20 does it describe Phenytoin? Lack of API supplier,
21 specialised manufacturing processes, patent or
22 regulatory hurdles in relation to something that has
23 been in the market since 1935?

24 MS BACON: Yes. He is saying what he considers to be
25 typically niche generics but I think either in his

1 evidence -- someone is going to give me the reference --
2 Mr Davies I think says Phenytoin is a niche generic.
3 But I am going to rely on somebody else to give me the
4 reference.

5 PROFESSOR WATERSON: But the point is it satisfies some but
6 not all of these characteristics.

7 MS BACON: Yes. Both his and Mr Williams' understanding was
8 that this is not a sort of what one could call
9 a commodity market in the definition given by
10 Mr Williams of generics piling in, like paracetamol
11 for example, or Ibuprofen, where you have generics
12 piling in and the price then drops to marginal cost.

13 I think there is also a danger of a too rigid
14 categorisation. Because it is really a continuum.
15 There is going to be, at one end of the extreme, some
16 generics where there is very intense competition. At
17 the other end of the continuum, of the spectrum, there
18 are going to be generics with very little competition
19 and there is a variety of factors which might place
20 products somewhere in the middle. What Mr Davies was
21 saying in his evidence about this leading product point
22 is that most mature companies like Flynn do have some
23 leading products where they do make more money than
24 their other products, and that is just a way that
25 pharmaceutical suppliers compete. They have some

1 run-of-the-mill products on which the margin is very low
2 and then they have some other products where the margin
3 is higher, and he says that is typical. So that does
4 not suggest that looking at the portfolio of another
5 generic company is a bad comparator, because what is
6 recognised is that within a portfolio there will be
7 higher and lower margin products.

8 I am being looked at. I think probably we ought
9 to pause there. I am making reasonably good progress.

10 THE CHAIRMAN: You are not doing a page-by-page approach.

11 MS BACON: On a page-by-page approach, it would appear that
12 we might not finish quite by 4.30 pm. I will try to
13 speed up this afternoon. But I have been dealing with
14 quite a lot of questions from the tribunal.

15 THE CHAIRMAN: Yes. But the questions may be quite
16 important.

17 MS BACON: Yes, I understand that, which is why I have
18 wanted to give full answers to them.

19 THE CHAIRMAN: 2 o'clock.

20 (1.00 pm)

21 (The short adjournment)

22 (2.00 pm)

23 MS BACON: Can I pick up on a couple of points from the
24 debate just before the adjournment. So firstly
25 a reference, I said Mr Davies had said that Phenytoin

1 was a niche generic and the reference for that is
2 paragraph 5 of his statement.

3 Secondly, you asked me what part of the Williams
4 definition of niche generics Phenytoin fell into, and
5 I had made the point that it is a continuum rather than
6 a rigid categorisation. But if you did want to put this
7 in a rigid categorisation he refers to niche markets
8 where the cost of developments have only a limited
9 market over which they may be recovered, so the small
10 market point. That is one point. And then declining
11 markets, so we would say both of those apply in this
12 case. But I would maintain my earlier point that it is
13 a continuum rather than a rigid categorisation.

14 The third point that I think you, Mr Lomas, were
15 putting to was if you have something that is a niche
16 generic, does that undermine the validity of the
17 comparison with a generic portfolio generally? Part of
18 the answer to that, apart from saying the continuum
19 point, is that if anything it means that if you look at
20 a portfolio of a generic company in which there will be
21 some more niche products and some more commodity
22 products, looking at that and looking at the overall ROS
23 or overall profit margin is likely to be conservative,
24 ie not in our favour. Because if you spliced your
25 comparator pool and only looked at the niche products

1 within a generic company's portfolio they would be the
2 ones with the higher margin.

3 So what you are doing, if you are looking at
4 a margin over a particular company, so a portfolio
5 margin, is that that company, and this was Mr Davies'
6 evidence, is likely to have some higher earning products
7 and some lower earning products. So the gross margin
8 overall of say the more niche-y products will be brought
9 down by the products where there are -- it looks more
10 like a commodity.

11 MR LOMAS: I understand the point, although of course if
12 Phenytoin had different economics and economic profile
13 from a niche generic that would cease to be true.

14 MS BACON: Yes, but we have two experts saying --
15 Mr Williams says it is undoubtedly a niche or specialist
16 generic, and Mr Davies says it is a niche generic. So
17 it comes back to the point about evidence. Industry
18 evidence before the tribunal says this is a niche
19 generic. Mr Davies says this is not at all uncommon, it
20 is very common, he says most mature companies like Flynn
21 will have some leading products in their portfolio. And
22 when cross-examined on that point, he said he couldn't
23 remember what they all were from his comparators but
24 they were likely to be the niche products, so it is not
25 an unusual phenomenon.

1 Then there is the captive user base point. Does
2 that mean Phenytoin is somehow different? That is
3 partly the point you were just putting to me. In our
4 submission it is not a relevant point. Any generic is
5 going to a market that is already there. That is
6 the whole premise of the generic market. So there is
7 an -- so the points that the CMA referred to: existing
8 drug, same for any generic, established track record,
9 same for any generic. And you heard the point I was
10 putting to Mr Harman about the approval process, the way
11 it works is you piggy-back off the safety and efficacy
12 data of the reference product.

13 So then the only question is: is there something
14 different because of the continuity of supply? In our
15 submission that is not relevant because we know on the
16 facts that Flynn lost a huge amount of market share to
17 both NRIM and parallel imports. So whatever the conclusion
18 the tribunal may come to as to the significance of those
19 facts from market definition, we know that Flynn did
20 lose the majority of its user base, if you like, for the
21 100mg which is where it competed with NRIM.

22 So Flynn did not have a guaranteed market share, and
23 nor did Flynn expect to, and I said at the outset Flynn
24 expected there to be generic competition and the
25 references were in our closings submissions for that.

1 So Flynn went into this knowing that there was likely to
2 be generic competition. Of course at that point the
3 MHRA guidance had not come out and we have the evidence
4 that until that point at least everyone thought it was
5 absolutely fine to be switching.

6 All that can be said is that perhaps some time later
7 than the guidance, and we know it is not November 2013
8 from what I have shown you this morning, maybe late
9 2014/early 2015 the market had got a bit more sticky,
10 but by that time the damage had been done. Flynn's
11 market share went down to parity with NRIIM for the
12 product that was competitive which was the majority of
13 the market, so over 70 per cent.

14 PROFESSOR WATERSON: Of course not all generics necessarily
15 have a captive user base.

16 MS BACON: It depends what we are talking about, what you
17 mean by captive user base, as in is there a market
18 already there? Generic by definition, the generic
19 authorisation will be piggy-backing off a reference
20 product.

21 PROFESSOR WATERSON: But that market may expand. I am
22 thinking of Ibuprofen.

23 MS BACON: So what you are saying is the user base may
24 expand from the branded -- yes. In this case one of the
25 features was that there was a declining market, and that

1 was one of the factors that was listed in Mr Williams'
2 what is a niche generic paragraph, declining market. So
3 there you are.

4 If I look at then what the CMA says in its written
5 submissions about Mr Davies' evidence, because obviously
6 we have placed considerable weight on Mr Davies'
7 evidence about the comparability of Phenytoin and its
8 activities to any generic, and the CMA tries to undermine
9 that in three ways at paragraph 188.

10 First, just to run through those quite quickly, the
11 first point they make is his assessment of risk was
12 based on the false assumption that tablets and capsules
13 were not in the same market. That is point 11 of my
14 errors note. His assessment of risk actually was not
15 based on that assumption. His assessment of risks for
16 Phenytoin referred to competition from NRI and NRI
17 alone. He did not refer to any risk of competition from
18 tablets.

19 The second point is to say -- this is 188(b) --
20 Mr Davies had not done independent analysis of whether
21 Flynn held safety stock, et cetera. Mr Davies' evidence
22 on those points was based on what he had been told. His
23 report just said "I understand", so he was not trying to
24 give primary evidence. The primary evidence was given
25 by Mr Walters and he said Flynn did hold safety stock

1 and did take steps to identify other potential API
2 suppliers.

3 The third point is also at 188(b), the latter part
4 of 188(b), Mr Davies was not aware of the indemnity in
5 the supply point with Pfizer. I am afraid I do not
6 think that that should be a factor that undermines the
7 entirety of Mr Davies' analysis on this. This is a very
8 complex market, he has given evidence about a complex
9 market. If an indemnity issue were relevant that would
10 have been a question to ask him and the question would
11 have been whether this sort of indemnity is commonly
12 seen in contracts between generic suppliers and the
13 manufacturers of their products. He could have been
14 asked that, Mr Walters could have been asked that, but
15 they were not.

16 MR LOMAS: I think questions may have been posed in
17 cross-examination actually. But surely the question was
18 not whether it was normal or not to do it, but whether
19 in the case of Flynn it shifted some of its risk profile
20 upstream to Pfizer which meant that it could expect
21 a lower -- or it required a lower rate of return because
22 the risk profile had fallen.

23 MS BACON: That is a factual question but it goes to whether
24 a generic comparator is a valid one. So actually the
25 question would have been the one I put: is it common in

1 generic contracts with their manufacturers, their
2 suppliers, to have this kind of indemnity? Because if
3 actually all generics, all non-manufacturing -- as
4 I said, to come back to my point, Flynn is not
5 manufacturing Phenytoin, so that is why Mr Williams'
6 comparisons were limited to non-manufacturers. So the
7 relevant question would be: in this market for generics
8 that do not manufacture do they all have indemnities?

9 MR LOMAS: Do they all have indemnities, yes.

10 MS BACON: And we do not know that so the CMA cannot take
11 a point on that without evidence.

12 So I think that really these points about Mr Davies'
13 evidence are very, very peripheral indeed. What they
14 should have done if they wanted to make this point is to
15 get evidence from an expert who would address all of
16 this and would say there is something fundamentally
17 different about Phenytoin or Flynn's activities and they
18 have not got that. The two experts on the industry have
19 both said generic companies are good comparators.

20 So that is all I really wanted to say about the
21 generic comparator point in terms of the Flynn's
22 activities and risks.

23 Can I move on to the PPRS, that is at paragraph 193
24 onward of their submissions. They start out their
25 section on the PPRS by objecting to our obsessive

1 focusing on this point on the basis that they say the
2 6 per cent is a relative but not determinative factor.
3 There is a short reason why we have obsessed, as they
4 say, about the PPRS and that is because as I have shown
5 you in opening, the SO made clear in terms explicitly
6 that the 6 per cent ROS was drawn from the PPRS and the
7 same is true of the decision.

8 As I put in our closing submissions, the decision
9 identifies three possible benchmarks. We have seen that
10 paragraph of the decision. And the only one of those
11 that produces the 6 per cent figure is what the decision
12 refers to as the allowable ROS under the PPRS.

13 So the CMA really cannot get away from the PPRS. If
14 it is not an appropriate benchmark then there is no
15 source for the 6 per cent. The ROS analysis is
16 therefore based on the wrong starting point.

17 You have heard and seen a lot of reasons why we do
18 not think the PPRS is a meaningful benchmark. What
19 I want to do now is to focus on the main points in terms
20 of what the CMA has said in its closing submissions.

21 MR LOMAS: You would accept, would you, that if the other
22 measures came to a lower figure than 6 per cent it was
23 prudent of the CMA to take the highest figure which
24 happened to be the 6 per cent?

25 MS BACON: It would have been then generous to us, yes. But

1 in that case I would still not say they should just take
2 that and forget about the rest. What they would then
3 say is, look, we have got a whole string of benchmarks,
4 Flynn's --

5 MR LOMAS: -- yes, I understand.

6 MS BACON: -- and looking at that we are going to be
7 generous to Flynn, we will take the highest. But they
8 did not do that, they did the opposite. They knew if we
9 looked at Flynn's internal ROS you would come out with
10 a higher figure and ditto if you looked at other generic
11 ROSs.

12 So if I just focus on then the main points that are
13 taken against me in relation to the PPRS and what we
14 say. The first and the most obvious point in relation
15 to the PPRS is that the 6 per cent is a target rate
16 across the portfolio. It is a bit strange that at
17 paragraph 156 of the CMA's submissions this point is
18 made as a point that the DH said which confirms the
19 CMA's reference to the PPRS. The CMA says it did:

20 "... however, make some statements which confirm the
21 CMA's reference to the PPRS. In particular the DH
22 stated (a) the measure covers the entire portfolio."

23 The odd thing about that is that actually that
24 point, if you recall the Department of Health
25 conversation memo which is at J1/20. I do not think we

1 need necessarily to go back to it. But that point was
2 made in the section where the DH was talking about
3 reasons which suggested that there were issues with
4 using the ROS. That was the first of their points. The
5 initials which I will not read out:

6 "... set out potential issues with using ROS for
7 benchmarking including the measure covers the entire
8 portfolio."

9 So actually the Department was saying that was
10 a reason why it was not necessarily a good starting
11 point but the CMA presents this as the opposite.

12 Mr Harman actually made our point for us when he was
13 asked about the cost pool, and you may recall that I was
14 asking him: if you are trying to compare the
15 profitability of Phenytoin to a 6 per cent ROS in
16 the PPRS, would it not be appropriate to try and do
17 the calculation as if Phenytoin had been in the PPRS?

18 If I get the transcript his response, that is Day 8,
19 page 191, lines 2 to 10. He says --

20 THE CHAIRMAN: Hang on.

21 MS BACON: Sorry, I am going too fast.

22 THE CHAIRMAN: Day 8/191?

23 MS BACON: Yes. Top of the page:

24 "You are saying that the Department would look at
25 the portfolio, but we are worried about the

1 excessiveness of an individual product. We never say
2 that the portfolio is the right metric, we say the
3 6 per cent is. It does not allocate to individual
4 products and, because it does not allocate to individual
5 products, we cannot actually use the PPRS scheme to
6 understand what it would be at a product level, because
7 it does not do it."

8 Obviously there are lots of unattached "its" in that
9 sentence. But he is basically saying you cannot just
10 look at the PPRS to extract something for an individual
11 product because the PPRS does not apply to individual
12 products. That was why he was rejecting my proposition
13 that you should try and do the cost allocation in a sort
14 of PPRS way, if you like. But actually it is our point:
15 we say you cannot use the PPRS for that reason, it is
16 a portfolio scheme.

17 His solution is to say, well, we are not using the
18 PPRS, we are just using the 6 per cent. And that is
19 what he said in that passage. But that makes no sense
20 because the 6 per cent target is a portfolio target. So
21 if it is to serve as a useful comparator the CMA has to
22 explain why plucking a portfolio target out the scheme
23 tells you anything about what the profitability of
24 an individual product should be, and Mr Harman is
25 essentially saying there it does not tell you anything

1 about individual profitability.

2 So that is the starting point problem with the PPRS.
3 The CMA says, well, we can still use the 6 per cent
4 target because the PPRS covers a lot of the market. We
5 now know that during the relevant period, it was
6 actually only 50 to 60 per cent by value and less than
7 25 per cent by volume which is not, in our submission,
8 a promising starting point when we know that this
9 particular product was not in the 50 to 60 per cent and
10 it was not in the 25 per cent.

11 We also know that the companies who are actually
12 held to the PPRS by being required to submit AFRs are
13 a small subset and Mr Williams thinks only about 30. We
14 know how many there were in and around 2009 to 2011
15 because that is Mr Williams' table which I am going to
16 come to and that showed there being 35, then 33, then
17 31. So 2011 was 31 companies that were in that subset.
18 So that is a small subset of the 50 to 60 per cent by
19 value and 25 per cent by volume.

20 But even if the CMA was right to say that sample
21 size is in and of itself significant, as they have
22 repeatedly said it is the quality and not the quantity
23 of the comparators that is relevant. And what we know
24 is the companies that do submit AFRs under the PPRS are
25 not at all like Flynn. They are large multinationals

1 who buy and sell their products under transfer pricing
2 arrangements and they operate models, group structure
3 models, which mean that their local profitability is
4 generally fixed and therefore notional. So in our
5 submission you could barely get a worse comparator to
6 Flynn.

7 The CMA cannot cure that by saying that the target
8 ROS is conservative. Because if the target ROS, the
9 6 per cent, is a meaningless benchmark for those
10 companies because their local profitability is
11 essentially fixed anyway, then saying that it is
12 conservative is meaningless too. You can only make
13 a meaningful statement that something is conservative if
14 you know that the thing that you are saying is
15 conservative is a meaningful figure to start off with.

16 We know now that the CMA actually does not have any
17 idea whether 6 per cent bears any resemblance to the
18 profitability of companies in the PPRS as a whole. I am
19 going to say something else about the AFR submitting
20 companies in a minute. But if we look at the PPRS as
21 a whole, there has been no attempt to find out what
22 across the PPRS the ROS of the PPRS members is, in
23 particular those who do not submit AFRs. We know it has
24 not done any analysis at all of the ROS rates of any
25 company other than Flynn and Pfizer and we know that

1 from Mr Harman's cross-examination.

2 There is no excuse that it is too difficult to get
3 that information. The CMA could have asked Flynn to
4 give it a list of the companies in the PPRS that were
5 most like Flynn, because Flynn is in the PPRS itself.
6 The CMA could say we would like to look at companies in
7 the PPRS that are like you, give us a list, and we will
8 go and look at their statutory accounts, you can
9 download them on line, I did it for a few, you can look
10 at their revenues and costs and you can work out their
11 overall ROS. It would not have been very hard to do.

12 Of course if the CMA had said that, Flynn would have
13 said "Well, why are you asking us about companies in
14 the PPRS because Phenytoin is not in the PPRS, it is
15 a generic. Is it not more relevant to look at the
16 statutory accounts of generics?" But that is obviously
17 a different point.

18 The point I am making here is if it had been
19 relevant to find out what the actual average ROS is
20 across the PPRS, or across companies in the PPRS that
21 are actually like Flynn, as in not the multinationals
22 with LRD models, then they could have done that. What
23 they are left with is a target that is really, as
24 Mr Williams says, only applied to multinationals with
25 LRD models, using transfer pricing arrangements, and

1 that means it is not at all meaningful to Flynn. So
2 however much of the NHS the PPRS covers does not solve
3 the problem. It is not a meaningful number. Saying it
4 is a target for lots of companies does not make it more
5 meaningful if it is not a meaningful number to start off
6 with.

7 So that brings me onto the transfer pricing point.
8 I am not sure that the CMA has understood what we are
9 saying about this. We are not saying that Flynn's
10 profitability should be assessed as if it benefited from
11 the transfer pricing allowance. What we are saying, and
12 it links to the point I have just made, is that the fact
13 that the 6 per cent was designed to deal with transfer
14 pricing arrangements, and the fact that all the
15 companies who were actually assessed under the PPRS and
16 held to that, the ones who submit AFRs, operate transfer
17 pricing averages, and that is Mr Williams' evidence,
18 that is one of the reasons why it is a meaningless
19 figure.

20 The point is, as I think I have made, if you fix
21 your transfer price at a level to ensure that your ROS
22 is within the 9 per cent which is the allowed level,
23 that is 6 per cent plus the MOT, then the conclusion
24 that you comply with the 9 per cent allowance does not
25 tell you very much about the reasonableness of the

1 underlying pricing.

2 The other point that I made was if Flynn had to
3 submit an AFR with Phenytoin on it, so if Flynn had been
4 over the AFR threshold, then it would have done what
5 everyone else does who is in that zone which is to set
6 up a group structure so it could use the transfer
7 pricing allowance that is built into the system.

8 The CMA's main answer to that seems to be that the
9 transfer pricing arrangements are supposed to be at
10 arm's length and companies, even those who are not
11 submitting AFRs, are supposed to adhere to the PPRS
12 rules. So it is a theory that you should be doing that
13 even if everyone is not or lots of people are not.

14 In our submission that is not good enough. What we
15 are looking for is a benchmark that represents what the
16 profitability can actually be expected to be of
17 a normally competitive product that is comparable to
18 Phenytoin. And as I said, that is an empirical
19 question. That requires the decision-maker to look at
20 the returns that companies actually make, not a notional
21 target that most companies under the PPRS are not held
22 to.

23 In any event, the CMA does not actually have any
24 evidence that it is not perfectly consistent with the
25 PPRS rules to set up a transfer pricing arrangement.

1 Mr Williams' evidence is, by contrast, that the use of
2 this sort of arrangement is absolutely consistent with
3 the rules. It was what the ROS benchmark was there to
4 deal with in the first place and that is the bit
5 I showed you in the Department of Health memo in
6 opening.

7 Mr Williams said repeatedly in a long section of his
8 cross-examination on this point, and I will just give
9 you the reference, Day 6, pages 86 to 89, that this was
10 consistent with the rules and that he had been at
11 meetings with officials at the Department where setting
12 up an affiliate procurement company had been, and I am
13 quoting him now, "discussed and even endorsed". That is
14 page 86 at lines 18 to 20.

15 So the evidence before the court is that this kind
16 of arrangement is consistent, is understood by the
17 Department, is endorsed by them.

18 The CMA's other answer is to say that the transfer
19 price allowance does not undermine the 6 per cent
20 because what you can do is just subtract it from the
21 out-turn ROS rates in Mr Williams' table, the table from
22 the twelfth PPRS report to Parliament. That is their
23 paragraph 198 and I am afraid every subparagraph is on
24 my errors note.

25 This is a technical point. I have set out the

1 answer to every subparagraph of 198(a) somewhat
2 laboriously on the note. I do not want to go through it
3 all now. Can I leave that as, as Mr Freeman says,
4 homework for the tribunal --

5 PROFESSOR WATERSON: We are looking forward to it.

6 MS BACON: I am sure you are. Can I make some high level
7 points to shortcut it and give you an overview. The
8 first point, and it is a serious one, is what the CMA is
9 trying to do in paragraph 198 is to give evidence about
10 how you can manipulate the figures given in this report
11 in a very complex scheme, but this I am afraid is not
12 legal submissions, it is a set of submissions on a very
13 technical topic that is outside the expertise of almost
14 everyone in this room except Mr Williams who is sitting
15 behind me.

16 Mr Williams has spent his entire professional career
17 advising on the PPRS. I think it is fair to say that
18 outside the Department of Health there is probably
19 nobody in the world who knows more about the PPRS. He
20 has given evidence on precisely the issue that is the
21 subject of paragraph 198, and he was cross-examined on
22 this point and his evidence was categorically that you
23 cannot do the mathematical exercise that the CMA is
24 trying to do here. It does not work.

25 The reason it does not work, as he has explained,

1 and I have given you all the references I hope on the
2 note, is that the out-turn figures reported in the table
3 that everyone is referring to here are not simply
4 a mathematical exercise of adding the transfer price to
5 the original local ROS. Actually, as I have explained
6 on the note, the transfer price profit is not added at
7 all on to any figures. What happens is that it is
8 removed as a cost at the out-turn stage, so that has the
9 effect of increasing the reported out-turn ROS.

10 But that is not the only thing that goes on, and
11 this is Mr Williams' point. What also happens is that
12 the ROS of those companies has been depressed at the
13 first stage, the company-submitted stage, by injected
14 costs and grossing up the R&D. In other words, it is
15 putting on to the balance sheet stuff that is not on the
16 company's statutory accounts. And there are various
17 disallowances that to some extent cut the other way.

18 So his evidence is you cannot do that neat
19 mathematical exercise, you could not even do it if you
20 were to build into your reverse-engineering something to
21 do with the injected costs and grossing up because those
22 would be company specific. It is not just a formula, it
23 depends on how many injected costs there were, how much
24 R&D there was to be grossed up. And then what happens
25 is that some of that gets disallowed and you see the

1 effect of that if you look at the more detailed
2 spreadsheet with the example workings that
3 the Department of Health sent to the CMA which I took
4 you to in opening. That gives you some examples because
5 you will see there are injected costs and then there are
6 notes on the right-hand side which show that some of
7 those costs get then disallowed.

8 So it is a whole load of quite complex calculations,
9 some of which turn on what the company has done and what
10 R&D has been spent and what costs have been injected.
11 There are other bits in relation to the disallowed costs
12 that turn on formulae built into the PPRS rules. So you
13 cannot just strip out the transfer price 13 per cent and
14 then say, bingo, that is your local ROS.

15 The other point is it is not really clear to me why
16 the CMA are trying to do this at all because what they
17 seem to be using this for, they seem to be trying to say
18 you can reverse-engineer those figures and extract some
19 information about what the original local ROS of those
20 companies would have been. But if it is relevant to
21 look at that, why do they not just go and get the
22 statutory returns of those companies? That would have
23 actually given you the local ROS rates without having to
24 try and assume them notionally from some
25 reverse-engineering exercise which Mr Williams says you

1 cannot do.

2 But if of course they did that, the question would
3 be the one I have just asked: why would they be looking
4 at the ROS rates of PPRS companies that are essentially
5 in LRD models rather than looking at generics that are
6 selling products outside the PPRS?

7 The other reason why it is a little bit odd that one
8 would try and do this reverse-engineering anyway is that
9 actually it is not disputed that the UK SMDCs, the sales
10 and marketing distribution companies that do file AFRs,
11 do have fairly low ROS rates. That is Mr Williams'
12 evidence. His point is they do have low ROS rates, they
13 do come in generally below 6 per cent, because they are
14 fixed under the LRD model. So I just do not understand
15 where this is going.

16 MR LOMAS: But for Flynn's activities with Phenytoin,
17 leaving aside the rest of their activities, are their
18 activities not relatively close to the LRD model?

19 MS BACON: No, because one of the main features here is
20 risk. The LRD model says whatever you do, however much
21 profit you make, we will change that year-on-year so
22 that the parent company shoulders the risk, the parent
23 company gets the risk and the reward. That is why we
24 can fix this at 3 to 5 per cent because you are bearing
25 no risk at all. No risk at all. It is always going to

1 stay at around that level, that is what Mr Williams
2 says.

3 What Flynn is doing with Phenytoin is it has no
4 beneficent parent company shielding it from the risk
5 saying we are going to take all the reward and all the
6 risk. It bears the risk, it puts the product on the
7 market. As we have seen, market share went down. That
8 is one of its risks. It is not in that kind of vertical
9 integrated arrangement.

10 One of the points --

11 MR LOMAS: It clearly takes some risk, of course it does.

12 But I thought the CMA's point was that its risk profile,
13 when you take account of the indemnity, when you take
14 account of the old product, et cetera et cetera, was as
15 a matter of fact not very different from the
16 multinational model you were just describing. Of course
17 it is not the same but it is within the same range.

18 MS BACON: Yes, and my answer to that is that for various
19 reasons, and presumably in order to comply with the PPRS
20 ROS, this 3 to 5 per cent is not a figure that reflects
21 the risk of those companies in a sort of meaningful
22 sense. We know the 6 per cent is the ROS target, we are
23 going to fix the risk at this, 3 to 5 per cent, it is
24 going to come in at that anyway. This is all notional
25 figures. We are dealing in all notional figures. What

1 is necessary and what we know from United Brands is to
2 look at an empirical benchmark and my point is the
3 6 per cent is not an empirical benchmark, it is
4 a notional benchmark that is applied to companies with
5 a notional local profit under the transfer pricing
6 arrangement.

7 Again, if any of this was actually disputed it would
8 have been open to the CMA to bring along somebody from
9 the Department and say "No, everything that Mr Williams
10 says is actually wrong. The PPRS is a very relevant
11 benchmark". But they did not do that, and what you have
12 is a memo of a call where the Department says for lots
13 of reasons there are issues with using the ROS as
14 a benchmark.

15 I return to the point: there is one and only one
16 expert in this proceeding who talks about the relevance
17 of a target rate drawn from the PPRS to Phenytoin and
18 that is Mr Williams.

19 Just to cover off the LRD point, paragraph 199 of
20 the CMA's submissions says that we point to the LRD
21 model to argue that pharmaceutical companies earn more
22 than the 6 per cent target. Actually you will see from
23 what I have just said that we are saying the opposite.
24 We are saying in the LRD model the UK SMDCs do indeed
25 have local ROSs that are typically less than the

1 6 per cent but, as I said to you, it is a notional
2 figure.

3 Can I then turn on to the ROCE cross-check argument
4 which starts at paragraph 200 of the CMA's closing
5 submissions. We made the point in our written closing
6 submissions that at various points in Mr Harman's
7 cross-examination he seemed to be using his ROCE/ WACC
8 conceptual framework to go far beyond simply saying that
9 this was just a cross-check. In fact he said this was
10 his overarching or underlying framework for the whole of
11 his analysis.

12 In its closing submissions the CMA seems to row back
13 from that somewhat and does only rely on the ROCE
14 analysis in this part of their submissions as a
15 cross-check. Even if the purpose of that analysis is
16 limited in that way, it fails for the reasons that we
17 have set out in our closing submissions. The basic
18 point is even if the theoretical premise is right, which
19 we say it is not, and I explained in our closing
20 submissions why the theoretical premise is not right and
21 I will come to those in a bit. But even if you assume
22 that the theoretical premise is right, looking at what
23 return on capital would be implied by a particular WACC
24 cannot be a cross-check on the reasonableness of
25 6 per cent because at its highest, and this is what

1 Mr Harman said in his report, it is just saying what the
2 minimum should be. It is the minimum that an investor
3 would require.

4 So that is the basic point. That is where Mr Harman
5 came down to in his second report after he had seen what
6 CRA said about this. In his second report he then says
7 it is the minimum, it is the floor. It is not saying
8 the 6 per cent is the correct figure.

9 The other point is that, as we have said, it is
10 a bit difficult to understand why Mr Harman did not take
11 the PPRS ROCE benchmark for his WACC instead of taking
12 a benchmark that was much below that. Because he said
13 he thinks the PPRS is a suitable starting point for the
14 ROS but why was it then not a suitable starting point
15 for the WACC?

16 If he had used the 21 per cent plus MOT, that would
17 have given him a WACC of 31 per cent, around three times
18 the WACC that he used, and his results would have been
19 different. So actually when he says, well, if you used
20 Pfizer WACC it shows you that 6 per cent is generous,
21 that is only because the 6 per cent is from the PPRS and
22 the equivalent ROCE in the PPRS is much higher than
23 Pfizer's WACC.

24 The CMA has a couple of answers to that. They say
25 the PPRS ROCE does not include amortisation or

1 intangibles as allowable expenses and that is
2 artificial. But there is nothing actually artificial
3 about it. The ROCE rule in the PPRS just says what is
4 allowed is a return of 21 per cent plus the MOT on the
5 real assets and nothing on the intangibles or
6 amortisation, they are just saying we will do it on top
7 of the actual assets, not intangibles --

8 MR LOMAS: Those PPRS figures are ROCE, not WACC, aren't
9 they?

10 MS BACON: Yes.

11 MR LOMAS: A WACC of 30 per cent would be an extraordinarily
12 risky proposition, I would have thought. So we are
13 probably talking ROCE not WACC.

14 MS BACON: Yes, but I am saying his WACC is not implied by
15 anything that is drawn from the PPRS. I am being told
16 that is right.

17 But in any event what he does not do, what Mr Harman
18 does not do is identify the intangibles for Phenytoin
19 and we know it has no amortisation. So this point about
20 no intangibles and no amortisation does not really mean
21 it is not a good comparator.

22 The second response is to say that the WACC
23 Mr Harman chose fitted Pfizer's WACC, and I think it is
24 good to look at the paragraph of the decision that they
25 reference here, it's paragraph 5.110. They say:

1 "There are a number of listed and unlisted
2 pharmaceutical companies that were reasonably comparable
3 to Pfizer and which state their WACC in their annual
4 reports, those range between 9 and 12 per cent. The
5 similarity between Pfizer's WACC and those of
6 a number of other pharmaceutical companies suggests that
7 Pfizer's is representative of what could be a common
8 level of return in the pharmaceutical industry."

9 What is odd is that when looking at the WACC, the
10 CMA does magically have the ability to take a selection
11 of comparable companies, look at their annual reports,
12 and use those to derive a benchmark. Of course in
13 Pfizer's case this WACC benchmark is just used as
14 a cross-check for the ROS that the CMA has adopted.

15 If they can do that for something that is really
16 only a cross-check, I just can't understand why it was
17 not possible to do the same exercise, look at
18 a selection of comparable companies, go and look at
19 their annual reports, and find the relevant ROS.

20 So that is the ROCE/ WACC cross-check dealing with
21 the points that are made here about this being
22 a cross-check. I am going to come back to it because
23 of course it arises again in the outlier analysis, it
24 arises at lots of points.

25 Can I then move on to the next section of the CMA's

1 skeleton that concerns us which is the cost allocation
2 point and that starts at around 213.

3 So the starting point is common ground. It is
4 common ground that there is not any uniquely correct way
5 to allocate costs. What the decision-maker has to do is
6 to look at the cost drivers, if any, in the relevant
7 sector and the characteristics of the relevant products
8 and companies. We do have one small authority which
9 gives some guidance on this, it is at authorities A1/7,
10 A1, tab 7, and it is Claymore Dairies. Just one
11 paragraph of that, you may have seen it already. It is
12 paragraph 211.

13 I will wait until everyone is with me. Authorities
14 A1, tab 7, paragraph 211:

15 "So far as possible, cost allocation should reflect
16 the underlying business reality. A reasonably detailed
17 understanding of the nature of business and how costs
18 arise is generally necessary when determining how
19 particular costs should be allocated. Similarly, how
20 a business itself treats the costs in its internal
21 management accounts will normally be an invaluable
22 source of information."

23 So the starting point is what is done in the
24 business. The other point, the general point of
25 principle goes back to the legal framework for excessive

1 pricing. It is the doubt point, and that is one of
2 the points on which I say Advocate General Wahl was
3 making a fairly standard proposition when he said that
4 doubts should be resolved in favour of the undertaking
5 being investigated.

6 So that is the conceptual or legal framework. The
7 CMA's starting point is to say how costs are allocated
8 in the industry is irrelevant, Flynn they say does not
9 allocate costs at all, and what is done for the PPRS is
10 irrelevant because the purpose of that exercise is to
11 allocate costs between categories, not individual
12 products.

13 We accept, and we have accepted throughout I think,
14 that Flynn's practice does not point in specifically one
15 direction rather than another because it does not
16 allocate costs at all. But the industry practice is, we
17 say, very relevant and the PPRS methodology cannot
18 simply be dismissed on the basis that it applies to
19 categories. Because the point about the PPRS is that
20 each additional product that is allocated into the PPRS
21 column will attract an additional amount of common costs
22 that corresponds to that product's revenue.

23 So if Flynn were to do an AFR and it were to put all
24 of its branded products in the NHS branded column in the
25 AFR, and then it were to add Phenytoin to the PPRS NHS

1 column, Phenytoin would then attract an amount of common
2 costs that would under standard practice be calculated
3 according to the revenue of Phenytoin and that is what
4 Mr Williams says. And that point is not disputed. He
5 says that is what is done under the PPRS and he has
6 never ever seen a pack-based methodology used either for
7 the PPRS or for any other purpose in this industry.

8 Now, that ought to be a powerful reason for using
9 the same methodology. It is not merely that it is the
10 accepted methodology in the context where costs
11 allocation is routinely done in this industry but also
12 that the context of the cost allocation is that it is
13 done specifically for the purposes of the assessment of
14 profitability. That is what the PPRS does and that is
15 what the CMA is trying to do here.

16 So in our submission that should be the case
17 whatever ROS the CMA or the tribunal take as the
18 benchmark ROS. But it applies a fortiori in our
19 submission if the benchmark ROS is derived from the
20 PPRS. Because in that case, if you do a profitability
21 analysis for Phenytoin on a different basis, then by
22 using a different cost allocation you are not comparing
23 like with like.

24 There are three other reasons to suggest that the
25 CMA's pack volume-based cost allocation should not be

1 used here. The first is that if you apply it across
2 Flynn's portfolio it leads to results that are very
3 different from the actual profitability of the products
4 looking at a measure such as product contribution. And
5 you will have seen this, I took Mr Harman to it, I went
6 to it in opening submissions. Looking at CRA's
7 portfolio analysis using the CMA's volume allocation you
8 can see there are some products that are very
9 unprofitable and that is why Professor Waterson asked
10 the question in opening. I will not say the names of
11 the products in open court because they are
12 confidential, but if you want to look at the CRA
13 diagrams again it is at D/2, CRA 2, figures 3 and 4. So
14 that is at tab 2. So it is page 18 of tab 2 of bundle
15 D.

16 I showed Mr Harman those diagrams and I pointed out
17 that that cost allocation approach resulted in actually
18 three of the products coming out as unprofitable,
19 several of them very, very unprofitable, on a ROS
20 analysis. And he tried to argue that that showed that
21 the commercial strategy in relation to those products
22 was somehow wrong. He said maybe the products were not
23 performing well enough. But the reality, as I put to
24 him, was that those were products with low costs and
25 high volumes of sales. In other words, cheap and

1 popular products, exactly what you would expect
2 a generic company to have within its portfolio and
3 a good thing if one were to look at a general common
4 good that a generic company is able to supply cheap and
5 popular products.

6 So the problem is not that those products are
7 underperforming, which is what Mr Harman was trying to
8 say, but rather that a manifestly unsuitable measure of
9 cost allocation makes it look like they are
10 underperforming. And the CMA's closing submissions do
11 not engage with the point at all, they do not say
12 anything about it.

13 The second reason for rejecting the CMA's
14 methodology is the homogeneity point. Paragraph 221 of
15 their closings says that Flynn's activities pertain to
16 the sale and marketing of medicines. And in footnote
17 411 the CMA says:

18 "Therefore Flynn's products are sufficiently
19 homogeneous."

20 They actually say "homogenous" but they mean
21 "homogeneous". I am that much of a pedant.

22 Leaving the pedantry point aside --

23 THE CHAIRMAN: Is that going to come out in the transcript?

24 MS BACON: That I am a pedant? I admit I am a pedant.

25 THE CHAIRMAN: No, the different pronunciations of that

1 word.

2 MS BACON: I hope it does come out in the transcript.

3 I looked in a few dictionaries.

4 THE CHAIRMAN: I think "pedant" is fairly well understood.

5 MS BACON: Yes.

6 This point, leaving aside spelling, the point is at
7 number 16 on the errors note because it is not factually
8 correct. During the relevant time period, Flynn did not
9 only sell medicines. One of its products was a medical
10 device, Collaguard, and Mr Harman did not know that
11 until I told him. His evidence was actually also not
12 that Flynn's products were sufficiently homogeneous
13 because they were medicines, his evidence was that they
14 were sufficiently homogeneous because they were all sold
15 in packs. You will recall very clearly the bit of the
16 cross-examination where we dealt with that, it is at
17 Day 8, page 142.

18 He said it was not an empirical question whether the
19 two products or groups of products were sufficiently
20 homogeneous. I asked him how he could tell without
21 looking at them, and his response was that they had
22 a common sales unit and that was sufficient. So
23 I asked, "Are you saying it is sufficient if two
24 products are sold in a sales unit of a pack?" And he
25 said "In my opinion, I think that is sufficient".

1 Again, this is somewhat glossed over in the CMA's
2 closing submissions because it is clearly not
3 a sufficient basis for saying that two products or
4 a group are sufficiently homogeneous that a volume-based
5 cost allocation can meaningfully be used.

6 Even if that bit of Mr Harman's evidence, as in it
7 is all about packs and it is sufficient if it is packs,
8 is ignored, and one goes back to the point that is made
9 in the CMA's closing submissions that it is actually all
10 about medicines, that still would not work for the
11 reasons that we have given in our evidence about the
12 different types of medicines and the arbitrary results
13 you get depending on the number of units in the pack.

14 The third reason for rejecting the CMA's cost
15 allocation is a basic one and that is that it is very
16 unfavourable to Flynn. That point ties in with my first
17 point about products that are cheap and successful.
18 What a volume-based allocation does is to say that
19 the only driver of the common cost allocation is the
20 number of packs that fly off the shelves, and that is
21 a very crude measure, and the result of using that kind
22 of crude measure is that you allocate more costs -- and
23 it is a trite point, you allocate more costs to the
24 products that simply have a large number of packs out of
25 the door and that is it. And it is Mr Williams'

1 contraceptive product versus oncology example.

2 So in Flynn's portfolio, the effect of a volume cost
3 allocation is to bump up Phenytoin's apparent
4 profitability under a ROS analysis because of the large
5 number of sales of other products that have a lot of
6 packs out of the door. So you take lots of the common
7 costs, you give them to the products like the ones that
8 I cannot mention their names which were illustrated on
9 CRA's diagram, and then it depresses the ROS of those
10 products but bumps up the ROS of other products.

11 That should, in our view, immediately have raised
12 a red flag to the CMA that this was not likely to be
13 an appropriate methodology in this context where one is
14 supposed to be giving the other and taking the benefit
15 of the doubt. Because what they are doing is to take
16 an inherently uncertain parameter and resolve it against
17 Flynn. And all of those points are reasons why, using
18 the CMA's language, using a revenue-based approach does
19 improve in our submission the reasonableness of the
20 allocation.

21 So the starting point should in our submission have
22 been to adopt the standard industry approach unless
23 there were very compelling reasons suggesting that it
24 would be inappropriate to do that.

25 The CMA have put forward two reasons which they say

1 are so compelling that they outweigh everything else.
2 They outweigh that it is not the standard industry
3 approach and they outweigh the fact that it goes against
4 Flynn. The first argument is the circularity point, so
5 that is the concern that if Flynn's prices are excessive
6 then a revenue approach would mask that excessiveness to
7 some degree.

8 As we have said in our written closing submissions,
9 even on a theoretical level if you look at the academic
10 literature that is cited by everyone, that is not
11 a reason to reject a revenue approach per se, it is
12 a reason to verify it with cross-checks which is what
13 Mr Williams has done.

14 But even leaving aside the theory and what Oxera
15 might or might not have said, what Mr Williams'
16 sensitised approaches do is to remove the circularity
17 concern. They do not just "sidestep" it, which is the
18 word that the CMA has used both in their skeleton
19 argument and in their closing submissions, they remove
20 the circularity altogether, because they reduce
21 Phenytoin's notional revenues in the cost allocation to
22 a figure that would not have given Flynn excessive
23 profits on the CMA's own case. In fact, as you will
24 have seen, Mr Williams' second sensitised approach uses
25 a figure that does not give Flynn any profits at all.

1 The result as you have seen, and we have given the
2 references in our closing submissions to the actual
3 numbers if you plug in all of that, on the sensitised
4 analyses the calculation is only a few percentage points
5 away from the base case. And given that the sensitised
6 analyses use quite extreme assumptions, that
7 corroborates the robustness of the base case. Or in
8 plain English, it indicates that the revenue-based
9 allocation does not mask an excessively high price on
10 Flynn's part.

11 MR LOMAS: But of course does not correct for the high input
12 costs.

13 MS BACON: That is the second point.

14 So the circularity is Flynn is making potentially
15 excessive profits so that will be masked under a revenue
16 approach, so that is swept away once you do
17 the sensitised approaches. Then that brings you to the
18 second objection to any kind of revenue approach and
19 that is the Pfizer supply price.

20 It is important to understand this is not
21 a circularity point. I asked Mr Harman this in terms,
22 is it a circularity point? And he said no, it is just
23 about it being high, Pfizer's price being high.

24 The short answer to that is it might be high but it
25 is the price Flynn actually paid. So there is no reason

1 for excluding it or using a different cost allocation to
2 exclude it.

3 Mr Hoskins' answer at paragraph 236 is to say this
4 is some kind of double-counting because Pfizer's supply
5 price is taken into account in the cost of goods sold,
6 the COGS element, and is then taken into account again
7 in cost allocation. And I am sorry, that is a really
8 bad point. In any revenue-based cost allocation you
9 will be taking the input price as the COGS and the input
10 price will then be reflected in the revenue. It will
11 always do that. It does not make a revenue-based
12 allocation wrong in principle. If that was the problem
13 you would never be able to do a revenue allocation but
14 it is an accepted means of cost allocation and it is
15 what the PPRS accepts.

16 Actually a volume-based approach does the same
17 thing. Volumes are also one element of the COGS and
18 they are then used in a volume allocation as the cost
19 driver for the cost allocation. So it is not
20 double-counting, it is just how cost allocation works
21 using either of those methods.

22 So that reason for rejecting a cost allocation does
23 not take the CMA any further forward so that is their
24 point: high input prices because you are
25 double-counting, we are not double-counting, that is

1 just how the cost allocation works. And there is no
2 reason to discount an input price that Flynn actually
3 paid, because we are trying to find a ROS in relation to
4 what it actually paid and the revenues that it actually
5 made.

6 THE CHAIRMAN: So you are not allocating common costs in
7 order to allocate common costs.

8 MS BACON: Well, that is the response to the first of
9 Mr Williams' two sensitised analyses and he says no, he
10 is not doing that. All he is doing is saying you,
11 CMA, say that Flynn's price might have been excessive,
12 and that will therefore bump up the revenue allocation,
13 so let us bring the notional revenue down to a level at
14 which you say Flynn could have lawfully sold the
15 product, which would be cost plus 6 per cent, so then
16 you get rid of any circularity, that is all that he is
17 doing.

18 Of course, by using that notional figure he is
19 accepting the CMA's cost allocations, he is accepting
20 that against Flynn. Against Flynn, let us accept the
21 CMA's figure is right, it is cost plus 6 per cent using
22 the CMA's cost allocation. Assuming all of that
23 absolutely against -- and that is one of the reasons why
24 he says it is a very, very conservative assumption.
25 Both of his sensitised analyses are conservative. They

1 are conservative against Flynn and they still come out
2 only a few percentage points away from the base case.

3 You will remember there was a bit of a discussion
4 about why one would do cross-checks or why one would do
5 sensitivity analyses and the answer is you do them to
6 test the robustness of the base case and that is what he
7 was doing.

8 So the other point to make about both of these two
9 points, the circularity point and the Pfizer input price
10 point, is that neither of those arguments have prevented
11 the revenue cost allocation from being accepted as the
12 reasonable method under the PPRS. The CMA's response is
13 to say that Mr Williams, when this was put to him,
14 accepted that the PPRS did not give rise to the same
15 concern. This is number 18 on the errors note because
16 actually he did not accept it. I have set out the
17 passage, you do not have to turn it up as the whole of
18 the relevant passage is on my note.

19 Mr Williams rejected the proposition. What he said
20 was that if a company only had a single line of business
21 selling branded medicines to the NHS, then of course
22 circularity is not really an issue because you put
23 everything in the same column, all of the costs would go
24 in the column, you do not have to allocate. But he says
25 as soon as you have different lines of business, so you

1 do have to do an allocation, in principle if this was
2 an issue then it could arise.

3 In other words, if there are indeed excessive
4 profits being incurred on one or other product line that
5 will affect the cost allocation as between different
6 columns. So if circularity in the sense of do some
7 products have excessive costs that are being somehow
8 masked, if that was an issue that prevented you from
9 using a revenue-based analysis then the question is,
10 well, why does the Department accept a revenue-based
11 cost allocation for the PPRS?

12 And it is certainly not -- as has been suggested by
13 the CMA, the Department is not worried if the
14 circularity goes one way or the other. As Mr Harman's
15 evidence pointed out, he referred to the footnote
16 of PPRS and I took him to it, there is no distinction
17 made in the rules on cost allocation according to where
18 the excess costs are going, it has to be on a fair and
19 reasonable basis. So that is the circularity point.

20 In relation to the high input price, we know how the
21 AFRs work through transfer pricing arrangements. They
22 do not control the input price at all. The AFR has
23 nothing to say, the PPRS analysis has nothing to say
24 about the transfer price. The transfer price is taken
25 as a given which is exactly what I am saying about

1 Pfizer's price here. The AFR takes the transfer price
2 as a given and does not bring the transfer price down.
3 That is the given starting point in the AFR.

4 So again if --

5 THE CHAIRMAN: I think there was something said about
6 transfer prices being arm's length and able to withstand
7 HMRC scrutiny being generally above board and all that.

8 MS BACON: Yes, and we have to assume that Mr Williams'
9 evidence on that which is that this is all accepted, 60
10 to 70 per cent is the normal transfer price is accepted,
11 is correct because that is not being disputed. The
12 point is that in those cases you do have a transfer
13 price which is quite a high element of the final price
14 and there is no suggestion the fact that you do have
15 a generally quite high, 60 to 70 per cent, transfer
16 price is a reason for disputing the revenue-based cost
17 allocation which is the basis that is always done under
18 the PPRS.

19 So in our submission there is nothing in the PPRS to
20 suggest that these two problems just do not arise, they
21 would arise in exactly the same way under the PPRS, and
22 yet a revenue-based approach is accepted by the
23 Department of Health as being the fair and reasonable
24 means of cost allocation.

25 The CMA's next point, going through their

1 submissions, is the cross-checks point. We have dealt
2 with those several times now. We have dealt with those
3 in our skeleton argument and in our written closing
4 submissions so I do not propose to say anything more
5 about those now.

6 Before I move on to the cost pool point I just want
7 to make one last point on revenue versus volumes and it
8 relates to the CMA's point that Flynn's underlying
9 reason for maintaining this point is to drive down
10 Phenytoin's profitability. That is at paragraph 244.

11 Putting the point in more neutral terms, it is
12 absolutely true that the effect of using revenue is that
13 Flynn's ROS is less than it would be under a pack
14 volume-based cost allocation. But that point cuts both
15 ways. The only reason the CMA wants to do a volume cost
16 allocation is it bumps up Flynn's apparent ROS.

17 What tips the balance in Flynn's favour is two
18 points. The first, Flynn is not suggesting something
19 outlandish or unusual. The approach that we advocate
20 has the merit of being the approach that is always used
21 under the PPRS. So I think if the opposite had been
22 true and we had come along and said "We want you to do
23 something that is completely novel that nobody ever
24 does", no doubt the CMA would be taking that against me.
25 They would say "You want us to do something totally nuts

1 and you only want us to do that so it looks like your
2 ROS is a bit lower".

3 But we are not doing that. We are saying this is
4 what everyone always does if you allocate costs in this
5 industry. The approach that the CMA advocates does have
6 the problem, it is the approach that is never ever used,
7 and the reason it is never used is it produces
8 completely arbitrary results.

9 The second key point about this you say/we say. You
10 want volumes because it sends your ROS down, we want --
11 sorry, you want revenues because it sends your ROS down,
12 we want volumes and it sends your ROS up. Well, we are
13 entitled to the benefit of the doubt. We say there
14 should not be any doubt anyway because of my first
15 point, what we are saying is standard practice. But if
16 that is not good enough then the fact that the CMA is
17 proposing something that is so unusual and so never done
18 must in any event give rise to sufficient doubt that
19 the matter should be resolved in our favour.

20 MR LOMAS: But is it not common ground that as there is no
21 absolutely right way of allocating common costs, the
22 exercise is to try and select the methodology that is
23 best for the decision that you are trying to take? That
24 at least is common ground, is it not?

25 MS BACON: I would say this: yes, if there is one

1 methodology that is preferable one should select
2 that and preferable for the decision, yes. But, two,
3 I do not think we accept that it is common ground that
4 one should select one rather than the other. If you
5 listen to everything that we have said and you think
6 actually there is not much between them, then the right
7 approach would be to say look at both. And that is
8 the basket of comparators point. Why do you not do both
9 and see what results come out under both and see if one
10 is more consistent with the general trend than the
11 other, and put those in and give each the weight that
12 you think would be appropriate. And it might be that
13 you say for this reason we will give this one a bit more
14 weight than the other but they are both things we should
15 look at, and that is actually sort of taking the
16 cross-checks to a different dimension and Mr Williams
17 has done one set of cross-checks.

18 Can I just spend maybe one minute on cost pool, it
19 is a very short point. It only arises if the ROS is
20 drawn from the PPRS. Mr Williams' point on this is if
21 you are doing a proper like-with-like comparison then
22 you need to mimic as far as possible the situation that
23 would arise if Phenytoin were indeed a PPRS product
24 assessed using an AFR. And if that were the case in the
25 counterfactual world, his point is you would not just be

1 taking account of the common costs attributable to
2 Phenytoin, but because it is lumped in with the whole of
3 the rest of the branded portfolio, you would also be
4 lumping Phenytoin in with a chunk of products that have
5 a whole load of directly attributable costs. And that
6 is the only point.

7 Mr Harman said "I understand the point but I just do
8 not recognise the portfolio approach", he said. And
9 that was the section of the transcript that I took you
10 to earlier where he said, well, you are not doing it on
11 a portfolio basis because it does not tell you anything
12 about an individual product.

13 But as we have said in our closing submissions, the
14 reason why Mr Williams has proposed doing it this way is
15 that the CMA is taking a ROS from a scheme that is
16 designed to apply to a portfolio and not to individual
17 products. So he is saying, well, that is a bad starting
18 point, but if for some reason the CMA thinks and the
19 tribunal agrees that that should be the starting point,
20 to take this portfolio approach, and really to compare
21 like-with-like and to do a meaningful comparison you
22 have to kind of pretend that Phenytoin is a PPRS product
23 in the AFR with a bunch of other branded products that
24 would have those directly attributable costs and those
25 would effectively shield it, then that would be the case

1 if it had been a PPRS product.

2 So that is cost pool and it is a short point.

3 He accepts that if you use, say, a 21 per cent ROS,
4 if you chuck the PPRS out of the window altogether and
5 say we are not using the PPRS as starting point you
6 would not have to mimic the PPRS in that case.

7 THE CHAIRMAN: He is not trying to slip extra costs in. He
8 is being quite open about it.

9 MS BACON: Exactly, he was never trying to just put in loads
10 of costs. He has always been quite transparent in
11 saying "I am doing this, it was not an error, it was
12 absolutely deliberate and this is the reason why
13 I did it".

14 THE CHAIRMAN: If it were an error it would be quite a big
15 error.

16 MS BACON: Yes, it would, because it is about double.

17 So what is the effect of changing the costs
18 allocation? I just want to show you some figures.
19 Unfortunately it is in three different places. This is
20 to answer the chairman's point that I think you made at
21 some point, well, it depends how material it is.

22 THE CHAIRMAN: Yes, it's the sort of question I am liable to
23 ask: does it make any difference?

24 MS BACON: Exactly, does it make a difference? It is a good
25 question.

1 So let us start with the effect of just changing the
2 cost allocation and nothing else. So you keep the CMA's
3 cost pool and the 6 per cent. That is Mr Harman's first
4 report, paragraph 360, that is his cross-checks table.
5 So that is bundle F, tab 1, page 32. It is line A
6 versus line B. You just change the cost allocation, you
7 do not change the cost pool. So that is the difference
8 already.

9 Next I want to look at the position if you change
10 the cost allocation, you stick with the PPRS, but this
11 time you do add in the cost pool and the MOT. That is
12 Williams 2, that is bundle D/12, and we can put away
13 Mr Harman now. For the rest of this we are in bundle D,
14 Williams 2, tab 12, paragraph 58. That is the totals.
15 Paragraph 58. So just to remind you, this is revenue
16 cost allocation, our cost allocation, PPRS ROS
17 6 per cent, but what we also change here is the MOT, and
18 we have the enlarged cost pool, if you like the PPRS
19 cost pool. And that is the total figure.

20 If you turn back a page to the table on page 15 you
21 get the figure broken down by strengths. The figures
22 that you need to be looking at are the figures in
23 the second row up from the bottom. That is the base
24 case. So 58 is the base case and the sensitised case
25 number one and totals. Page 15, the previous page, is

1 broken down by strength just for the base case.

2 This is one of the places where I say you can see
3 there that the sensitised approaches are not very
4 different from the base case. You can see it is a few
5 per cent.

6 The second sensitised approach for that you need to
7 turn to Williams 3.

8 MR LOMAS: The sensitised cost allocation in 58, the
9 differences between the base case and the sensitised
10 costs are both MOT and cost pool?

11 MS BACON: Yes, exactly. So on both of those cases -- so
12 the CMA's figure is everything, the CMA's analysis.

13 MR LOMAS: Yes.

14 MS BACON: The base case and the sensitised case are both
15 our cost allocation but MOT and our cost pool, as in
16 PPRS cost pool, the larger cost pool. Is that clear?

17 MR LOMAS: Yes.

18 MS BACON: So the second sensitised approach is Williams 3,
19 paragraph 41. So that is exactly the same as I have
20 just said, so our cost allocation, the enlarged cost
21 pool, 6 per cent but plus the MOT. So if you like the
22 only bit you keep then of the CMA's parameters is the
23 six per cent starting point. You bump that up to the
24 9 -- well, it is not 9 per cent because he does
25 a weighted average because the MOT changed during the

1 relevant period.

2 MR LOMAS: Where are you now?

3 MS BACON: Paragraph 41 of Williams 3, bundle D, tab 13,
4 page 13. That then sets out the totals actually for all
5 of what I would call the PPRS based approaches. So you
6 see the CMA's figure, base case, sensitised one and
7 sensitised two. And this is still using the
8 six per cent as a starting point, adding the MOT and
9 enlarged cost pool and the revenue-based cost
10 allocation.

11 Finally if you now change the ROS to 21 per cent,
12 and in this case you use a revenue-based cost allocation
13 but the CMA's cost pool, because Mr Williams accepts if
14 you use the 21 per cent ROS the CMA's cost pool is the
15 right one. That is at Williams 3, a bit further on,
16 paragraphs 57 and 58.

17 At 57 he does just the base case and his most
18 conservative sensitised analysis. The figures that you
19 are looking at are the blue figures rather than the
20 orange ones. So he has broken it down here by strength,
21 and then you get the total at the end. So 57 is the
22 base case. And 58, table 6, is the most conservative
23 sensitised approach and you can see the totals are only
24 2 per cent apart.

25 In essence this last set of calculations is the one

1 that Mr Williams says is the most appropriate if you
2 were to do a ROS in the first place.

3 THE CHAIRMAN: So you are suggesting to us that it does make
4 a difference.

5 MS BACON: Rather laboriously, yes.

6 THE CHAIRMAN: Is that a good moment to break?

7 MS BACON: Yes.

8 THE CHAIRMAN: Ten minutes.

9 (3.15 pm)

10 (A short break)

11 (3.25 pm)

12 MS BACON: Sir, can we pick up at paragraph 252 of the CMA's
13 submissions. That is a wrap-up point on this question
14 about does it make any difference.

15 What is said in this paragraph and indeed in
16 the last two sentences:

17 "These returns are all excessive."

18 So even if the tribunal were to accept one of
19 Mr Williams' approaches, Flynn's prices would still be
20 excessive. That is the first time that the statement
21 has ever been made. It is not in the decision, it is
22 not in the defence.

23 THE CHAIRMAN: It could not be in the decision, could it?

24 Mr Williams did not --

25 MS BACON: Well, no, what could have been said in

1 the decision is we did talk about costs allocation, so
2 the CMA could have said under even under Flynn's cost
3 allocation. And we did talk about comparator ROSs as
4 well, so they could also have said it. So I do not
5 accept the point that it could not have been in the
6 decision.

7 It is not in the defence, and by that time we
8 squarely had put all of these including the 21 per cent
9 ROS in issue. It is not in the CMA's evidence in two
10 successive expert reports from Mr Harman. It is not in
11 their skeleton argument. It was not in Mr Hoskins'
12 opening submissions.

13 So this is the first time that the CMA has ever said
14 that a ROS, at even the levels I have just shown you,
15 particularly the 21 per cent, would be excessive, and it
16 is a single sentence in a very long set of closing
17 submissions. In our submission it is far too late to
18 take that point now.

19 If authority is needed, we have cited Napp for a
20 different point about the free-standing before and after
21 comparison point but the same applies. And the other
22 authority on this point I will not take you to, I will
23 just give you the reference, that is Aberdeen Journals,
24 authorities A1, tab 2, paragraphs 176 to 177.

25 The basic point is it would completely distort the

1 entire nature of this process if the CMA could put
2 an entirely new case at this stage which was not raised
3 at the administrative procedure.

4 THE CHAIRMAN: Presumably Mr Hoskins will explain in due
5 course whether it is an entirely new case or not.

6 MS BACON: Yes. In our submission, if that was their case
7 it would need to have been put to Flynn and it cannot
8 just be pulled out of the hat now. But in any event we
9 say the submission is wrong anyway if you look at the
10 levels of the excess that I have just shown you, and
11 that is using the various different assumptions that
12 I went through. You see that particularly if you look
13 at the broken down figures for 100mg which represent
14 most of the market.

15 I entirely accept that if you break down according
16 to strength, if that is what you are doing, you see
17 larger figures for the 25 and 50mg, but they are a very
18 small part of market. And just to remind you where you
19 have got the breakdowns of the market, that is decision,
20 paragraph 3.16. If you put that side by side with the
21 table from Mr Williams that I have just shown you, you
22 can see. And actually if you look at the 100mg figure,
23 on any basis it is minuscule by the time you get to
24 Mr Williams' preferred approach which would be the
25 21 per cent ROS revenue cost allocation and accepting

1 the lower cost pool, CMA cost pool.

2 But that is not the end of the matter because one
3 has to think about materiality. And as I said a little
4 while ago, materiality is contextual. 21 per cent ROS,
5 that is not put forward by Mr Williams as the benchmark.
6 He said this is a more suitable benchmark if you are
7 doing a ROS analysis.

8 21 per cent ROS is an average. Different companies
9 have ROS figures that vary considerably around that
10 average. It is the point I made to you just after the
11 lunch adjournment that in any event, if anything, if you
12 are trying to look at other niche generics it is
13 a conservative figure for Phenytoin.

14 Mr Williams makes the point that the ROS of
15 Alliance, which he said in his first report the closest
16 comparator was 26 to 27 per cent. That was the one that
17 was put to the CMA in the response to the SO, so they
18 have had that for a while.

19 Set in that context, variations of the extent that
20 I have shown you cannot be regarded as indicative of
21 excess, and there is not any support in the case law for
22 finding an excess on these figures particularly if you
23 get down to using the MOT and using the 21 per cent ROS
24 as the benchmark.

25 The CMA referred in the decision to a price 46.8 per cent

1 above cost in Albion and 25 per cent in Deutsche Post,
2 and especially once you get down to the later sets of
3 the figures I showed you, it does not come anywhere near
4 those levels.

5 We would actually say the same about all of the
6 figures in paragraph 251 of the CMA's closing
7 submissions. Even on the basis of using a ROS that we
8 say is still far too low, the excess figures are below
9 those in Deutsche Post and a long way below the Albion
10 figure with perhaps the sole exception of the figures
11 for the 25mg strength which accounts for 6 per cent of
12 sales.

13 THE CHAIRMAN: But you do not accept that any percentage is
14 necessarily binding because each case is fact-specific.

15 MS BACON: Yes, the next point I was going to make was that
16 the products in those other cases are very different.
17 Albion was a supplier of water, Deutsche Post concerned
18 bulk mailing postal services, and the Commission said in
19 terms it was a market for processing large volumes with
20 a very low profit margin. In 1997, as was recorded, the
21 average profit margin was 3 per cent and the total price
22 of each unit of goods was less than a euro. That is set
23 out in the decision at paragraphs 162 to 164.

24 This is a completely different sort of market in
25 an industry where, on any view, there is reasonable

1 variation in profit margins. I am going to take you in
2 a bit to how much they do vary, not as much as the CMA
3 seem to make out, but there is considerable variation in
4 profit margins between different products and --

5 THE CHAIRMAN: Sorry to labour my point. You are not saying
6 the percentages that Mr Williams comes up with are below
7 the Deutsche Post case and therefore they are all right,
8 you are saying that the CMA had referred to these
9 percentages and that your figures are below them?

10 MS BACON: Yes. Yes, sorry, I am not accepting that
11 Deutsche Post and Albion are the correct benchmarks --

12 THE CHAIRMAN: Relevant percentages. Some kind of test for
13 excessive --

14 MS BACON: Yes, those were the excess figures in those cases
15 in very different markets. My point is even if you use
16 those, if you look at the figures in the CMA's
17 paragraph 251, with the exception perhaps of the 25mg,
18 the figures are still below even those. But then one
19 has to take into account the materiality point and that
20 is a context-specific point relating to the individual
21 market. The point is if you have a market with really
22 very small percentage profits and very little
23 variability, 5 per cent here or there is likely to be
24 more material than if you have a market with generally
25 larger profit margins and greater variability. It is

1 a point about standard deviation or statistical tests
2 for deviation, whether one puts it in statistical terms,
3 or one simply says the variations of profit in this
4 industry are such that just saying it is a few
5 percentage points above or below does not really allow
6 you to draw meaningful conclusions. It would have to be
7 much more excessive than that in our submission.

8 So the bottom line is even if this point is
9 admissible, which we say it is not, the CMA's claim that
10 using a revenue cost allocation and a proper
11 evidence-based ROS, such as 21 per cent, would still
12 lead to a finding of excessiveness for the purposes of
13 limb one we say is not well-founded.

14 MR LOMAS: The conclusion of your analysis surely is if you
15 put together cumulatively the ROS figure you would like,
16 the cost allocation you would like and the cost pool you
17 think is appropriate to that, Phenytoin in Flynn's
18 portfolio was a very average product.

19 MS BACON: Yes. Although to qualify what you just said,
20 cost pool we say, if it is the ROS figure that we want,
21 we agree with the CMA's cost pool.

22 MR LOMAS: Yes, yes.

23 MS BACON: So actually on our best case scenario, using
24 a reasonable ROS drawn from a generic comparator pool of
25 actual ROS rates drawn from statutory accounts, using

1 that and our cost allocation it is very ordinary, and as
2 you will see from the last set of figures, the ones at
3 paragraphs 57 and 58 of Williams 3 are barely excessive
4 at all especially in relation to the 100mg.

5 MR LOMAS: Barely excessive at all having increased the
6 price 26 times from where it was before, for Flynn.

7 MS BACON: I am --

8 MR LOMAS: For Flynn.

9 MS BACON: I am going to come, if I have time, to the before
10 and after. The point is that the price increase does
11 not tell you anything if your starting point is not
12 a meaningful one. You can test it this way: supposing
13 the price had been even more loss-making then you would
14 have even more of an increase and it still would not
15 tell you anything.

16 The point in United Brands is that you test against
17 a relevant benchmark. And if we are using profitability
18 benchmarks, and that is the CMA's base case, if you
19 like. Their base case is use a ROS, use a cost plus
20 method, use some benchmark for the ROS, and they use
21 6 per cent. And we say, okay, let us just take that on
22 its own terms. We do not agree that in this industry
23 a cost plus method is ever used. We do not agree it is
24 the right starting point. First point.

25 But let us suppose against us you did that

1 methodology rather than doing gross profit or product
2 contribution. Assume you do that. If you do that, you
3 are starting off from a position which no one uses, so
4 you treat it with caution. You should use a reasonable
5 ROS, evidence-based, and you should use an
6 evidence-based cost allocation methodology.

7 If you do only those two things you can see where we
8 come out and that is the last of the sets of figures
9 I have just shown you. Even using that, it is barely
10 above cost plus especially for the 100mg. Leaving aside
11 the point about the 25mg, they are priced slightly
12 differently, but the CMA has not said they are in
13 different markets, it comes out barely above cost plus,
14 and not to an extent that one could say in this industry
15 would be material.

16 That is not the only point because we say let us now
17 look at other comparators and see if they point in
18 the same direction. That was where I was going to go
19 next.

20 THE CHAIRMAN: Please do.

21 MS BACON: So general comments. CMA's section on
22 comparators starts at paragraph 254. This section
23 starts by making a broad point about the difficulty of
24 finding comparators in pharmaceutical markets. What
25 this does not acknowledge is the point that I made

1 earlier, that the CMA has itself relied on a comparator
2 to gets to its ROS benchmark. The CMA has tried to
3 dance around that but, as I have said, there is only one
4 source for the figure of 6 per cent.

5 So in a quite fundamental sense the CMA's discussion
6 of comparators is asking the wrong question. The
7 question should not be: have the appellants come up with
8 a good enough comparator that it should be taken into
9 account now? The real question is: given that the CMA's
10 comparator is the PPRS target ROS, Flynn's comparators
11 are the profitability of our other products and the
12 profitability of various generic suppliers and the price
13 of tablets. Which one or more of those comparators is
14 or are the best comparators, or in other words the best
15 benchmarks, for Phenytoin?

16 Once you have put the question that way you can see
17 that the CMA's position is profoundly misconceived.
18 Because all of the comments that the CMA makes about the
19 heterogeneity of the market apply a fortiori to the
20 CMA's own comparator of the PPRS.

21 That brings me to a broader evidential point which
22 is that the CMA plucks various statements out of our
23 evidence to try and make the argument that comparing
24 with different companies is all very difficult, and you
25 see that at 264 of their submissions. I am presuming

1 that these are the very best bits of the evidence that
2 the CMA can find on the point. But even on that basis
3 you can see that the evidential support for their
4 argument about pharmaceutical markets, very
5 heterogeneous comparators, all very difficult, the
6 evidential support for that is all very thin.

7 Starting with Mr De Coninck, this is
8 paragraph 264(a), this is also I believe on our --

9 THE CHAIRMAN: Number 19.

10 MS BACON: Is it number 19? For some reason I did not have
11 that in my notes. Yes, that is right.

12 Mr De Coninck was making a rather obvious
13 proposition that it is difficult to find an exact match.
14 But, yes, as the chairman says, number 19, he went on to
15 say repeatedly that he thought Flynn's portfolio was
16 a reasonable pool for comparison.

17 Mr Williams in the extract cited was making another
18 very obvious statement: you need to exercise caution.
19 But he did not say that that made a comparison with
20 different companies inappropriate. On the contrary, his
21 evidence was unambiguously, and he said again in
22 cross-examination, his comparator pool was a far better
23 fit than the PPRS for a benchmark. We have some of the
24 references to that on note at 19.

25 And then we have Mr Davies who is not mentioned

1 here. His evidence, as we have discussed, is that Flynn's
2 activities for Phenytoin were comparable to those of
3 other generic companies in general and he has put
4 forward his own set of generic comparators. So this is
5 another example of the evidence cited by the CMA not
6 quite saying what they wanted it to say.

7 There is also a general point about the weight to be
8 given to the evidence of the experts on this point. As
9 I said, the two industry experts who have been in
10 the tribunal are Mr Williams and Mr Davies. What is
11 striking about their evidence is not that they both make
12 the same general qualitative conclusion that it is
13 appropriate to compare the profitability of Phenytoin
14 with that of their various sets of generic comparators,
15 but they come out with the same quantitative conclusion
16 as well. Although they did not use the same comparator
17 sets their results both come out with an average ROS of
18 21 per cent.

19 I know probably somebody is going to be thinking
20 what do you mean by average? And I am looking at the
21 person who is probably thinking it. Just to anticipate
22 that, in case you were thinking it I did make sure I had
23 the answer. Mr Williams' average is weighted by
24 revenue, Mr Davies' figure is not weighted but is
25 an arithmetical mean. The reason -- and I wanted to

1 find this out. The reason he said is that in his view,
2 if you had done a weighted average using his comparator
3 sets, several of the outliers would have distorted the
4 analysis. He says once you actually kick off those
5 outliers, even if you did a weighted average it would
6 come out at around that figure. That is just the
7 explanation. He has not set out so much of his
8 underlying workings as Mr Williams but that is just in
9 case you were wondering.

10 If the average ROS rates, on whatever basis the
11 average was calculated, if they had come out with wildly
12 different results, the CMA might have been forgiven for
13 saying it is a bit difficult for us to choose between
14 them. Although if, for example, the average was
15 21 per cent from Mr Williams and 41 per cent from
16 Mr Davies, that would have still provided some useful
17 information about whether the 6 per cent benchmark was
18 right.

19 But we do not have that in this case because the
20 averages do come out at completely coincidentally the
21 same figure, and that was coincidental because they were
22 working completely independently.

23 If you go to the raw data which Mr Williams does set
24 out, you can see that the ROS rates are not as different
25 as the CMA suggests. I handed up a corrected version of

1 Mr Williams' annex in opening, but fortunately the
2 figures that we are looking at are not affected by
3 the typo so we can go to bundle D, tab 12, pages 22 to
4 23, the uncorrected versions.

5 What Mr Williams has done is he has put a load of
6 companies, and we can focus for the time being on the
7 non-manufacturers because those are the ones that drive
8 his average of 21 per cent. If you look at the
9 non-manufacturers and you look at their ROS rates, they
10 are not actually all that far apart.

11 So starting off with Alliance it is 26/27 per cent.
12 Then down to Morningside 31 per cent, 28 per cent.
13 Aspire 27/18. Genus 29/28. And then we have one
14 outlier, Sandoz, 11/14. Dr Reddy's 20/23. And then we
15 have the average at the bottom, 21, that is a weighted
16 average.

17 So they are not all that different, with the
18 exception of one outlier which actually has
19 disproportionate weighting because Sandoz has quite high
20 revenues.

21 Although if you look at their gross margins which we
22 also have there is a bit more variability, what you can
23 see from this is that none of the non-manufacturers in
24 this set have gross margins that are very significantly
25 lower than Phenytoin's gross margin. The lowest figure

1 again is Sandoz but that is the main outlier. Because
2 of its higher revenues that would have been excluded
3 from Mr Davies' comparator set because its revenues are
4 so much greater than Flynn's, and even then that is not
5 very much below the gross margin of Phenytoin.

6 So this point about, well, we cannot use comparators
7 because the margins are so very different that it does
8 not tell us anything useful, in our submission just does
9 not go anywhere. It does give you useful information.

10 There is variability. And that is why I made the point
11 about materiality of variations, there is variability --

12 PROFESSOR WATERSON: Particularly in the gross margins.

13 MS BACON: As one would expect. There is less variability
14 in the ROS rates, there is more variability in the gross
15 margins. But then that brings me to a general point
16 about information gathering. Lots of the CMA's
17 criticisms of the comparator samples boil down to the
18 proposition that there is insufficient information about
19 individual products within the samples.

20 Leaving aside the point that -- again you can say
21 that in spades about the PPRS, but as I think has been
22 pointed out by the chairman and Professor Waterson
23 a couple of times during the expert evidence, if the CMA
24 needed that information at that level of granularity, if
25 that really was important, the CMA could have used its

1 powers to obtain it. We cannot get that information.

2 So in our submission the starting point should have
3 been that this was an informative comparator set and on
4 any rate better than looking at the PPRS notional
5 target. So that is the general point. I now want to
6 look at the specific arguments that the CMA makes about
7 the different comparators, and I am going to follow the
8 structure of the CMA's submissions as I have done until
9 now.

10 Starting off with the tablet point, and that starts
11 at paragraph 267. I am not going to say very much about
12 that because we have dealt with that in written
13 submissions and Mr Brealey has addressed it yesterday.
14 I just want to make two points. The first is that
15 paragraph 275 of the CMA's submissions are number 20 in
16 our errors note. That is the point we have already
17 discussed, that there were more tablet suppliers at the
18 relevant time. And the second point is we are of course
19 not denying that in the meeting with Flynn in
20 November 2012 the Department told Flynn that Flynn
21 should not assume that the Department was happy with the
22 price of the tablets. But the point is that the
23 Department did intervene to reduce the price of the
24 tablets, and that was what Flynn understood to be the
25 case and Flynn's belief turned out to be correct. We

1 now know that the Department went much further than just
2 negotiating but actually according to Mr Beighton told
3 him what the price was going to go down to.

4 That in our submission is what reinforces the
5 validity of the tablet price comparison and means that
6 even if one might make comments about the competition in
7 the tablet market -- we know there were and are other
8 tablet suppliers anyway. But even if there is a general
9 concern which has not been proven because the CMA has
10 not investigated it, but even if there were despite all
11 of those a general concern, what we know is that this is
12 a market where the price has been set through regulation
13 by the Department of Health and that is why we say,
14 insofar as there is any concern about whether that is
15 a good benchmark, that in a way resolves that.

16 MR LOMAS: We have very little evidence before us in
17 relation to the tablet market and its mechanics,
18 virtually none. You said the price was set by
19 regulation. Being very precise, the price was set as
20 a result of the discussions between Teva and DoH.

21 MS BACON: It was set as a result of the discussion --

22 MR LOMAS: In consequence anyway.

23 MS BACON: Yes, and the Department of Health said you were
24 going to reduce the price of this, and according to
25 Mr Beighton they said if you do not do this we are going

1 to bring it down anyway.

2 PROFESSOR WATERSON: Then the tablet price may well have
3 moved subsequently.

4 MS BACON: It stayed at that level.

5 MR LOMAS: It seems to have fallen subsequently.

6 MS BACON: I am told it has fallen since 2016, yes. The
7 drug tariff price.

8 THE CHAIRMAN: What about prior to 2016?

9 MS BACON: We think it had stayed at that level. And that
10 is one of the points that has been made, that it had
11 been brought down to that level in 2007 to 2008 and then
12 it was not subsequently reduced. That was why Flynn
13 took that as the relevant benchmark and thought that it
14 was a relevant benchmark because it assumed -- yes, it
15 is at the table underneath 3.492 of the decision. I do
16 not think you need to go to it. But what it shows is --

17 MR HOSKINS: I think you would like to go to it. 289 of the
18 decision.

19 MS BACON: I am happy to go to it. We have a tablet price,
20 drug tariff price at £30 and then it reduces over time
21 from April 2016.

22 MR LOMAS: So it is implicit. Was it at 30 until 1 April?

23 MS BACON: I think that is implicit, yes. That is the drug
24 tariff price until then.

25 THE CHAIRMAN: What are we talking about? What pack? It is

1 a pack of how many tablets, do we know?

2 MS BACON: 28.

3 THE CHAIRMAN: 28 tablets.

4 MR LOMAS: That is the tariff price. I think the paragraph
5 above that makes the point that the average selling
6 price to wholesalers did decrease to about [X]by 2013,
7 so that does suggest there was some price movement
8 before 2016.

9 THE CHAIRMAN: There is some confusion about this because
10 there is a figure given in the CMA's closing at
11 paragraph 282 that refers to an 84 tablet pack.

12 PROFESSOR WATERSON: That is for three packs I think.

13 MS BACON: Yes. I think they are larger packs because our
14 100mg are in packs of 84. The point that is being made
15 to me is we did not know what Teva's wholesale ASPs
16 were.

17 THE CHAIRMAN: These are ASPs, not the drug tariffs.

18 MS BACON: Yes, ASPs, not the drug tariffs.

19 If I can then move on from the tablet to other
20 generics. To a large extent I have covered that point.
21 This is at paragraphs 286 and onwards. 286 to 287.
22 These are submissions about the differences between
23 Phenytoin and other generics. The short answer to all
24 of this is that the various companies' ROS rates are
25 actually not all that different.

1 MR LOMAS: Treating Phenytoin as just a generic.

2 MS BACON: Yes. But as I said, if anything that is
3 conservative.

4 MR LOMAS: You say that is conservative.

5 MS BACON: Because if one were to drill down and say, well,
6 actually our subset is only the niche generics, then one
7 would expect from the evidence of Mr Williams and
8 Mr Davies that they would be the more profitable
9 products within the portfolio.

10 MR LOMAS: I understand the point.

11 MS BACON: The best evidence you have on that is Mr Davies'
12 leading product comparison. So that really deals with
13 the point that the ROSs are average figures and there is
14 variability.

15 Can I then look at Flynn's products, that is
16 paragraph 289 to 291. The basic point in those
17 paragraphs seems to be that Flynn's other products are
18 not sufficiently similar to Phenytoin that
19 a profitability comparison can meaningfully be made with
20 them. The argument is a little bit odd because what the
21 CMA seems to be saying in these paragraphs is that even
22 if you are looking at products within the very same
23 company which, by definition, will have the same cost
24 accounting policies and so on, the comparison is not at
25 all valid, and they would say it does not give you any

1 information at all, not even in the basket, unless you
2 look at factors such as whether the products are subject
3 to continuity of supply and pricing regimes.

4 To pick up one of the chairman's comments during the
5 trial, that would almost be defining the comparators out
6 of existence. What we are looking at is to try and find
7 something that will provide us with some information, it
8 may not be a perfect fit, but the reason why we call it
9 a comparator is you are making a comparison.

10 It is also very odd that the CMA set such a high
11 threshold for comparators in this respect when it is
12 willing to pluck a figure out of the PPRS which applies
13 to branded products sold under a completely different
14 pricing regime by companies with a very different
15 structure to Flynn.

16 What we do know about Mr De Coninck's comparisons is
17 that he did actually try to control for this kind of
18 variability to some extent by looking at not only the
19 totality of Flynn's portfolio but looking at the subset
20 of products that do not have significant sales,
21 marketing and amortisation costs. So products that were
22 more like Phenytoin.

23 So in this subset we have a comparator set which
24 Mr De Coninck uses that are not only drawn from the same
25 company but products with similarly little or no

1 promotional amortisation costs, and that in our
2 submission is again a far better comparator set than the
3 one that the CMA used.

4 Then we have some general points about why gross
5 margins and direct margins according to the CMA are not
6 good measures of comparison. So I should just deal with
7 those because then the last of those leads on to the
8 outlier argument which I think is an important one to
9 address.

10 So starting with the gross margin point, and that is
11 at paragraphs 292 to 296, the CMA says that gross
12 margins are misleading and incomplete because they do
13 not take account of directly attributable costs. And it
14 is a non-point. In relation to Flynn's portfolio,
15 Mr De Coninck has already controlled for that by his
16 subset. So he has looked at products that do not have
17 promotional amortisation costs, so he has already dealt
18 with that possible difference.

19 In relation to the portfolios of other generic
20 companies there is a problem because we cannot control
21 for that. We do not have the information about their
22 directly attributable costs. But the question there is,
23 and I raised it when I was talking in general terms
24 about the gross margin measure, is there a reason to
25 believe that looking at portfolio gross margins for

1 other generic companies is likely to be a misleading
2 comparison because there are likely to be significant
3 directly attributable costs, and that is a point
4 I explored with Mr Harman.

5 The answer to that is if you look at Flynn's
6 portfolio you can see that the only products that incur
7 significant directly attributable costs are the branded
8 products and not the generics. So one would expect that
9 generics are not likely to have those higher costs which
10 would distort the comparison. There is a good reason
11 for that and it is an obvious one which is in a branded
12 market there will generally be sales and marketing costs
13 arising from competition based on the brand which will
14 not be the case to the same extent for a generic market.
15 Mr Williams had made a similar point in his first report
16 where he says at paragraph 14 of annex 2:

17 "There is an understanding and recognition that
18 within a PPRS member company's portfolio there will be
19 a range of different products' profitability
20 characteristics, typically with brand new products that
21 are incurring high launch and promotional expenditure
22 being less profitable than mature brands where little,
23 if any, marketing effort is required."

24 In a generic market one tends -- as one sees from
25 Flynn's portfolio, you tend not to see high directly

1 attributable costs.

2 If the CMA disputed that and if they thought that
3 there really is potentially a problem there, they could
4 have got evidence of that. But Mr Harman accepted that
5 he did not have any evidence that generic products do
6 incur significant directly attributable costs. So this
7 is a problem, a potential problem, but without any
8 evidence that it is an actual problem, if I can put it
9 like that. It is a theoretical problem but with no
10 empirical underpinning as to whether in this instance
11 the problem is likely to distort the result.

12 Mr De Coninck's evidence on this was that it did not
13 mean that gross margin comparisons should be rejected.
14 When asked whether it could lead to misleading
15 comparisons, he quite fairly said:

16 "If you want a yes or no answer, yes, it may."

17 And that is the bit that has been extracted to 295.
18 But actually what the CMA did not say is that he went on
19 to say:

20 "Gross margin is still a very commonly used measure
21 and often the first measure that one looks at, but with
22 Flynn's own products you could do a better analysis by
23 looking at product contributions."

24 That is, for your note, at Day 7, page 51, line 18
25 over to page 52.

1 So he accepted, yes, it could be in principle
2 a problem, but look, gross margins are still very, very
3 commonly used within the industry and that is a starting
4 point, but if you do have direct contributions that is
5 better. That is what Mr Harman came down to saying in
6 the end.

7 But then going back to the point that if the CMA did
8 have good reason to believe this was a problem which it
9 does not have, the solution was in its gift. It could
10 call for more information from those companies regarding
11 their directly attributable costs, whether in total or
12 relating to individual products in their portfolios.

13 The CMA's other point about gross margins is that it
14 is sensitive to where costs are recorded. That is on my
15 errors note at number 21. What the CMA has done here is
16 to extract Mr De Coninck's answer to a very general
17 question that fell outside his evidence and used that to
18 set a point that relates to the comparisons done in this
19 case. The reason it fell outside Mr De Coninck's
20 evidence was that he was not talking about comparisons
21 with other companies. So the point should not have been
22 put to him at all, it should have been put to,
23 for example, Mr Williams or Mr Davies because their
24 evidence was about comparisons with other companies.

25 But Mr Hoskins did not ask either of them that

1 question, ie, are your comparisons distorted because of
2 where costs are recorded? Presumably because he knew if
3 he asked them they would say, well, no. But I did put
4 that point to Mr Harman in his cross-examination and
5 again it quickly became clear that this was a completely
6 theoretical point that didn't have an evidential
7 underpinning because all Mr Harman could say was: as an
8 accountant it is a general issue as to where you account
9 for things. When I then pushed him on whether that
10 accountancy point really suggested that one should
11 reject a gross margin comparison, what he said was very
12 similar actually to what Mr De Coninck said: if he had
13 no other evidence then he might be able to place some
14 weight on a gross margin analysis, but if he had both
15 gross margins and product contributions then he would
16 prefer the latter.

17 So it came down to weight. And that ultimate
18 position, when I pushed him, is not something that we
19 disagree with. Yes, if you have both then it is
20 obviously preferable to take the more granular measure.
21 But in the case of our gross margin comparisons, we
22 could not get both. We cannot go to Actavis or Sandoz
23 or whatever and say hand us over all your commercial
24 information.

25 THE CHAIRMAN: I hope not.

1 MS BACON: I am sure we would be here on another charge if
2 we did.

3 Now, direct margins. So direct margins, product
4 contributions. Same thing, synonyms. Mr Harman calls
5 them direct margins, we call them -- or Mr De Coninck
6 says product contributions so I will stick with our
7 terminology.

8 We do have a product contribution analysis for
9 Flynn. That was part of what CRA did. It showed that
10 Phenytoin's product contribution was actually in the
11 middle to the lower end of the range of Flynn's products
12 that had no promotional amortisation costs. And that is
13 in the CRA. Do you want to look at that again? No.

14 MR LOMAS: Not that one does not, but it is a fairly
15 familiar table.

16 MS BACON: Yes, I thought so.

17 Now, I want to go through Mr Harman's objections to
18 this. His first objection was a rather silly point that
19 products with high directly attributable costs need
20 higher margins. So he said, well, you cannot -- even
21 with a product contribution analysis that is not
22 informative.

23 He couldn't support that with any evidence and, as
24 I showed him, that certainly was not true for Flynn's
25 portfolio. In any event, if that was a concern, it is

1 totally solved by taking a subset of products with no
2 promotional amortisation costs which Mr De Coninck has
3 done.

4 So ultimately Mr Harman's objection to looking at
5 product contributions came down to the outlier analysis
6 and that is the point that the CMA focuses on in its
7 written submissions.

8 The basic point that Mr Harman makes and which the
9 CMA seizes on is that Phenytoin looks like an outlier if
10 you plot the volumes sold against the absolute margins
11 per pack in pounds. You will probably remember that
12 graph as well.

13 That is another area where the CMA relies on a set
14 of propositions which are based on incomplete citations
15 of the evidence and in particular Mr De Coninck's
16 evidence. I have set those out on our errors note at
17 numbers 22 to 25.

18 Again, rather than taking you through the detail of
19 that, I think it is most helpful if I just focus on the
20 essential point which is that Mr De Coninck did not say
21 that looking at volumes or unit costs was irrelevant to
22 Flynn's business generally. What he was saying was that
23 they were irrelevant for the purposes of looking at
24 whether product contributions are a meaningful
25 comparison. So he did not say it is irrelevant whether

1 a product sells or not or what its costs are, it is just
2 saying for this purpose, for the purpose of doing
3 a product contribution analysis and saying is that
4 a meaningful comparison to do, it is not relevant to
5 look at volumes or unit costs.

6 The reason he said that was as a matter of economic
7 consensus and we gave various --

8 MR HOSKINS: Are we back to some economic evidence or is it
9 going to come from the evidence in the case?

10 MS BACON: Sorry?

11 MR HOSKINS: Are you about to give economic evidence or are
12 you going to take us to something in the case?

13 MS BACON: No, I am talking about what Mr De Coninck was
14 saying.

15 THE CHAIRMAN: Carry on.

16 MS BACON: I am explaining his evidence which is in his
17 report, and if you want to look at his report I will
18 take you to it but I think everyone in the room has read
19 his report.

20 The reason why he was saying, and he was saying it
21 was a matter of economic consensus, the relevant metric
22 for the comparison of profitability is percentage
23 margins, in other words relative profit margins. And if
24 you look at percentage margins, which his analyses do,
25 he says Phenytoin is not an outlier.

1 I have put the citations on our note, I have put the
2 references to his evidence in our closing submissions,
3 and I hope I do not need to go to every single report
4 for every proposition I am summarising.

5 Mr Harman's disagreement with that and his
6 proposition that it is necessary to look at volumes and
7 unit costs turned on his theoretical framework which is
8 that products with high volumes and high unit costs
9 require a lower return. I did cross-examine him on that
10 point and it was clear that his theory has no legs at
11 all for the reasons that I have given at paragraphs 125
12 to 127 of our closing submissions. The reasons that
13 I have given at those paragraphs are fully referenced to
14 the evidence.

15 I am not giving economic evidence on my feet, I am
16 simply explaining the economic evidence that our witness
17 has given and the evidence that Mr Hoskins' witness has
18 given and I cross-examined him in detail on the point
19 and I did put to him our case.

20 THE CHAIRMAN: I am quite happy for you to do it in this way
21 because I am concerned you should cover this ground
22 fairly speedily to leave time for some more general
23 points.

24 MS BACON: So Mr Harman's theory is conceptually wrong for
25 the reasons which Mr De Coninck gave in his reports,

1 which I have summarised at paragraph 125. Those reasons
2 were conspicuously not challenged in his
3 cross-examination by Mr Hoskins, so that is
4 the conceptually wrong reason. And the detail is there,
5 I am not going to go over all of that now.

6 Mr Harman's theory is also practically unworkable
7 for the reasons I did explore with him in
8 cross-examination and it is also not supported by any of
9 the academic or regulatory literature as he conceded.

10 The CMA in their closing submissions have glossed
11 over this. I have not found, maybe it is there but
12 I have not found anything in their closing submissions
13 which refers to the supposed inverse relationship
14 between ROS and volumes which was the centrepiece of
15 Mr Harman's conceptual framework. Instead, what they
16 have done, as I have said, is to selectively cite from
17 Mr De Coninck's evidence, make various points about the
18 commercial attractiveness which Mr De Coninck said was
19 irrelevant, and then say, well, if you look at
20 Mr Harman's diagrams Phenytoin looks different.

21 With great respect, it is a fairly obvious point
22 that looking at a scattering of points on a graph will
23 only tell you anything meaningful if there is
24 a meaningful relationship between the X and the Y axes.
25 Mr Harman said there was a meaningful relationship

1 because of his theory about the inverse relationship
2 between volumes and profit margins. So in other words,
3 his theory is the required explanation for his graph,
4 his theory about inverse relationship between ROS and
5 volumes is what makes his graph a meaningful one, and
6 that theory cannot be applied to this market for the
7 reasons that I have given and which I put to Mr Harman
8 in cross-examination, as in it is conceptually wrong and
9 it is practically unworkable.

10 So if that is right then there is no sustainable
11 conceptual basis for plotting volumes against absolute
12 margins and that is what Mr De Coninck says. But that
13 is what Mr Harman's outlier graph does and Mr De Coninck
14 said repeatedly it is not an interesting question. He
15 said in his report it is not meaningful. And that was
16 Mr De Coninck's point when he was shown the graph, he
17 could say visually Phenytoin looks like an outlier. But
18 as one would expect an economist to say, he said
19 repeatedly the graph does not show any linear
20 relationship between the points. He also said that
21 the graph was completely dependent on the use of
22 absolute margins which he had rejected in his report as
23 being irrelevant to whether other products were good
24 benchmarks.

25 Then there was another graph which plots percentage

1 margins against volumes, and Mr De Coninck's evidence
2 about that other graph was that Phenytoin was not
3 an outlier at all. When I put this to Mr Harman, all he
4 could say was that although in statistical terms it
5 could not be said that Phenytoin was definitely
6 an outlier, he thought it still looks different. And
7 I am afraid that is not an answer that is grounded in
8 economics and it is certainly not a sufficient basis to
9 reject a comparison between Phenytoin and Flynn's other
10 products --

11 PROFESSOR WATERSON: Just for clarification, did
12 Mr De Coninck check whether statistically it was
13 significantly different or not?

14 MS BACON: No, because Mr De Coninck said on that graph
15 Phenytoin is not an outlier at all. That was his
16 evidence.

17 PROFESSOR WATERSON: Is that tested? Did he test that
18 statistically?

19 MS BACON: I do not think so. His evidence was that you do
20 not look -- he said volumes are not meaningful for any
21 purpose in this respect. But even if you plot volumes
22 against percentage margins, it is not an outlier because
23 you have a cloud -- and by the way, the word is "cloud"
24 in both cases. You have a cloud of points, and he said,
25 I think you will recall the question. Mr Hoskins said,

1 "Phenytoin in the top right-hand corner, does that not
2 show you that it is an outlier?" Mr De Coninck says,
3 "I can tell you it is not." And Mr Hoskins says, "Why
4 not?" And he says, "I do a lot of data analysis and
5 I can tell you that Phenytoin is not an outlier on that
6 basis."

7 I can probably give you the relevant bit of the
8 transcript and you can find it.

9 MR LOMAS: I had the impression he was using "outlier" in a
10 relatively technical sense there.

11 PROFESSOR WATERSON: That is why I asked, yes.

12 MS BACON: Yes. But no, I do not think he has tested it
13 statistically. My point is that neither has Mr Harman
14 who relies on this point. Mr Harman admitted that he had
15 not done any statistical test to see whether on this
16 other graph, where he said Phenytoin looks different,
17 whether it was actually meaningfully statistically
18 different. All he said was it looks different because
19 it is in the top right-hand corner.

20 Where something is on a graph like that does not
21 tell you whether it is an outlier. You see if it is
22 an outlier by doing a statistical test and seeing if you
23 can identify a regression line or some other
24 relationship between them. I hope by saying that I am
25 not going to be accused of giving economic evidence,

1 I am just pointing out some general principles of
2 statistics.

3 THE CHAIRMAN: No, no. It would not be a regression line in
4 this case.

5 MS BACON: Yes, regression lines, which we all know about.

6 The only other graph the CMA relies on is the graph
7 that plots profit against net revenues and that is at
8 paragraph 307.

9 There is no attempt again to provide any reason why
10 that is a meaningful outlier analysis. All it shows is
11 what I have already accepted, that Phenytoin is more
12 profitable than the other products in Flynn's portfolio.
13 But that does not tell you whether other products are
14 poor comparators unless there is a theoretical rule that
15 says that there should be a relationship between total
16 revenues and profit margin. And that comes back to
17 Mr Harman's conceptual analysis because that is the only
18 thing that does tell you that there is a theoretical
19 rule that says that there should be a relationship
20 between the margin and your total revenue in absolute
21 terms. And as I have said in paragraphs 125 and 126,
22 that just fell apart on cross-examination.

23 MR LOMAS: But you would accept that what this graph does
24 show is the importance of Phenytoin to Flynn's business?

25 MS BACON: Yes, and that goes back to Mr Davies' leading

1 product --

2 MR LOMAS: Which is not the point you are making, I
3 understand.

4 MS BACON: I absolutely accept it, and it goes back to
5 Mr Davies' leading product analysis. He says if you
6 were to say Phenytoin is an outlier because it has
7 a product or a few products that make a lot of money
8 compared to the other products, to say that that was in
9 some way unusual, you would have to test that against
10 looking at other generic product portfolios. And he
11 says it is absolutely common. He said in most mature
12 companies you will have this and he does the analysis
13 based on that. And we say, well, the CMA has not put
14 any expert to say the contrary.

15 MR LOMAS: No, I realise it is not a scientific point but if
16 you step back and look at the big picture on that
17 scatter plot that you have, you have a fix on Flynn's
18 business across a period of time, they do the deal with
19 Pfizer and you introduce on to it three points which are
20 radically changing for the business in terms of its
21 profitability.

22 MS BACON: Yes. There is no dispute about that. But the
23 question is: where do you benchmark profitability? And
24 what that graph does not tell you at all is where you
25 benchmark profitability.

1 MR LOMAS: Understood.

2 MS BACON: Because actually you see a whole range of profit
3 margins across the bottom of that. None of those tells
4 you where Phenytoin ought to be because, on any of
5 those, obviously as you go further to the left,
6 Phenytoin would start to come down but Phenytoin is
7 around the middle of that. So all we see is something
8 that we do not dispute, which is that it is very
9 important for Flynn's business but there is no analysis
10 of whether that is unusual for a generic company.

11 MR LOMAS: It does not tell you whether the price is
12 excessive.

13 MS BACON: No, and the only analysis that does look at
14 whether that is unusual for a generic company in general
15 terms, as in whether it is unusual for a company to have
16 a product that contributes a lot, is Mr Davies' and he
17 says it is not unusual.

18 THE CHAIRMAN: Ms Bacon, I am anxious that you should be
19 able to address us on everything you want to address us
20 on.

21 MS BACON: I was planning to, very sadly, ditch penalty.
22 Those beside me have worked very hard on this, but I was
23 proposing that I was probably just going to say a few
24 words about Epanutin and prices in other Member States.
25 Do I anticipate from your comment that you then are

1 going to ask me lots of general questions?

2 THE CHAIRMAN: I do not think so.

3 MS BACON: Sorry, I thought you were saying there were some
4 more questions coming.

5 THE CHAIRMAN: I just want you to have time to deal with the
6 questions we do ask you.

7 MS BACON: I might be able to say a few words about penalty.
8 The last point then, right at the end of the CMA's
9 closing submissions, in the unfair limb section, we get
10 to the points about the Epanutin price and prices in
11 other Member States. I can take those quite shortly
12 because we have dealt with both of those in our skeleton
13 argument and in our written closings. Can I just add
14 a brief point on each.

15 In relation to the Epanutin price, you have our
16 point that the historic price does not provide
17 a meaningful benchmark because it was loss-making.
18 I do not just make that submission on the basis of the
19 case law. You have seen the case law we have cited. It
20 is United Brands and Scandlines and they both say
21 loss-making price is not a benchmark. But also we make
22 that on the basis that the price for Epanutin has, as
23 Pfizer has explained, been suppressed through the
24 mechanism of the PPRS, which meant that, in our
25 submission, it was and is not a reliable indicator of

1 the economic value of the product to the Department or,
2 putting it in United Brands terms, the normal
3 competitive price. So that is all I wanted to say about
4 the before and after.

5 THE CHAIRMAN: You have said various other things as well in
6 writing, but there is a large percentage increase in
7 the price and we have seen various pieces of evidence
8 suggesting that this has cost; is costing the state,
9 health service, a considerable amount of money. Where
10 does that fit into your argument? Is it a completely
11 irrelevant factor because of your arguments about
12 fairness or --

13 MS BACON: It is not an excess argument because nothing in
14 United Brands suggests that simply looking at the
15 difference of a price over time is a relevant benchmark.

16 THE CHAIRMAN: I think it comes into the unfair.

17 MS BACON: If anything, it would come into unfairness. And
18 our point in respect of that is, yes, we acknowledge
19 that the price went up and that had an effect on the
20 NHS, but any price for any pharmaceutical product is
21 going to have an effect on the NHS. Simply saying your
22 buyer is the NHS does not make it necessarily unfair.

23 THE CHAIRMAN: But what about the actual amount of the extra
24 money that the NHS has to find, whether it is a health
25 service or anybody else?

1 MS BACON: That will be true. The absolute point applies in
2 the same way; that any product that comes on the market
3 and is approved by NICE is going to be a cost to the
4 NHS.

5 THE CHAIRMAN: Are you really saying to us that the
6 assessment of whether the price is excessive and unfair
7 is an exercise done according to the way in which you
8 and Pfizer have described, and that produces a price
9 which I presume is what is currently charged. The
10 burden of your defence is that the price currently
11 charged is a fair price.

12 MS BACON: Yes.

13 THE CHAIRMAN: Therefore we put out of our minds altogether
14 on this analysis the fact that it has gone up a lot.

15 MS BACON: I would not go so far as to say that you should
16 simply put all of those contextual factors out of your
17 mind. Indeed, it would be very difficult for you to do
18 that, given the weight that has been placed on those by
19 the CMA. However, they are contextual factors and, in
20 my submission, they should not be decisive. Because, if
21 they were decisive, then in any case when one is testing
22 whether a price charged for a pharmaceutical product is
23 excessive, you would come down to the same thing, which
24 is that the customer is the NHS and, therefore, that is
25 a cost to the taxpayer or the consumer. And that, in

1 our view, is going to be the same for every case. So
2 although undoubtedly it is something that you look at in
3 the round if you get to the unfair limb, if you look at
4 the excessive limb and you conclude that the price is
5 a fair one, then it should not suddenly --

6 THE CHAIRMAN: Non-excessive.

7 MS BACON: Sorry. If you get to the excessive limb and you
8 conclude that the price is a non-excessive one, then in
9 our submission it cannot become an abuse just because
10 the customer is the NHS. But I do not say --

11 THE CHAIRMAN: I was not putting it in terms of the customer
12 being the NHS, I was putting it in terms of the very
13 large increase and the extra money being paid by the
14 customer.

15 MS BACON: Then the same applies to that.

16 THE CHAIRMAN: I am trying to keep the emotion out of it.

17 MS BACON: Yes. If you conclude that the price is
18 a non-excessive one, then the fact that it is a lot more
19 than the historic price, especially when you know that
20 the historic price was loss-making and under a regime
21 which suppressed it to below a normal competitive level,
22 then simply looking at before and after does not tell
23 you very much about whether it is unfair or not. That
24 is why I say actually in this case there is a general
25 mushiness between limb one and limb two. It is not that

1 they collapse into the same point, but in this case one
2 does end up looking at both from the perspective of the
3 comparator products because it is very difficult to test
4 economic value other than by looking at comparator
5 products in this kind of market. So that is the before
6 and after price.

7 As to the European prices, the CMA does not rely on
8 them in relation to Flynn to establish excessiveness
9 I do not think, it relies on them mainly or only in
10 relation to unfairness. What is said at paragraph 345
11 is that the appellants have not identified any specific
12 objective dissimilarities. But that point shifts the
13 burden of proof. It puts the burden of proof on us to
14 show why they are different, but actually the burden of
15 proof is on the CMA. So if the CMA wants to rely on that
16 kind of price comparator, it bears the burden of proof
17 to show that it is meaningful. We say it is not
18 a meaningful comparator, but the CMA has to show some
19 basis for saying that that should be an informative
20 benchmark, and it has not done so. Because there is
21 nothing at all in the decision to consider whether the
22 various member states that are chosen are remotely
23 comparable on the basis of the sort of criteria set out
24 in the Latvian Copyright case. That is the point we
25 have made in our written closing submissions. So the

1 only additional point then is the burden shifting point,
2 and we say that is not permissible.

3 I have some submissions on penalty. I think I can
4 take that quite shortly if you are happy for me to do
5 so.

6 THE CHAIRMAN: I think we take it that you do not like the
7 penalty.

8 MS BACON: Yes. If you are content, I can simply stop
9 there. We have made submissions on penalty at all
10 stages. You have our written submissions. If there is
11 anything I need to come back to in reply, I can. There
12 is not really anything new in the CMA's submissions on
13 penalty that we have not already dealt with. So I can
14 answer any questions that you might have but, otherwise,
15 I think those are my submissions.

16 THE CHAIRMAN: Can I just be absolutely clear. I referred
17 to your current prices. I did not mean that. What
18 I meant was is your case that the prices charged by
19 Flynn as at December 2016 were not excessive and, if
20 they were excessive, they were not unfair. That is your
21 case.

22 MS BACON: Our case is that they were not excessive and
23 unfair. They were not abusive. Our case is, if they
24 were not excessive, then they do not suddenly become
25 excessive because of the before and after point. And in

1 that there is a sequential analysis there. If they are
2 not excessive, then you do not go into unfair. In
3 relation to the question, if they are excessive, then do
4 we say that they are not unfair, it depends how you
5 measure excessiveness. Because if you agree with our
6 submission that comparators come in at both stages, then
7 really you are asking the same question under
8 limb two -- or the relevant question is the same under
9 limb two as under limb one. So we say that would not
10 really arise.

11 THE CHAIRMAN: The reason for asking is the CMA has said to
12 us we do not have to determine the price, we just have
13 to find that the prices were excessive. That is why
14 I am putting to you that your case is that they are not
15 excessive.

16 MS BACON: It is. But our case is also, as I said to you
17 when we were going through your questions, we agree you
18 do not have to determine a benchmark price and you do
19 not need to do that. In fact, it would be very
20 difficult in most markets to do that. You just look at
21 the cloud or basket of different indicia to determine
22 whether, looking at all of them together, you can say
23 with sufficient certainty that the price was excessive.

24 THE CHAIRMAN: I think that is fine then. Thank you.
25 Tomorrow, Mr Hoskins?

1 MR HOSKINS: Yes.

2 THE CHAIRMAN: Normal time to start?

3 MR HOSKINS: Absolutely.

4 THE CHAIRMAN: We have slight time constraints at the end of
5 tomorrow. You might like to bear that in mind.

6 MR BREALEY: Sir, can I just make one comment before
7 Mr Hoskins starts. In the CMA's closing, and it is in
8 annex 1, which is the Department of Health's powers,
9 I just rise because, if the Department of Health is
10 still listening on the transcript, this is directed to
11 a certain extent to them. So there is an annex to the
12 CMA's closing, annex 1, the regulatory powers of the
13 Department of Health. You will see that there are bits
14 in green which, as I understand it, the Department of
15 Health want to keep confidential. That is to say,
16 potentially out of any public judgment. They all relate
17 to the same issue. For example, if one goes to
18 paragraph 26.

19 THE CHAIRMAN: Yes, I am familiar with the issue.

20 MR BREALEY: I would ask the tribunal then to ask Mr Hoskins
21 to ask the Department of Health whether they still
22 maintain confidentiality in that. Because, if they do,
23 we would want to actually have a debate about that and
24 whether it should be in a public judgment.

25 THE CHAIRMAN: Perhaps you would clarify that before you

1 start tomorrow.

2 MR HOSKINS: I am only looking at Mr Bailey because he
3 is dealing with confidentiality.

4 THE CHAIRMAN: Anything else? Thank you.

5 (4.35 pm)

6 (The hearing adjourned until 10.30 am on Thursday,
7 23 November 2017)

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